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BUSINESS RESCUE, RESTRUCTURING & INSOLVENCY

NEWSLETTER

DISPUTE RESOLUTION

IN THIS ISSUE

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Since the lifting of the curfew in time for the New Year's countdown, we have observed with cautious optimism that our *"new normal"* has started to resemble life as we once knew it a bit more. The halls of our offices have started to bloom with life, while traffic has yet again become an issue to consider in planning our morning routines.

Despite the initial global panic caused by COVID-19's unprecedented mutation into the Omnicron variant, scientists have since reported that its dominant spread may actually mark the beginning of the chapter where we can start to live with, as opposed to in fear of, COVID-19. So similarly to a company undergoing an exercise in business rescue and restructuring, it seems that we needed to give the pandemic some space to get worse in order for things to ultimately get better.

Turning to the latest business rescue and restructuring news, the recent headlines have been dominated by the controversial developments in the business rescue of the Gupta-associated company Optimum Coal Terminal (OCT). This is mostly due to the ongoing battle between the National Prosecuting Authority (NPA) and OCT's business rescue practitioners (BRPs) regarding the sale of the Gupta owned OCT shares to Liberty Energy. While the BRPs argue that the sale is necessary for the successful rescue of OCT, the NPA argues that the shares should be subject to a preservation order under the Prevention of Organised Crime Act (POCA), as they were allegedly initially acquired with proceeds of crime. The NPA have even gone so far as to contend that the conclusion of the deal would result in the BRPs committing a money-laundering offence. Notwithstanding this dispute, OCT's creditors have recently voted overwhelmingly in favour of adopting the proposed business rescue plan, which if implemented, will result in this controversial deal. Whether or not this will occur will depend on the outcome of the NPA's court case, which has been scheduled to be heard in March.

In less controversial news, the BRP for Mango SOC Ltd (Mango), Sipho Sono, has reported that several potential investors have submitted expressions of interest to acquire the entire shareholding of South African Airways SOC Ltd (SAA) in Mango. The expressions of interests are currently being evaluated, after which qualifying potential investors will commence with a due diligence process into the affairs of Mango. Mango's business rescue is set to be yet another example of the distressed investment opportunities being presented by the business rescue process. The Takatso Consortium has also made headway in taking advantage of the distressed asset transaction whereby it is seeking to acquire a 51% stake in SAA from Government. The Consortium has confirmed its due diligence of the national carrier has been completed, with no material issues having been identified. Next in the process is for the negotiations with the Department of Public Enterprises (DPE) regarding the terms of the transaction to conclude, and for the transaction to thereafter be implemented.

In this month's newsletter, we discuss recent noteworthy judgments that have emanated from both South Africa and Kenya. From a South African perspective, we discuss the recent judgment of *Gore NO & Another v Ward & Another*, as well as the findings in the recent judgment of *Segalo v Botha N.O. and Others; Botha N.O. and Another v Segalo and Others*. From a Kenyan perspective, we consider the welcomed developments in the law of receiverships brought about by the case of *Kimeto & Associates Advocates v KCB Bank Kenya Limited & 2 others*.

Despite already being in February, the CDH Business Rescue, Restructuring & Insolvency Sector would like to wish our clients and readers a prosperous year ahead; and looks forward to continuing to assist with navigating the commercial obstacles brought about by the aftermath of the pandemic.

