DISPUTE RESOLUTION

BUSINESS RESCUE, RESTRUCTURING & INSOLVENCY

NEWSLETTER

Volume 10 | 17 July 2020

CDH
CLIFFE DEKKER HOFMEYR

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Business Rescue, Restructuring & Insolvency

As we all cosy up in our "*home*" offices during this cold front, sipping on the last bit of Old Brown Sherry that you may have left in your alcohol cabinet (after 5pm of course), it is evident that while things are very different from how the year started, the cogs of life seem to be turning and it is business as usual in many sectors.

For us in the business rescue, restructuring and insolvency space, largely as a result of COVID-19 and the fragile state our economy is in at the moment, business rescues and the like have been making news headlines and sparking interest on social media platforms. Just this week, we saw the SAA business rescue plan being adopted – this after much litigation, which ultimately saw the Labour Appeal court make a ruling around employee rights during a business rescue. This has been a landmark judgment for business rescues going forward as the court placed huge emphasis on the need to protect job security and ultimately the rights of employees to fair labour practice. The court highlighted, quite literally, the sentiments of Doug Conant, who once said "*To win the marketplace, you must first win the workplace*". Our team partnered up with our employment law colleagues and recorded a podcast where we discussed the practical effects of the judgment.

In this edition of our Newsletter, we unpack two interesting judgments which were recently handed down by the SCA. In one of the judgments, the court did not take lightly to the litigants hiding behind the veil of divorce proceedings and pension fund collusions in a window-dressing exercise in an attempt to evade their creditors.

While we all strive to return to some sort of normality, there is no surprise that 2020 has been described by many as somewhat 'apocalyptic'.

Following suit has been the term used to describe struggling companies, being that of "zombie companies", especially during these times.

A zombie company has commonly been described as business which still generates cash, but after settling the monthly running costs, there is only enough left to service the interest on their loans, but not the capital.

Although prior to COVID-19 there were many businesses who found themselves in an 'apocalyptic' state, we have seen this issue of zombie companies being exacerbated and in turn causing even further damage to our already fragile economy where these companies continue to receive government bailouts and/or payment holidays from banks and other financial institutions. In order to combat the effects that these companies ultimately have on our economy, the directors need to make use of the legal mechanisms as provided for in the Companies and Insolvency Act – be it by way of restructuring, business rescue or liquidation proceedings.

It remains to be seen whether there are directors out there who are bold enough to take the plunge in admitting that alternative measures need to be taken. However, for as long as directors are in denial about their business' financial distress, the economy will continue to buckle under the pressure.

