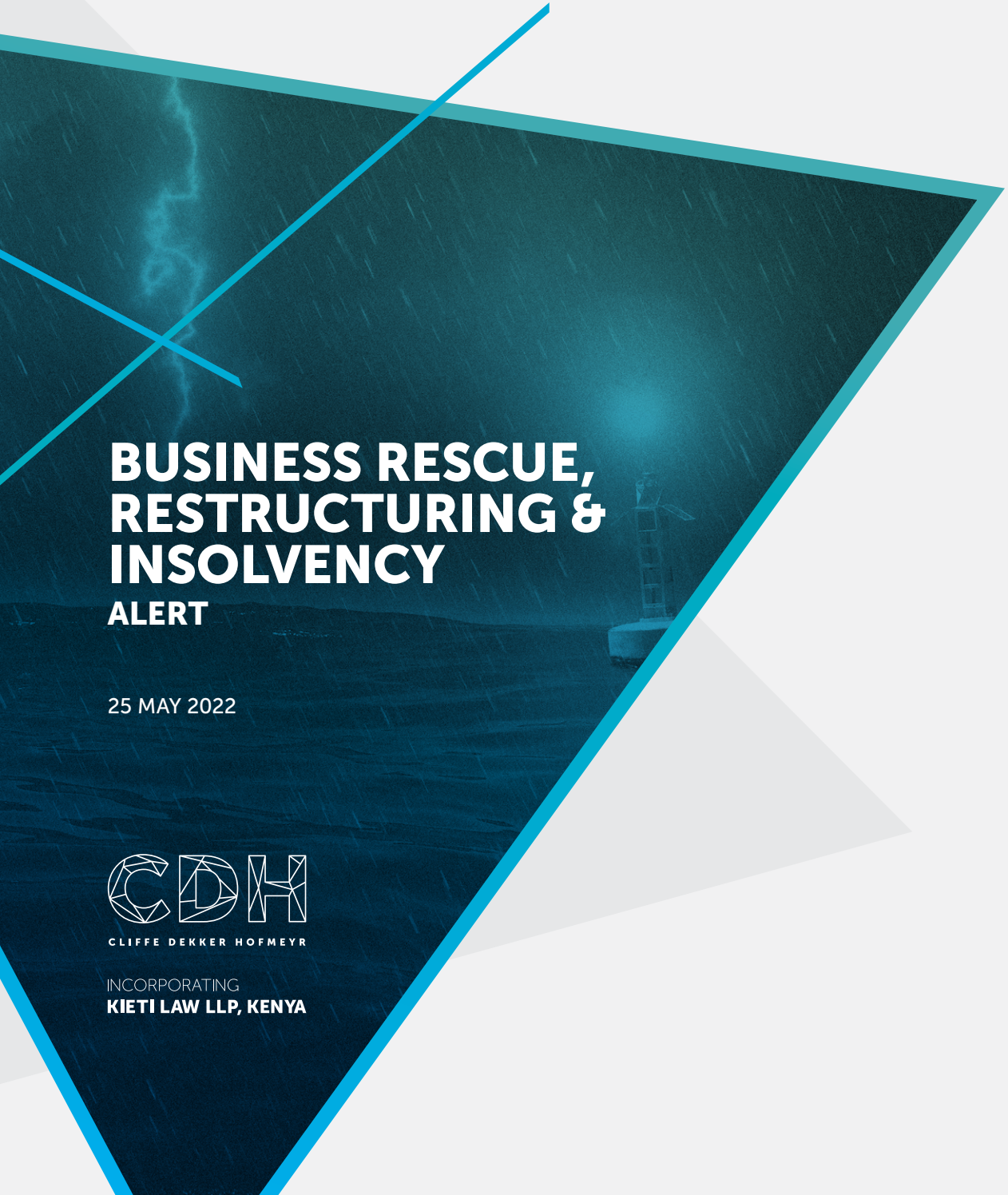

BUSINESS RESCUE, RESTRUCTURING & INSOLVENCY

ALERT

25 MAY 2022

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INCORPORATING
KIETI LAW LLP, KENYA

IN THIS ISSUE

Almost 10 years in, and still no hope of being rescued: BRP slapped with personal punitive costs order

The recent case of *Commissioner for the South African Revenue Services v Louis Pasteur Investments (Pty) and Others* may be the first of its kind to admonish the actions of a business rescue practitioner (BRP) by granting personal punitive costs against the BRP where the business rescue proceedings endured for more than eight years and were set to continue for a further two years in terms of an adopted business rescue plan.