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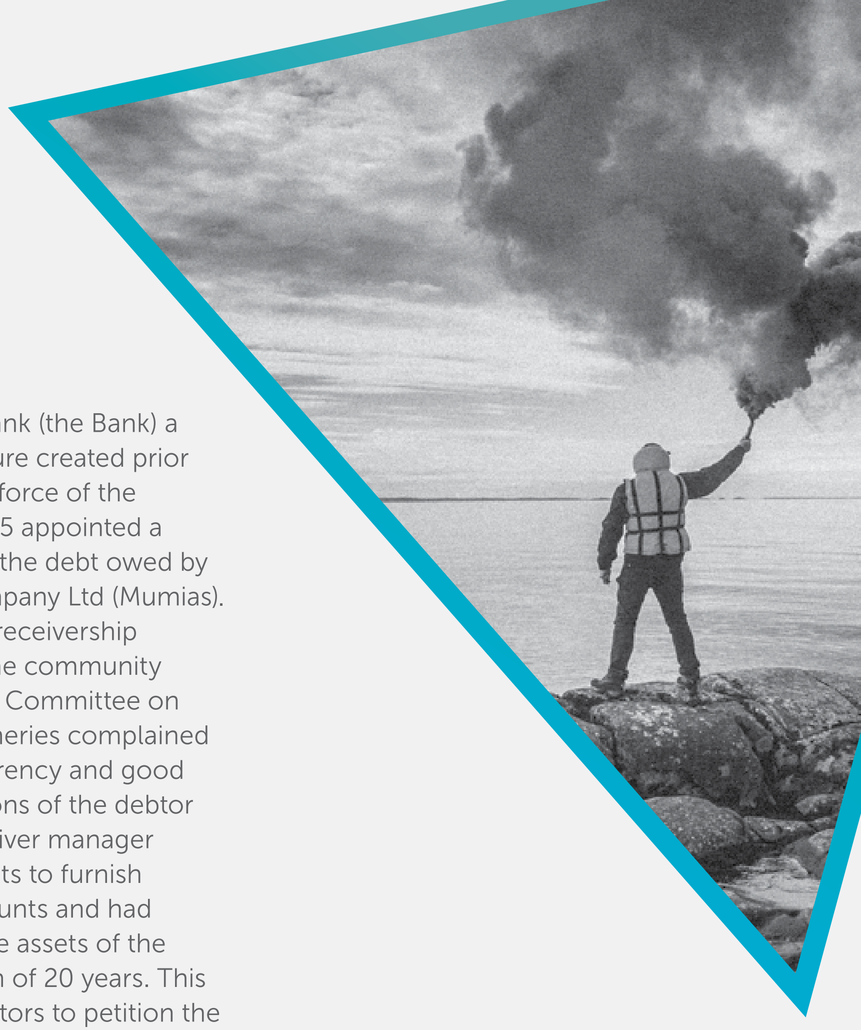
KENYA

No longer at ease: The conflicting duties of the receiver manager in the corporate rescue process

Receiverships have historically been viewed as a kiss of death to financially distressed companies. In essence, the receiver manager only has a duty to safeguard the interests of the appointing debenture holder, and not the whole body of creditors or the public. However, the ruling in *Kimeto & Associates Advocates v KCB Bank Kenya Limited & 2 others* [2021] may be considered a breath of fresh air possibly giving a chance for the recovery of companies placed under receivership.

In this case, KCB Bank (the Bank) a holder of a debenture created prior to the coming into force of the Insolvency Act, 2015 appointed a receiver to recover the debt owed by Mumias Sugar Company Ltd (Mumias). Two years into the receivership the creditors and the community through the Senate Committee on Agriculture and Fisheries complained of a lack of transparency and good faith in the operations of the debtor company. The receiver manager had ignored requests to furnish statements of accounts and had decided to lease the assets of the company for a term of 20 years. This prompted the creditors to petition the High Court (the Court) for an order restraining the receiver from selling or leasing Mumias's assets and for an administration order.



KENYA

No longer at ease: The conflicting duties of the receiver manager in the corporate rescue process

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The Court held that the process of receivership was a matter of public interest and that the receiver had a duty to ensure the receivership process not only vindicates the private interests of a debenture holder but also all other secured and unsecured creditors. The Court also held that the insolvency process ought not be a private process between a creditor and a debtor. Instead, the interests of the public should also be considered since their social and economic livelihoods are significantly impacted by insolvency decisions. This requires receivers to shift from the traditional approach and now balance between the interests of the secured creditors with that of equitable claimants such as employees and the public. In this case, the Court noted that Mumias was not just an ordinary business enterprise but that it was the largest sugar company in the region. Its collapse would have dire social and economic consequences to the sugar belt (Western Province).