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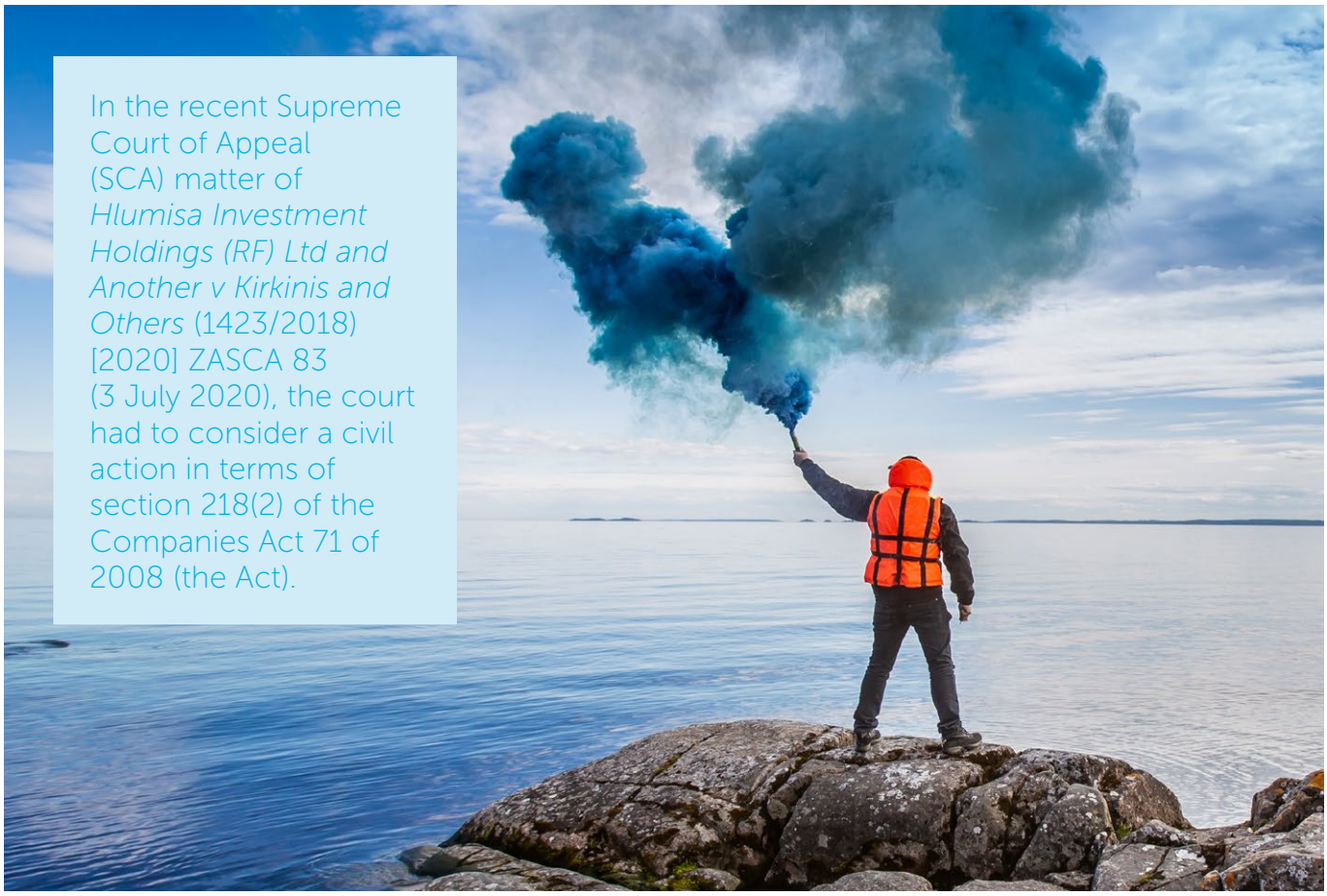
Directors' liability and the section 218(2) civil action – in whose hands is the claim?



In the recent Supreme Court of Appeal (SCA) matter of *Hlumisa Investment Holdings (RF) Ltd and Another v Kirkinis and Others* (1423/2018) [2020] ZASCA 83 (3 July 2020), the court had to consider a civil action in terms of section 218(2) of the Companies Act 71 of 2008 (the Act).

The action was brought by two shareholders of African Bank Investments Limited (ABIL) against ABIL's directors for an order in terms of section 218(2) of the Act, holding the directors jointly and severally liable for damages suffered as a result of the diminution in the value of their shares in ABIL, on account of the directors' alleged misconduct in relation to the affairs of the company.

Section 128(2) of the Act provides that any person who contravenes any provision of the Act is liable to another person for any loss or damage suffered by that person as a result of that contravention. Section 128(2) essentially provides a claimant with a civil claim against a person who has contravened the Act and thereby caused the claimant to suffer damages.

The shareholders alleged that, in breach of section 76(3) of the Act, the directors had failed to exercise their powers in good faith and in the best interests of ABIL, which resulted in the business of ABIL being carried out recklessly or with gross negligence in contravention of the provisions of section 22(1) of the Act. The shareholders further alleged that this caused ABIL to suffer significant losses, which in turn caused the ABIL share price to drop.

The shareholders alleged that the damages they suffered were a direct consequence of the directors having acted in bad faith, for ulterior purposes and without the requisite degree of care, skill and diligence as expected of them in terms of the Act, particularly in terms of section 76(3) of the Act.

The High Court findings

One of the pertinent issues which was largely debated by the court a quo was whether or not the shareholders could use the mechanism as provided for in terms of section 218 of the Act to bring such a claim against the company directors for their loss suffered as a result of the diminution of the shares.

