DISPUTE RESOLUTION

BUSINESS RESCUE, RESTRUCTURING & INSOLVENCY

NEWSLETTER

Volume 20 | 11 June 2021

CDH
CLIFFE DEKKER HOFMEYR

INCORPORATING
KIETI LAW LLP, KENYA

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Business Rescue,
Restructuring &
Insolvency

Just like that, we are halfway through the year, which has essentially felt like the glorified extension of 2020. Although COVID-19 and working from home may tempt us to forget to differentiate between the passing months, we should pause to remember that June is a particularly important month for both our country, in particular, and the world at large. On June 16th we will be celebrating National Youth Day, where we commemorate the 1976 Soweto Uprising and we are encouraged to remember the role that our youth plays in an effective democracy. Globally, June also marks Pride Month where the world similarly commemorates the individuals who have historically fought for the equality of our LGBTQIA family, friends and colleagues.

The CDH Insolvency, Business Rescue and Restructuring Sector accordingly wish our clients, colleagues, friends and families a Happy Youth Day and Pride Month.

Moving onto our monthly update on the world of business rescue and insolvency - we have noticed that corporations are increasingly starting to realise the value in business rescue with CNA, after 125 years of operating, going into business rescue this week. The company, hard-hit by COVID-19, seems to have followed suit from its erstwhile owner, Edcon, in taking proactive steps to address its financial distress.

Some further interesting dynamics have emerged in the case regarding the liquidation of the crypto-investment scheme Mirror Trading International (MTI), as its 50% shareholder has filed court papers in which it is exhaustively argued that MTI should instead be placed under rescue. Interestingly, the shareholder argues that the liquidation should be set aside as MTI's terms and conditions made it clear that those investing in the scheme were members of a club, rather than creditors. We look forward to seeing how this argument will be developed in court, and how the court will deal with this relatively unique case.

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With reference to South African Airways' ever-continuing road to recovery, we have learnt that Government will not relinquish its entire shareholding in the enterprise and that it will continue to fly under the same name. As for its subsidiaries, they appear to still be in the early stages of their road to recoveries, as Mango appears to continue to sporadically delay their flights. We can only hope that our proudly South African airlines pursue the legal mechanisms available to them to get back into the skies.

In this month's newsletter, we have two articles in which we consider our courts' findings in the recent notable cases of *De Wet and Another v Khammissa and Others* and *M Van Zyl v Auto Commodities (Pty) Ltd*, respectively.

Although we are in the thick of winter and having to light candles more than we would like, we remain optimistic as the first half of this year has certainly shown our communal resilience and adaptability in the face of significant adversity. So, let's layer up, light some candles and keep forging forward.

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Leftover liability: surety's obligations after successful business rescue proceedings in terms of section 154(2) of the Companies Act

The COVID-19 pandemic has unfortunately affected many businesses negatively. Many of these struggling businesses have resorted to business rescue to save them. Business rescue has been a saving grace to many struggling businesses in the past, however, it is not a process without consequence. The recently decided case of *Martin van Zyl v Auto Commodities (Pty) Ltd* (279/2020) [2021] ZASCA 67 (3 June 2021) dealt with the vexing question of the effect of successful business rescue on the liability of sureties. The case provided useful insight into the interpretation of section 154(2) of the Companies Act 70 of 2008 (Act).

Section 154(2) states that "*if a business rescue plan has been approved and implemented in accordance with this Chapter, a creditor is not entitled to enforce any debt owed by the company immediately before the beginning of the business rescue process, except to the extent provided for in the business rescue plan*" (own emphasis added).

Factual Background

The Appellant, Mr van Zyl, was the former Chief Executive Officer of Blue Chip Mining and Drilling (Pty) Ltd (BCM), a company to which the Respondent, Auto Commodities (Pty) Ltd, provided petroleum products to on credit. Mr van Zyl bound himself as surety with BCM for the products acquired on credit from the Respondent. BCM was placed under business rescue in December 2014, the business rescue plan being successfully adopted in June 2015. The Respondent received two dividend pay outs amounting to R1,9 million in December 2015 and 2016 from BCM. BCM's business rescue terminated in January 2017 since the business rescue plan had been substantially implemented. In July 2017, the Respondent issued summons against Mr van Zyl for the shortfall of BCM's indebtedness to the Respondent, being in excess of R6 million.