In determining the principles to be adopted in considering public interest the Court adopted the principles laid down by Professor Janis Sarra in Creditor Rights and the Public Interest: Restructuring Insolvent Corporations where she explained that it is in the public interest to:

a) avoid premature liquidations. Restructuring schemes are a valuable mechanism to prevent them. These entail a temporary suspension of control or enforcement rights in order to provide an opportunity to establish the cause of financial distress and evaluate the prospects of rehabilitation;

b) protect the claims of various stakeholders such that there is not a race to enforce individual claims to the detriment of other claimants;

c) respect the statutory allocation of priority claims while still allowing parties the opportunity to determine their deferring claims in anticipation of generating value for the long term;

d) enhance access to information about the insolvent firm to allow for informed negotiation for an optimal solution; and

e) generate economic activity and create a going forward business strategy that preserves creditors, workers, and firms' specific economic investments to maximise the wealth of the entity.

KENYA

No longer at ease: The conflicting duties of the receiver manager in the corporate rescue process

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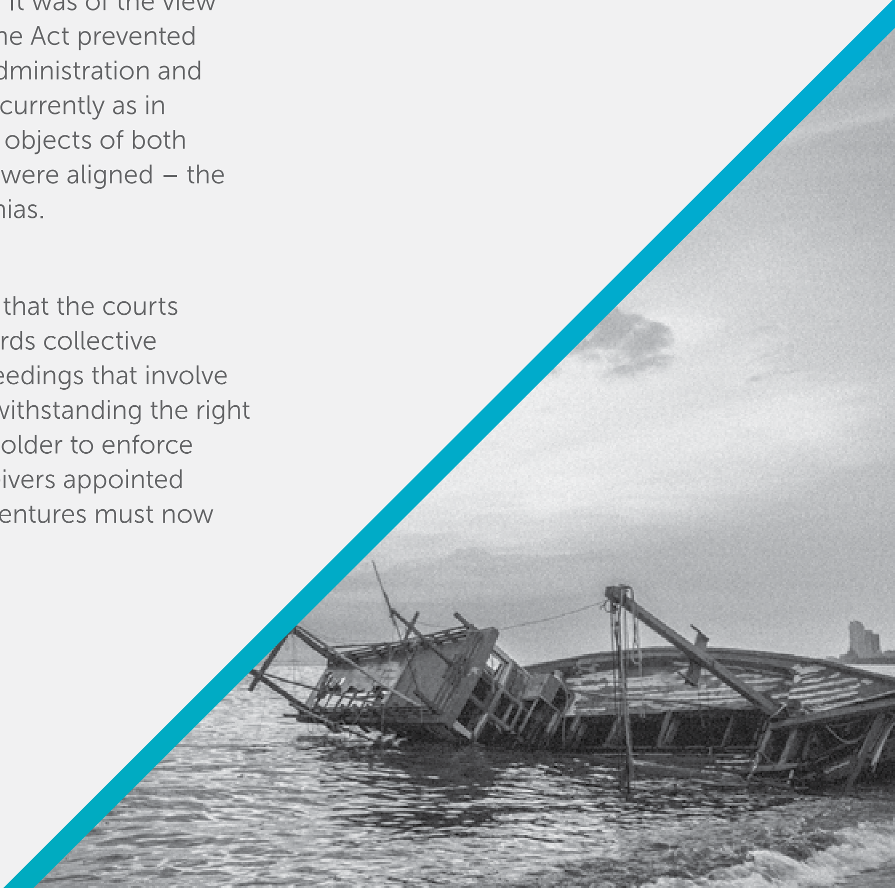
In addition, the Court held that a receiver was bound by the national values and principles of governance as enshrined in section 10 of the Constitution of Kenya of 2010. The Court acknowledged that despite the dealings between Mumias and the Bank being a private affair, the process of receivership was a matter of public interest. The basis for this conclusion was that the rights of 3rd parties such as unsecured creditors, sugar farmers and employees were involved. Further, the fact that Mumias is a public body meant that the matters touching on it were a matter of public interest. The receiver by virtue of his position was therefore bound by section 10 as he was deemed to be implementing public policy decisions. The import of this decision is that receivers now have an obligation to be transparent and accountable while undertaking their duties in the receivership process. They are now required to disclose the particulars of the receivership process to third parties.

The Court further held that it had the jurisdiction to intervene in the receivership process and to supervise the actions of a receiver in order to take care of the public interest although in an unhindered manner. It issued an administration order and directed the receiver to also act as an administrator. It was of the view that nothing in the Act prevented the running of administration and receivership concurrently as in this instance the objects of both these processes were aligned – the recovery of Mumias.