The High Court stated that the section requires for a particular person to have suffered damage as a result of a particular contravention. What this means is that the particular person who has suffered damage must be a person who is able to invoke a claim for damages as a result of a particular contravention of the Act.

Directors' liability and the section 218(2) civil action – in whose hands is the claim?*...continued*

The court stated that a claim that alleges that directors are liable for damages as a result of a breach of section 76(3) must be brought in terms of section 77(2), which specifically creates the liability for a breach of section 76(3). The court went on to state that, where a statute expressly and specifically creates liability for the breach of a section, then a general section in the same statute cannot be invoked to establish a co-ordinate liability. It was emphasized that section 77(2) required claims for a breach of section 76(3) to be brought in accordance with the principles of the common law. A reflective loss claim cannot be brought under section 77(2) because the common law does not permit such a claim.

The High Court concluded that the shareholders could not rely on section 218(2) of the Act for their reflective loss claim. The shareholders' action was dismissed and the shareholders took the matter on appeal.

SCA findings

The SCA accepted that there was a diminution in value of the shares held by the shareholders, that losses were caused to ABIL and that these losses were due to the alleged misconduct on the part of the directors.

The SCA however indicated that the issue to be considered was whether section 218(2) of the Act provides for a basis for a claim by the appellants, in their capacity as individual shareholders in ABIL, against the directors based on contraventions by the directors of section 22(1), 45 and 74 and breaches of section 76(3) of the Act.

The SCA stated that, where a wrong is done to a company, only the company may sue for damage caused to it. This does not mean that the shareholders of a company do not consequently suffer any loss, for any negative impact the wrongdoing may have on the company is likely also to affect its net asset value and thus the value of its shares. The shareholders, however, do not have a direct cause of action against the wrongdoer. The company alone has a right of action.

What a shareholder cannot do is to recover damages merely because the company in which he is interested has suffered damage. Where a company suffers loss caused by a breach of duty owed to it, only the company may sue in respect of that loss.

The SCA went on to state that the principle is that, where harm is wrongfully caused directly to a company and indirectly to its shareholders, the law gives the right of action to claim compensation to the company. It does so because if, instead, the right were given to the shareholders, then the company and its creditors would be prejudiced. If both the company and the shareholder were given the right to recover, the wrongdoer would suffer *"double jeopardy"*.

Our law recognises the rule against claims for reflective loss, more particularly in respect of claims by shareholders for compensation for a diminution in the value of their shares due to loss occasioned to the company by a wrongdoer. The shareholders' claims against the directors in this case are quintessentially reflective loss claims. Based on the the shareholders' version of events, ABIL has a claim against the directors.

The court came to this conclusion on the premise that the shareholders presented no independent cause of action against ABIL. The alleged claim for wrongdoing in fact resonated with the company and not that of the shareholders.

Directors' liability and the section 218(2) civil action – in whose hands is the claim?*...continued*

The SCA stated that the common law position is that a director has to act bona fide and in the best interests of the company. The duties owed by the directors in terms of section 76(3) are owed to the company, not to individual shareholders. The company, in the event of a wrong done to it in terms of any of the provisions of that subsection, can sue to recover damages. The company would be the proper plaintiff. It is no coincidence then that section 77(2)(a) provides that a director of a company may be held liable for breaches of fiduciary duties resulting in any loss or damage sustained by the company.

The SCA concluded by stating that there must be a link between the contravention and the loss allegedly suffered. In the present case, loss was occasioned to the company and the company is the entity with the right of action. The SCA dismissed the shareholders' appeal with costs.

Conclusion

Section 218(2) of the Act deals with liability to third parties (i.e. not only the company) and is very far-reaching in its ambit.

When it comes to directors' liability, creditors and/or shareholders must ensure that they have a separate and distinct cause of action against the directors of a company when bringing claims against them. They must also ensure to rely on the correct provisions of the Act when instituting civil action, depending on the facts and circumstances of the specific case.

