DISPUTE RESOLUTION

BUSINESS RESCUE, RESTRUCTURING & INSOLVENCY

NEWSLETTER

Volume 26 | 8 December 2021

CDH
CLIFFE DEKKER HOFMEYR

INCORPORATING
KIETI LAW LLP, KENYA

Tobie Jordaan
Sector Head
Director

Business Rescue,
Restructuring &
Insolvency

Just as we had started to get over the sting of the resurging EskomsePush notifications and recent fuel price hike, 2021 decided to yet again deliver another seemingly insurmountable obstacle – the novel Omnicron COVID-19 variant. Just like that, international trips were cancelled overnight, and COVID-19 testing sites started to overflow again. Having accepted that most of our foreign counterparts have definitively, and somewhat controversially, closed their borders to us; the focus has now turned inwards, with many expressing concern that President Cyril Ramaphosa may also shut down inter-provincial travel during the upcoming festive season. Fears and apprehensions aside, after a year characterized by lockdowns, loadshedding, retrenchments and fuel hikes, the CDH Business Rescue, Restructuring and Insolvency Sector would like to extend a message of hope to our colleagues, clients and readers during these trying times. Until otherwise stated by the powers that be, we are still at liberty to continue planning our December breaks. We accordingly encourage you to do so, because if this extraordinarily taxing year has taught us anything it's the value of rest and spending time with our loved ones. All that we ask is that you continue to observe the necessary protocols to protect your loved ones and those around you; and to avoid giving President Ramaphosa a reason to shut down our festive season plans.

In business rescue news, the previous month has again proved quite eventful in the distressed investment market. Ster-Kinekor's business rescue practitioner (BRP) has reported that London-based special situations investment firm, Blantyre Capital, has partnered with Cape Town-based specialist private credit investment management firm, Green Point Capital, to provide an updated amplified investment offer. However, the receipt of this amplified offer has caused Ster-Kinekor's BRP to request a further extension on the deadline for the publication of the business rescue plan to 21 January 2022, in order to hash out the details of the offer and incorporate it as part of the terms of the plan. The financially embattled 125-year-old stationer CNA has also received an offer to be bought out by Black Mountain Investment Management, a Durban-based hedge fund. Despite reports that the terms of the proposal will result in CNA's creditors not receiving anything, the chain was saved when its business rescue plan was recently approved by 78% of its creditors.

The Competition Tribunal has also been active in providing its requisite nod of approval for distressed asset transactions. Just this week the Competitional Tribunal provided its unconditional approval for the acquisition of Comair's SLOW Lounge by FirstRand Bank, thereby allowing Comair to take a significant step towards the successful conclusion of its business rescue proceedings. The Competition Tribunal has also provided approval for the acquisition of the Gupta-owned Optimum Coal Mine by Liberty Coal, in terms of a debt-for-equity deal.

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On the topic of Gupta-owned companies, there has been quite a bit of activity in the business rescue proceedings of some of the eight Gupta-owned companies that were placed under voluntary business rescue in February 2018, following the decision by South Africa's major banks to terminate their accounts. Gupta-owned Tegeta Exploration and Resources (Tegeta) recently managed to temporarily block the BRPs of Optimum Coal Terminal (OCT) from convening a creditors' meeting aimed at adopting OCT's proposed business rescue plan. The order was granted on the basis that a dispute regarding who would vote on the plan on behalf of OCT, with the choice being either Tegeta or OCT's BRPs, having to be resolved first. Additionally, the Constitutional Court recently refused a bid by the junior BRP for Gupta-owned Shiva Uranium (Shiva) to overturn the Supreme Court of Appeal judgment confirming Mahomed Tayob and Eugene Januarie as Shiva's validly appointed BRPs.

In this month's newsletter, we consider the circumstances in which a judgment involving a company under business rescue is vulnerable to being rescinded, with reference to the findings in the recent case of *CNA Operations (Pty) Ltd and Others v Anglowealth Sharia (Pty) Ltd and Others*. We further discuss the what, when and how's of insolvency enquiries convened in terms of section 417 as read with section 418 of the Companies Act 61 of 1973.

In closing our final newsletter of the year, the CDH Business Rescue, Restructuring and Insolvency Sector would like to say thank you for the continued support that we have received from our colleagues and clients during yet another unprecedented year. We hope that each of you makes the most of this festive season with your loved ones. We will be waiting on the other side to continue assisting our clients with adapting and thriving in the "*new normal*".