CONCLUSION

This case shows that the courts are leaning towards collective insolvency proceedings that involve all creditors notwithstanding the right of a debenture holder to enforce its security. Receivers appointed under these debentures must now balance the conflicting interests in the receivership process noting that the court has the jurisdiction to interfere in their decisions on account of public interest.

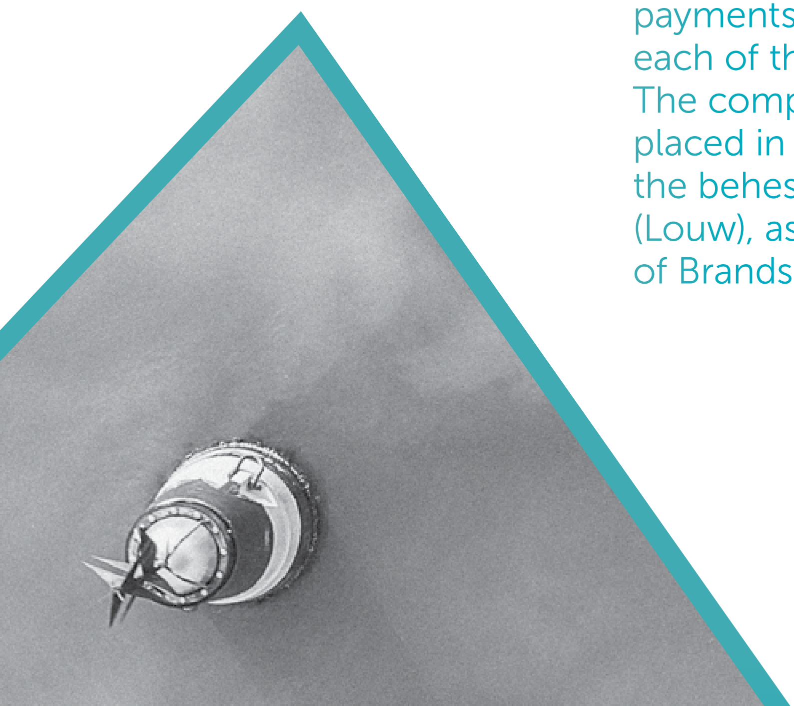
DESMOND ODHIAMBO, CHRISTINE MUGENYU AND JANETTE NYAGA



SOUTH AFRICA

"Robbing Peter to pay Paul"

In the recent High Court judgment of *Gore N.O & Another v Ward & Another* (Case no 2977/2021), the applicants, who were joint liquidators of a company called Brandstock Exchange (Pty) Ltd (Brandstock), brought an application for an order setting aside two payments of R250,000 to each of the respondents. The company had been placed in liquidation at the behest of Mr CJ Louw (Louw), as the only creditor of Brandstock.



The background to this case is rather miserable, much of the misery having been caused by a long-gone Mr Bruce Philip (Philip), the sole shareholder and director of Brandstock. Philip had entered into an oral agreement with Louw, whereby Louw would finance the purchase by Brandstock of cattle. Brandstock would then on-sell the cattle for a profit. Upon receipt of payment by the purchaser of the cattle, Louw would be reimbursed for his outlay, and would also be entitled to 70% of the profit. Louw paid the required sum of R2,257,200 to Brandstock (upon the request of Philip) and eagerly awaited payment in terms of the agreement, by no later than 8th May 2018. Needless to say, Louw was not paid any money on the 8th of May 2018, and after Louw made a few attempts to address the matter with Philip, Philip disappeared. Louw subsequently discovered that Philip is indebted to a number of other people, including his own (Philip's) father-in law and that there was an application pending for the sequestration of Philip's estate.

Louw subsequently brought an application for the winding up of Brandstock and testified that he had previously done business with Philip through another company called BRP Livestock CC. Philip had informed him that BRP Livestock's bank account had been frozen for administrative reasons, whilst in truth the company too had been placed in liquidation. After reviewing Brandstock's bank statements, the liquidators (applicants) noted two sums of R250,000 leaving the bank account, shortly after Louw made his payment of almost R2,8 million. An investigation revealed that these sums had been paid to the respondents for monies previously advanced by them to Philip, which amounts had been due and owing for more than three years.