In terms of section 424 of the Act, and in a winding up of a company, directors can be held personally liable for the debts of the company where the business is or was being carried on recklessly or with intent to defraud creditors of the company. This is a remedy that is utilised quite a lot in practice and it is one of the most important mechanisms invoked by creditors and/or liquidators of companies during liquidations of companies unable to pay their debts.

It must be noted that liability under section 218(2) is not limited to situations where the company is placed in liquidation; it applies at all times, unlike section 424. Another difference is that section 218(2) read with section 22 does not make the director personally liable for the actual debts of the company, but instead he may be held liable for any "*loss or damages*" suffered by the third party as a result of the relevant contravention of the Act.

If a creditor or shareholder of a company is thinking about bringing legal action against the directors of a company to hold them liable for misconduct, we suggest that you first consult our Business Rescue, Restructuring and Insolvency team at CDH in order for us to guide you regarding directors' duties and obligations under the Act, as well as which provisions under the Act you should be relying on for a claim against a director of the company.

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In sickness and in health: Are pension fund proceeds included in an insolvent estate even when hidden through collusive dealings between husband and wife?

The recent Supreme Court of Appeal (SCA) judgment of *Moreau and Another v Murray and Others* (251/2019) [2020] ZASCA 86, handed down on 9 July 2020 interestingly unravels the collusive dealings of a husband and wife in order to prejudice creditors in an insolvent estate.

This appeal, heard from the Gauteng Division of the High Court, primarily considered whether a pension benefit paid out to an insolvent, Mr. Moreau, before his estate was sequestrated enjoyed the protection provided in section 37B of the Pension Funds Act 24 of 1956 (Pension Funds Act). The secondary issue was whether certain dispositions made by the insolvent to his then wife, Mrs. Moreau, and the second appellant, Iprolog (Pty) Ltd (Iprolog) should be set aside in terms of the provisions of the Insolvency Act 24 of 1936 (Insolvency Act).

The factual background illustrates that Mr. Moreau received a pension payout two years prior to his sequestration and that such monies received were almost immediately disposed of to both Mrs. Moreau and Iprolog. Iprolog, in turn, purchased immovable properties with the money received from Mr. Moreau. The trustees of Mr. Moreau's insolvent estate successfully obtained an order in the court a quo which set aside the dispositions and interdicted Mrs. Moreau and Iprolog (the appellants) from alienating the immovable properties indirectly purchased with the pension monies. Iprolog was registered on 6 April 2009, with Mr. Moreau becoming sole director on 30 April 2009. Shortly thereafter, on 5 May 2009, Mr. Moreau and Mrs. Moreau became trustees of the Les Baux Family Trust (the Trust), which in due course became the sole shareholder of Iprolog. On 18 May 2009, a full court ordered Mr. Moreau to pay one of his creditors, Lowveld Cooperative Investments (Lowveld) the sum of R726, 638.35, interest and costs, an order which he immediately applied to appeal.

On 31 May 2009, Mr. Moreau requested payment of his provident fund benefit from Mindkey Corporate Selection Retirement Fund (Mindkey). Mindkey subsequently paid out Mr. Moreau's provident fund and he received a sum of R4,639,000.00. Within a period of 8 days after receiving his provident fund payment, Mr. Moreau transferred R3,500,000.00 into the trust account of an attorney, for the benefit of Iprolog. The balance of R1,023,867.00 was paid directly into the account of Mrs. Moreau. Mr. and Mrs. Moreau had been married out of community of property for almost 29 years and, according to the appellants, Mrs. Moreau had filed for divorce in April 2009, without claiming patrimonial relief or maintenance, a mere two days after Mr. Moreau applied to appeal the judgment granted in favour of Lowveld against him.

The payment to the trust account of the attorney was alleged to be for purposes of the proprietary consequences of their divorce, in line with certain terms agreed upon in Mr. and Mrs. Moreau's antenuptial agreement. The antenuptial agreement provided that Mr. Moreau would purchase a property for Mrs. Moreau for R100,000.00. It was alleged that the equivalent current value of such sum amounted to R3,722,213.14 in 2009. The balance of R1,023,867.00 which was paid directly to Mrs. Moreau allegedly represented a loan amount which comprised unpaid wages for a period which Mrs. Moreau worked for Moreau and Associates, Mr. Moreau's business in which he was a financial advisor.