Leftover liability: surety's obligations after successful business rescue proceedings in terms of section 154(2) of the Companies Act...*continued*

In the *court a quo*, the Respondent was successful in its claim against Mr van Zyl, the claim being based on an argument that the wording of the deed of suretyship allowed it to claim payment from Mr van Zyl for the balance of the indebtedness that was owed by BCM. Clause 3 of the Deed of Suretyship specifically provided that leniency, extension of time or any other such arrangement between the Respondent and BCM would not constitute a waiver of the Respondent's claim in terms of the suretyship. Furthermore, clause 5.4 provided that no event of compromise between the Respondent and BCM, particularly the payment of dividends, would prejudice the Respondent's right to recover "*to the full extent of this Suretyship, any sum which, after the receipt of such dividends or payments, will remain owing*" from the surety.

Mr van Zyl appealed to the Supreme Court of Appeal and argued that when the business rescue terminated, section 152(4) of the Companies Act released BCM from any further indebtedness to the Respondent, which in turn released Mr Van Zyl as surety from liability. The rationale of the argument was that suretyship is an accessory obligation, and release from the principal debt is release from the accessory debt. On the other hand, the Respondent argued that the deed of suretyship was wide enough to maintain Mr van Zyl's liability, regardless of the effect of section 154(2) of the Act.

Although the business rescue plan made provisions to release BCM from the balance of some, and not all, of its debts; the wording of the deed of suretyship was sufficient to discharge Mr van Zyl's case, and the appeal was ultimately dismissed.

This judgment has brought about certainty in the interpretation of section 154(1) and (2) of the Act.

Interpretation of sections 154(1) and 154(2) of the act

The court found that the heading of section 154, being "*The discharge of debts and claims*" suggested an inherent distinction between the effect of section 154(1), being the discharge of debts, and section 154(2), being a limitation on the enforcement of debts.

Section 154(1) states that "*a business rescue plan may provide that, if it is implemented in accordance with its terms and conditions, a creditor who has acceded to the discharge of the whole or part of a debt owing to that creditor will lose the right to enforce the relevant debt or part of it*". Although the court was not required to state with certainty the meaning of section 154(1), it was accepted that the aim of section 154(1) is to extinguish the creditor's right to enforce its debt, which would in turn extinguishes the creditor's right to enforce against the surety.

Leftover liability: surety's obligations after successful business rescue proceedings in terms of section 154(2) of the Companies Act...*continued*

Regarding section 154(2) the court found that the wording of the section merely limits the creditor's enforceability of its right, specifically against the debtor, but does not extinguish the debt in its entirely. The court further confirmed the constitutionality of this interpretation, particularly on whether the interpretation could be considered a deprivation of property in terms of section 25(1) of the Constitution. The court found that the ordinary creditor would not read section 154(2) to mean that their deed of suretyship is rendered worthless in the event of an adoption and implementation of a business rescue plan. Thus, the interpretation that section 154(2) merely limits the creditor's claim but does not deprive them of their right which may still be enforceable against sureties.

Conclusion

It is standard commercial practice that a deed of suretyship would contain clauses such as clause 3 and 5.4 in the deed of suretyship in this case. Therefore, any person who binds themselves as surety should be alive to the possibility that although the principal debtor might be released from its obligations following a business rescue plan, it does not necessarily mean that the surety is also released from its obligations. As such the surety can still be held liable for the principal debt. This is what we call leftover liability. Although section 154(2) may limit a creditor's claim against the principal debtor after the business rescue plan has been implemented, this is not the equivalent of extinguishing the debt and as such a surety's liability, depending on the wording of the deed of suretyship, still remains. We encourage clients to be mindful of leftover liability that may apply to sureties after the successful implementation of a business rescue plan, and to seek legal advice when faced with such an issue.