SOUTH AFRICA

"Robbing Peter to pay Paul"

CONTINUED

PROCEEDINGS IN THE HIGH COURT

The applicants sought to set aside the payments made to the respondents totalling R500,000 on the basis that these payments constituted a disposition without value and therefore stood to be set aside in terms of section 26 of the Insolvency Act 24 of 1936, read with section 340 of the Companies Act 61 of 1973.

It was the first respondent's case that he did not concern himself with where the money had come from and although he had never heard of Brandstock, he was aware that the money he received essentially came from Philip through Brandstock. He denied that Brandstock had obtained any rights to the money or had received any real benefit from the funds. Rather, that Brandstock had merely been used as a conduit through which to channel the money, which Philip had fraudulently obtained from Louw.

The applicants in turn argued that Louw had dealt with Brandstock, being a separate juristic entity, and not Philip in his personal capacity. As such, there was a valid contract between the parties, which Louw had entered into and performed in terms of, based on Philip's representations and instructions.

In determining the matter, the court tasked itself with answering two questions. Firstly, whether Brandstock should be treated as bound to the agreement between itself and Louw or liable for the loss suffered by Louw. Secondly, whether Philip had been authorised to enter into the transaction on Brandstock's behalf.

The court answered the first question by reiterating the fact that a company has no mind of its own and can therefore only be bound by a person representing it. Even though this representation may have been dishonest or fraudulent, the company remains bound thereby. On the second question, the court found that Philip, despite his deceitfulness in doing so, had actual authority to act on behalf of the company given that he was the sole director and shareholder. Brandstock was thus undoubtedly liable for the money stolen by Philip.

The respondents, however, were not giving up that easily and had one final argument up their sleeve – namely reliance on the so called "*directing mind doctrine*". The doctrine says that, "*the acts of the directing mind will be attributed to the company only when the action taken by the so-called directing mind (i) was within the field of the company's operation assigned to him or her, (ii) was not totally a fraud on the company and (iii) was by design or result partly for the benefit of the company*".

SOUTH AFRICA

"Robbing Peter to pay Paul"

CONTINUED

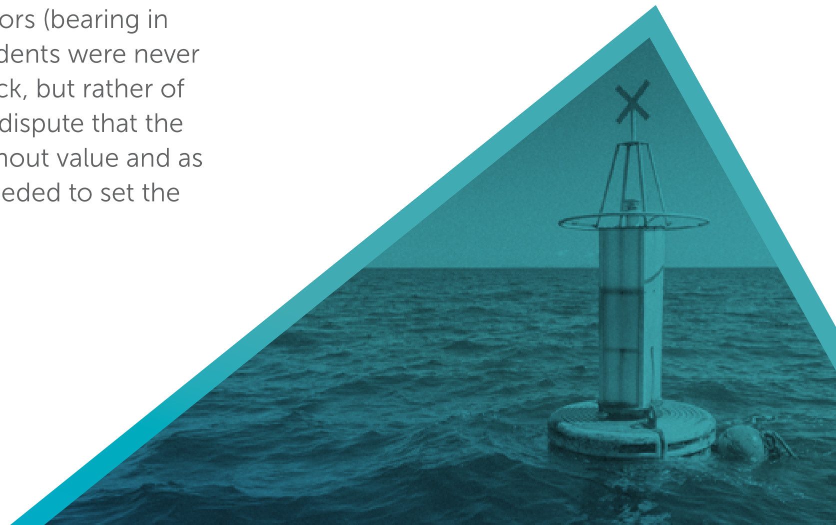
The court gave serious consideration to this argument, Judge Binsward reflected on several previous judgments, some of which he had penned himself. What became clear was that the applicability of the doctrine was context specific, and the facts in this matter differed in material respects from those where the doctrine had been successfully applied. In this case there was a contractual reason for the payment by Louw to Brandstock and an intention by Louw to make the payment. Brandstock, at least from the perspective of the bank where its account lies, had obtained an effective right to the money and the bank would not be free to reverse the credit. Consequently, the funds essentially became Brandstock's "*property*" within the wide definition contemplated in section 2 of the Insolvency Act. Additionally, the subsequent payments that went out to the respondents were not made by Philip in his personal capacity, as the bank specifically made those transfers on behalf of Brandstock, the account holder.