FOR MORE INSIGHT INTO OUR EXPERTISE AND SERVICES

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The recent case of *Commissioner for the South African Revenue Services v Louis Pasteur Investments (Pty) and Others* may be the first of its kind to admonish the actions of a business rescue practitioner (BRP) by granting personal punitive costs against the BRP where the business rescue proceedings endured for more than eight years and were set to continue for a further two years in terms of an adopted business rescue plan.

THE FACTS

A summary of the facts are:

- The South African Revenue Service (SARS) obtained judgments in 2010 and 2011 against Louis Pasteur Investments (Pty) Ltd (LPI) to the value of approximately R13 million. These orders were never challenged by the company or the BRP once the company was placed into business rescue.
- LPI had been placed into business rescue in June 2012 and a business rescue plan was adopted on 15 November 2012.
- In 2013, SARS commenced an audit of LPI's business, and revised its claim to an amount of over R200 million.
- SARS was not aware of the business rescue proceedings as it had not been duly notified. SARS' orders were also not included in the business rescue plans .
- SARS instituted an application in 2017 to set aside the business rescue proceedings and convert them into liquidation proceedings.
- It was not disputed that LPI was insolvent and unable to pay its debts.
- On 4 March 2021, an order was granted converting the business rescue proceedings into liquidation proceedings in terms of section 132 (2)(a)(ii) of the Companies Act 71 of 2008 (Act) and placing LPI in provisional liquidation.
- Mr Prakke, who had taken over as BRP from Mr Naude, some five months after Mr Naude resigned as BRP, had sought to oppose the granting of the final order together with an intervening party who sought to rescind the conversion to liquidation on the bases that the intervening party was an affected person who had not been given notice of the hearing.

The opposition for the granting of the final order was argued on three grounds:

- The intervening party argued that the order granting the conversion from business rescue to liquidation should be rescinded as the intervening party had not been given notice of the hearing.
- Prakke on behalf of LPI opposed the conversion on the basis that it was not competent for SARS, as a creditor, to apply to court for such a conversion. Such a conversion, so the argument went, could only be made by the BRP acting in that capacity. Prakke argued that the business was actually capable of being *"rescued"* in the eight months between the time of the hearing of the application on 23 February 2022 and the expiry of the 10-year period set out in the business rescue plan.
- Only the last two grounds of opposition will be discussed.

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ARE CONVERSIONS FROM BUSINESS RESCUE TO LIQUIDATION SOLELY WITHIN THE POWERS OF BRPS?

The court considered section 132(2) of the Act, which outlines the three ways in which business rescue proceedings may come to an end:

1. Where the court sets aside the board resolution or court order that commenced business rescue proceedings, or orders the conversion of business rescue to liquidation proceedings (section 132(2)(a)).
2. Where the BRP files for the termination of business rescue proceedings, most likely when they realise the company is incapable of being rescue and ought to be liquidated (section 132(2)(b)).
3. Where the business rescue plan "*falls away*", either because it was not adopted or because it was substantially implemented (section 132(2)(c)).

The court noted that each of these procedures are separate and distinct, and each should be considered and applied as such.

Prakke argued that section 132(2) of the Act, properly construed, means that only the BRP can apply for the conversion of business rescue into liquidation proceedings. It was also argued that since the SARS judgment and claim arose prior to the adoption of the business rescue plan, in terms of section 152(2) read together with section 152(4), the SARS claim could not be enforced except to the extent provided in the business rescue plan. It was also argued that had SARS wished to challenge the plan, then that was the procedure it ought to have followed.