In terms of the divorce settlement agreement reached between the parties, Mr. Moreau undertook to pay Mrs. Moreau a large sum of maintenance on a monthly basis, various other expenses with Mrs. Moreau retaining ownership of two farms situated in Mpumalanga, which had been purchased by Iprolog with monies received from Mr. Moreau. A final decree of divorce was granted on 21 August 2009, incorporating the settlement agreement reached between the parties. Shortly thereafter, on 2 November 2009, Mr. Moreau resigned as a director of Iprolog and was replaced by Mrs. Moreau.

In sickness and in health: Are pension fund proceeds included in an insolvent estate even when hidden through collusive dealings between husband and wife?

...continued

In May 2010, Lowveld instituted proceedings for the sequestration of Mr. Moreau's estate, as his unsatisfied judgment debt, interest and costs had escalated to an amount of R2,027,587.74. In October and November 2010, in the midst of the proceedings, the farms purchased by Iprolog in Mpumalanga were sold and a portion of the proceeds were used to purchase an immovable property in Edenvale in Gauteng (the Edenvale property). Mr. Moreau moved to the property in March 2011 and was joined by Mrs. Moreau in April 2011. The parties alleged that their co-habitation was due to Mrs. Moreau's ill-health and that Mr. Moreau felt morally obliged to care for her. They continued to jointly occupy the Edenvale property until the judgment in relation to the sequestration proceedings was handed down in the court a quo.

On 1 August 2011, a final order of sequestration was granted against Mr. Moreau. The trustees appointed to administer his insolvent estate (Trustees) launched an application on 1 March 2013, to have the payments made to Iprolog and Mrs. Moreau set aside. The Trustees alleged that collusion occurred between Mr. and Mrs. Moreau in terms of which Mrs. Moreau would be stripped of his assets and income to avoid paying his debt to Lowveld. This allegation by the Trustees was based on various factors such as the allegation that Iprolog was *"the alter ego and corporate veil"* of Mrs. Moreau and Mr. Moreau; by making the Trust the sole shareholder of Iprolog they sought to distance themselves from the company and *"create a further trench which had to be crossed by any creditor seeking to gain access"* to Mr. Moreau's pension monies; their separation occurred only after the full court upheld Lowveld's appeal and that their divorce was *"merely a sham"* and *"window-dressing"*.

The appellants attempted to rely on section 27B of the Pension Funds Act which provides that pension monies are exempt from attachment. They denied any disposition of monies from Mr. Moreau to Iprolog and claimed that it was a loan granted by Mrs. Moreau to the Trust and the Trust loaned the same amount of Iprolog.

The learned judge in the *court a quo* considered section 37B of the Pension Funds Act and concluded that, since Mr. Moreau received his pension monies before his estate was sequestrated, it no longer enjoyed the protection which the section provides to pension money. It was reasoned that, at the moment the money was received, it formed a part of the estate of Mr. Moreau. It was found that there had been clear collusion between Mr. and Mrs. Moreau in order to prejudice Mr. Moreau's creditors. The court a quo therefore set aside the dispositions in terms of section 31 of the Insolvency Act.

The SCA confirmed that section 37B of the Pension Funds Act means that, while pension money is within the control of the pension fund, it cannot be included in the insolvent assets. It protects only the pension benefit of a person whose estate is sequestrated, which Mr. Moreau's estate was not when he received his pension pay-out. The effect of a sequestration order is to divest an insolvent of his or her estate and to vest it in a trustee. When Mr. Moreau received the payout, his estate had not as yet been sequestrated and there was thus no insolvent estate or trustees to speak of. Section 37B of the Pension Funds Act therefore could not find application when the payment was affected. Consequently, Mr. Moreau could not bring himself within the legal exception, and payment could only have been made into his regular estate. Mr. Moreau's then disposal of those monies in the manner in which he did, renders them susceptible to attack. If a pension benefit is received before a beneficiary's estate is sequestrated, section 37B of the Pension Funds Act does not find application.