The final question that remained was whether these payments (essentially money stolen from Louw) fell within the definition of a "*disposition*". The Insolvency Act defines a disposition as "*any transfer or abandonment of rights to property and includes a sale, lease, mortgage, pledge, delivery, payment, release, compromise, donation or any contract therefor, but does not include a disposition in compliance with an order of the court*". The court found that the payments by Brandstock to the respondents constituted an abandonment of rights and was made for no value. In addition, as a result of the disposition, Brandstock could thereafter no longer reimburse Louw or pay its other creditors (bearing in mind that the respondents were never creditors of Brandstock, but rather of Philip). There was no dispute that the dispositions were without value and as such, the court proceeded to set the dispositions aside.

CONCLUSION

This judgment is a sad testament to the fact that unscrupulous directors quite often use a company's juristic personality to drive their fraudulent activities. Despite the remedies offered by the Insolvency Act and the Companies Act, when such a director simply disappears it is likely that the victims of the fraud are left to fight over whatever money remains, culminating in a lose-lose situation.

LUCINDE RHOODIE, MUWANWA RAMANYIMI AND KARA MEIRING



SOUTH AFRICA

Liquidation may leave you homeless

It is common, and probably necessary for people to work towards purchasing property to live in, as the proverbial 'roof over their heads'. It is also common for people to have ownership of the property registered in the name of a company or a trust, and for the shareholder or trust beneficiary to live in the property with his or her family as their family home. The company or trust is seen as a 'safe haven' that provides protection against the individual's creditors. However, what if the 'safe haven' company becomes insolvent and is eventually liquidated?

When a company is liquidated, the Master of High Court must appoint a liquidator for the insolvent company. The liquidator must then take control and custody of all assets of the company, and may eventually sell them and distribute the proceeds of the sale amongst the company's creditors in accordance with their ranking. The property, which is seen as the family home, would form part of the company's assets and may be sold by the liquidator for the benefit of the company's creditors.

Ordinarily, the execution and sale of an immovable property that is someone's primary residence must be done with 'judicial oversight'. Essentially, this means there must be a court order authorising the execution, with a reserve price set by the court.

SOUTH AFRICA

Liquidation may leave you homeless

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The court may not authorise the execution against a primary residence unless the court has considered that the execution is warranted. This is to ensure that those living in the property are not arbitrarily deprived of their constitutional right to have access to adequate housing.

The protection which ordinarily exists in the execution and sale of a primary residence does not apply when the property in question is owned by a company, and happens to be the primary residence of its director or shareholder. In *Segalo v Botha N.O. and Others*; *Botha N.O. and Another v Segalo and Others* (2020/11582; 2019/44572) [2021] ZAGPJHC 770 (6 December 2021), the sole shareholder and director of Blue Flame Advertising and Marketing (Pty) Ltd – which was already in liquidation – sought an order declaring that failure to provide judicial oversight over sales of residential immovable properties of liquidated companies is unconstitutional and invalid. There was also an order sought declaring it unconstitutional for the Master of the High Court to authorise the sale of immovable property to the extent that this permits the sale of a home of a person.

The court held that the protection of the right to have access to adequate housing is aimed at poor people who own and occupy property sought to be executed without proper consideration of their circumstances. No judicial oversight is required when the property belongs to a company. Where the property is owned by a company and the shareholder is the beneficial owner of the property, the protection is not applicable. Juristic persons, such as companies, do not have a right to have access to adequate housing.

Liquidation is a creditor-driven and creditor-friendly process, with a liquidator whose primary function is to *liquidate* the assets of the insolvent company and pay creditors. Should those assets include a property registered in the name of the insolvent company, then that property may also be sold as part of the liquidation of the assets of the company. Whoever lives in that property faces the risk of being evicted and becoming homeless as the liquidator attempts to sell the property, and give undisturbed occupation of the property to the buyer.

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OUR TEAM

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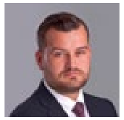

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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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