Despite the various cases the court was referred to in support of Prakke's opposition, the court ultimately disagreed and found that section 132(2)(a)(ii) does provide a separate and distinct way in which business rescue can be ended and that in the circumstances, the order sought by SARS was correctly granted. That is, the order converting the business rescue into liquidation and granting a provisional order. SARS, as a creditor, was entitled to apply to convert the business rescue proceedings to liquidation.

CAN LPI STILL BE RESCUED AFTER SO LONG?

The other question that the court had to determine was whether LPI was capable of being rescued – that it would become solvent and be able to pay its debts – after more than eight years of business rescue.

In answering this question, the court considered:

1. The general approach to business rescue proceedings which is designed to resolve a company's future direction quickly. Where a turnaround is unlikely to succeed, the aim of the procedure is to administer the affairs of the company in a way that results in a better return for the creditors than through a liquidation.

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2. The factual position of LPI and the features of the business rescue plan. LPI was factually and commercially insolvent. The plan made provision for holders of LPI's debentures to convert their claims against LPI into equity. It also made provision for the rescue to take 10 years to succeed. The court noted that sections 128 to 137 of the Act made it clear that as a whole, such proceedings were designed and intended to be implemented within a limited period.

Based on the report filed by Prakke (when requested to do so before the provisional order was granted), the court noted that such report made it clear that the business rescue plan had not achieved its purpose to any degree in the preceding eight years up to the time of the preparation of the report. Surprisingly, Prakke still opposed the granting of the final order – making a volte-face in which he then formed the view that in the year or so remaining of the 10-year plan, LPI could be restored to solvency.

After considering the financial information available to it, the court found that LPI was hopelessly insolvent and that all things being equal, the granting of the final liquidation order was appropriate.

Prakke suggested that to restore LPI to solvency, *inter alia*, the remaining fixed assets be liquidated. The court held that no reasonable BRP could, on objective consideration of the facts, hold such a view. The court noted that the proposed action was in fact a winding-up and not a business rescue. The consequences of allowing the plan to continue and necessarily be extended as demonstrated in this case, is not the rehabilitation of the business and the payment of a full or better dividend to all creditors but rather a preference in favour of some to the detriment of others.

The court accordingly agreed with the obiter views expressed in *SARS v Beginsel* where it was held that the court has the power to intervene where it is shown that the BRPs have committed a material mistake in concluding that the continued implementation of the business rescue plan would result in a better return for creditors. The court further held that the actions already taken and proposed by Prakke did not contemplate the operation or rehabilitation of LPI. They were nothing more than an informal winding-up.

PERSONAL COSTS AGAINST THE BRP

In considering whether punitive costs were appropriate against Prakke, the court noted that BRPs are officers of the court and are expected to conduct themselves with utmost good faith and to provide an objective and reasoned approach in assessing the state of the business and then deciding whether or not to continue with business rescue.

Despite initially reporting that the business rescue was a sham, Prakke made a volte-face and chose to oppose the granting of the final order.

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This opposition was ill considered and a deliberate and flagrant disregard of his obligations. In addition, Prakke filed hundreds of pages of affidavits and annexures containing repetitious argument which served no purpose but to overburden the papers to an extent that the application could not be heard on the ordinary opposed roll, all while hiding behind his statutory preference for payment of his fees and expenses.

In these circumstances, the court awarded punitive costs against Prakke in his personal capacity.

CONCLUSION

It appears that our courts are becoming increasingly displeased with the manner in which business rescue proceedings are conducted with such displeasure resulting in punitive costs against BRPs. This judgment may very well open the floodgates for punitive costs to be granted against BRPs for failing to conduct themselves with utmost good faith and to provide objective and reasoned approaches in business rescue proceedings.

ROXANNE WEBSTER AND
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BBBEE STATUS: LEVEL ONE CONTRIBUTOR
Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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