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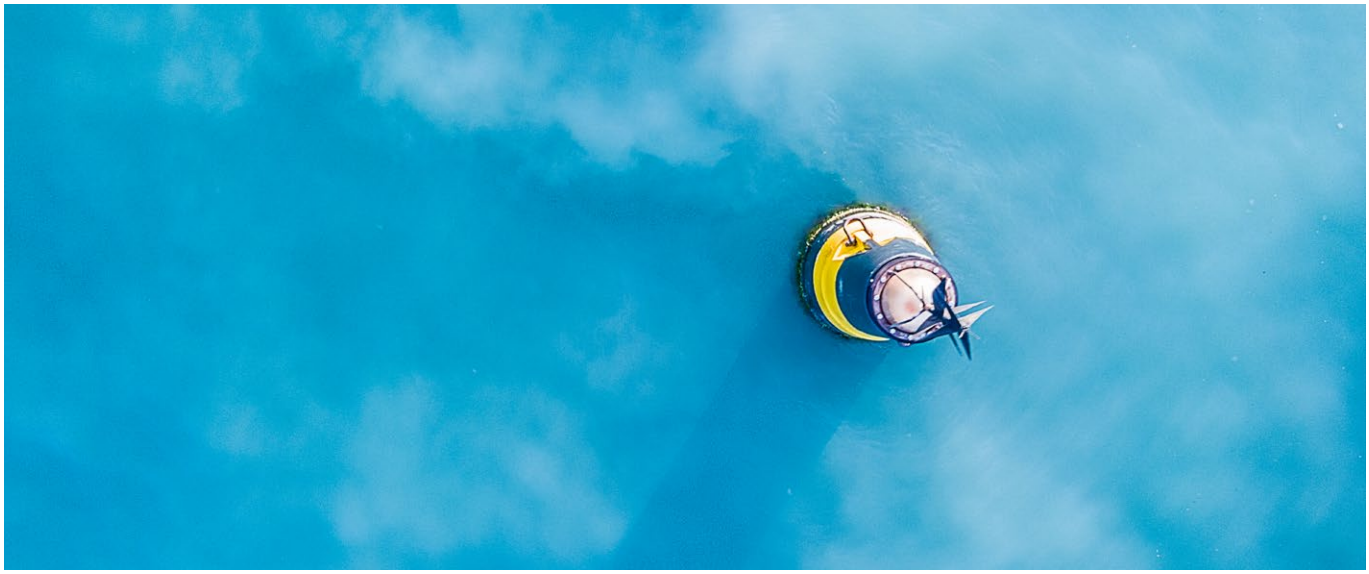
Blowing hot and cold – the court's take on a Master's decision to go back on her decision in the appointment of liquidators



The doctrine of "*functus officio*" dictates that the decisions of officials are deemed to be final and binding once made. Thus, the decision of the Master, as an officer of the court, is deemed to be final and binding once it is published, announced or otherwise conveyed to those affected by it.

In an interesting line of litigation, in *De Wet and Another v Khammissa and Others* (358/2020) [2021] ZASCA 70 (4 June 2021), the Supreme Court of Appeal (SCA) has provided finality in what became a peculiar back and forth of decisions by the Master in respect of the appointment of liquidators in an insolvent estate. The doctrine of "*functus officio*" was thus considered.

In giving some context to the above, the litigation was pursuant to liquidation proceedings of a company and the appointment of liquidators in respect of same. On 31 August 2017, the Master decided not to appoint Gert de Wet and Johan Engelbrecht as additional joint liquidators of Duro Pressing (Pty) Ltd (in liquidation) (Duro) following the death of one of the existing joint liquidators (the first decision). However, on 25 October 2017, the Master then decided to appoint Gert de Wet and Johan Engelbrecht as additional joint liquidators of Duro (the second decision). The existing joint liquidators challenged the lawfulness of the second decision.

The second decision came about after the Master had received a letter from attorneys acting on behalf of an undisclosed group of creditors requesting reasons for the first decision. Once the reasons were provided, the undisclosed group of creditors requested that the Master reconsider the first decision.

As such, the Master reconsidered the first decision and handed down the second decision, and issued an amended certificate of appointment reflecting Gert de Wet and Johan Engelbrecht as additional joint liquidators of Duro.

The existing joint liquidators launched an application seeking to review and set aside the second decision, and for confirmation of the first decision as valid. They argued that the second decision was:

- *ultra vires*;
- procedurally unfair;
- taken arbitrarily or capriciously; and
- not rationally connected to the information before the Master.

In a scramble of argument and submissions raised by both parties on the grounds of insolvency law and company law in the *court a quo*, the SCA was able to rummage through what was described as the "*unnecessary*" legal argument, identifying the

Blowing hot and cold – the court's take on a Master's decision to go back on her decision in the appointment of liquidators...*continued*

root of the issue: whether the Master had become *functus officio* once she had made the first decision, and thus had no power to revoke it and replace it with the second decision. In considering this issue, it became evident that the legal question was that of an administrative law nature rather than one of insolvency or company law.

In coming to its decision, the SCA highlighted the importance of the courts' central role in the identification of issues and the necessity for the court to be able to identify the true issue for determination and to not allow the freight of unnecessary legal argument and application murky the metaphorical waters.

The SCA went on to highlight that the appeal turned on the question of the legality of the second decision. The question to be considered was whether the Master had the power to vary the first decision or whether the first decision was final.

The SCA considered commentary by Hoexter wherein the author explains that finality is a point arrived at when a decision is published, announced or otherwise conveyed to those affected by it, i.e. it must have passed into the public domain in some manner. In considering this literature, and the facts before it, the SCA found that the Master's first decision had in fact passed into the public domain, thus, in the absence of any statutory provision to state otherwise, the Master had no power to revoke the first decision.

The SCA accordingly found the Master's first decision to be final and irrevocable, thus rendering the second decision invalid. On this basis, the SCA found that the appeal failed.

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BBBEE STATUS: LEVEL TWO 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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