The SCA referred to the case of *Jones & Co. v Coventry* [1909] 2 KB 1029 which conveyed an important statement and held the following –

> *"Pension, when it has been paid to the person entitled to receive it, ceases any longer to be pension; it has lost its character of pension, just like dividends which, after payment, lose the character of dividends. It becomes part of the pensioner's ordinary money. . .."*

The appellants further unsuccessfully attempted to rely on section 37A(1) of the Pension Funds Act which protects any benefit or right to any benefit provided for in the rules of a registered pension fund payable to a member of such fund, against any reduction, transfer, cession, pledge, hypothecation, attachment or judicial execution. However, the SCA held that this sections means *"any member or former member of the association by which such fund has been established', while in the second category, 'member' means 'a person who belongs or belonged to a class of persons for whose benefit that fund has been established"*.

Significantly, in respect of both categories, the definition excludes *"any person who has received all the benefits which may be due to that person from the fund and whose membership has thereafter been terminated in accordance with the rules of the fund"*. Mr. Moreau is therefore excluded from protection under section 37B of the Pension Funds Act by this definition, as he had received all the benefits and his membership of the provident fund had been terminated thereby. The learned judge further referred to Van Aartsen v Van Aartsen 2006 (4) SA 131 which held that –

> *"it could also be argued that once [the beneficiary] had received his pension payout, it was no longer a pension benefit as intended in the Act, but rather a sum of money, that is, a movable thing and not a legal right or claim"*.

In sickness and in health: Are pension fund proceeds included in an insolvent estate even when hidden through collusive dealings between husband and wife?

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The SCA confirmed that the court a quo correctly applied section 31 of the Insolvency Act which provides specifically for collusive dealings. Section 31 provides that "*After the sequestration of a debtor's estate the court may set aside any transaction entered into by the debtor before sequestration, whereby he, in collusion with another person, disposed of property belonging to him in a manner which had the effect of prejudicing his creditors or of preferring one of his creditors above another*".
The appellants, referring to the divorce settlement, which was made an order of court, further unsuccessfully attempted to rely on the definition of disposition in the Insolvency Act insofar as that it does not include disposition in compliance with an order of the court. The SCA held that the exclusionary provisions in terms of section 2 of the Insolvency Act do not apply to the payment made to Iprolog and therefore it could be set aside. However, the second payment made to Mrs. Moreau is considered in a different light as it was made after the final decree of divorce between the parties and therefore notionally protected by the exclusionary provisions of section 2.

The SCA found that the founding affidavits of Mr. and Mrs. Moreau indicated clear collusion and that the entire premise of their case rested on the existence of such collusion. It was considered to be a carefully designed plan by Mr. Moreau to keep his pension payout from his creditor, Lowveld, and that Mrs. Moreau and Iprolog were an integral part of such plan. The divorce between the parties was undoubtedly a sham, which had become evident by their continued co-habitation of the Edenvale property. This conclusion is inescapable by considering the timeline of events and that Mrs. Moreau instituted action for divorce a mere two days after Mr. Moreau's leave to appeal was dismissed by court and her involvement in the settlement agreement which granted her all Mr. Moreau's assets and money. The court concluded that neither of the protective provisions of section 37B or 37A of the Pension Funds Act applied to Mr. Moreau's pension payout. Furthermore, it was held that the dispositions made by Mr. Moreau to Mrs. Moreau were made in clear collusion in order to prejudice a creditor, Lowveld. As a consequence, these dispositions were able to be set aside pursuant to the provisions of section 31 of the Insolvency Act. Based on these considerations, the appeal failed. Both the payments to Iprolog and Mrs. Moreau were set aside, and the respondents were ordered to repay those monies to the applicants.

The judgment clearly illustrates that pension monies cannot be shielded from attachment if there are elements of collusion present and that the court will examine the true intention of the parties whilst entering into transactions or disposing of monies. Pension money ceases to have special status the moment it is paid to an individual and therefore forms part of any estate which may be sequestrated thereafter.

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