Tobie Jordaan
Sector Head and Director

PRIMARY CONTACTS

Tobie Jordaan
Sector Head
Director
T +27 (0)11 562 1356
M +27 82 417 2571
E tobie.jordaan@cdhlegal.com

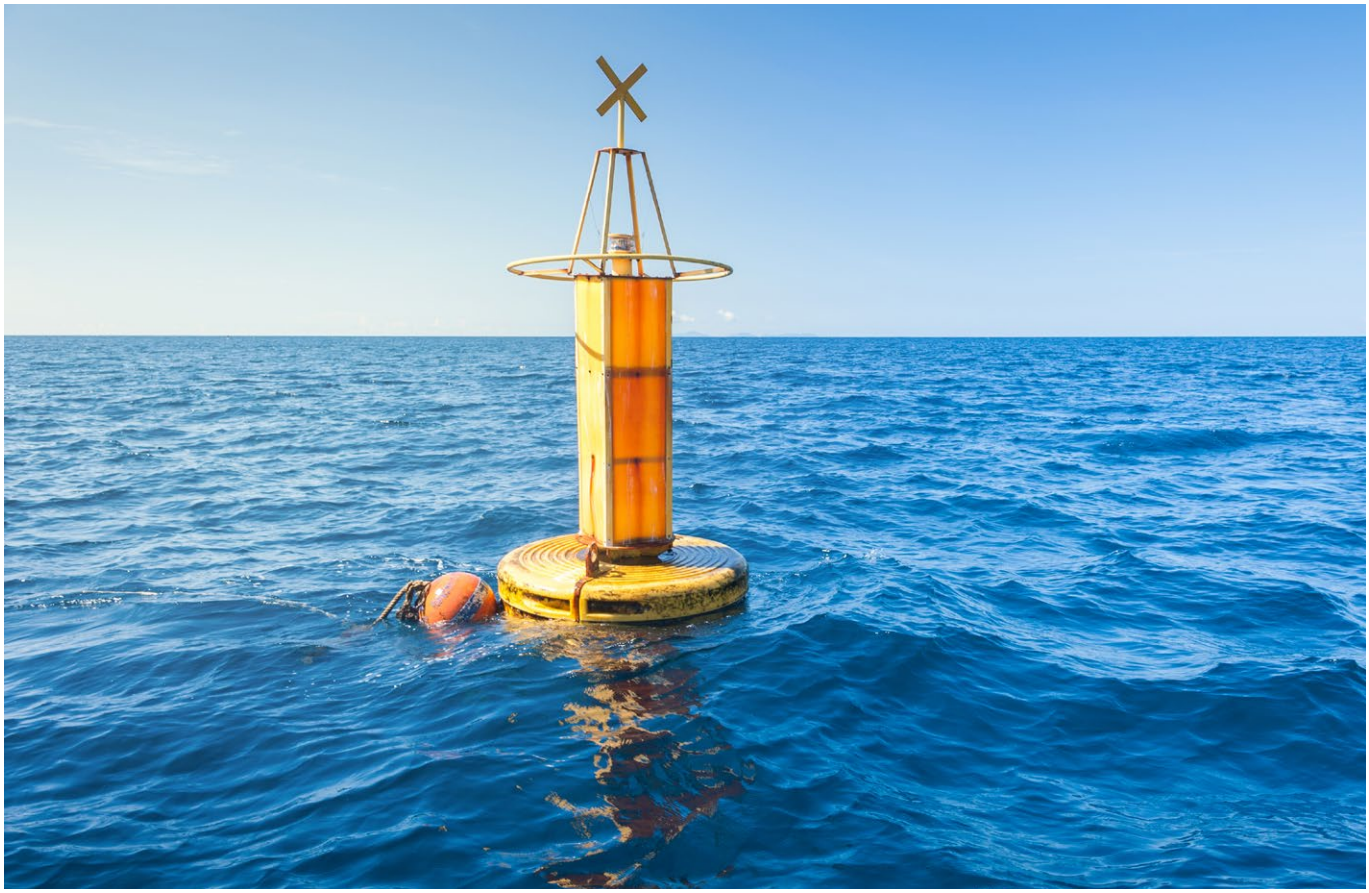
Richard Marcus
Director
T +27 (0)21 481 6396
M +27 82 902 9437
E richard.marcus@cdhlegal.com

Kgosi Nkaiseng
Director
T +27 (0)11 562 1864
M +27 76 410 2886
E kgosi.nkaiseng@cdhlegal.com

Shedding light on a sunken ship: The why, what and how of insolvency enquiries

When a company is placed under liquidation, it is sometimes more than just a business venture gone wrong. More often than not a myriad of factors contributed to the company's downfall, many of which could potentially have been avoided. Mismanagement of the company, or acts of misconduct or impropriety by those in charge of the company's affairs may well have led to its current financial predicament and prejudice to its creditors. Consequently, the urge to conceal any potential wrongdoing could grow strong in any person closely connected to the company's affairs. Given that a liquidator is essentially an outsider looking into the affairs of the company, it seems likely that certain transactions would be difficult to uncover or understand by merely looking at the company's financial books.

Shedding light on a sunken ship: The why, what and how of insolvency enquiries*...continued*



For this reason our legislature has made provision for private insolvency enquiries to be conducted. Insolvency enquiries are still conducted in terms of the old Companies Act 61 of 1973 and regulated under section 417, read with section 418 of the Act. Section 417 sets out the powers of the Master or a court to convene an enquiry and section 418 allows for the delegation of these powers to a commissioner.

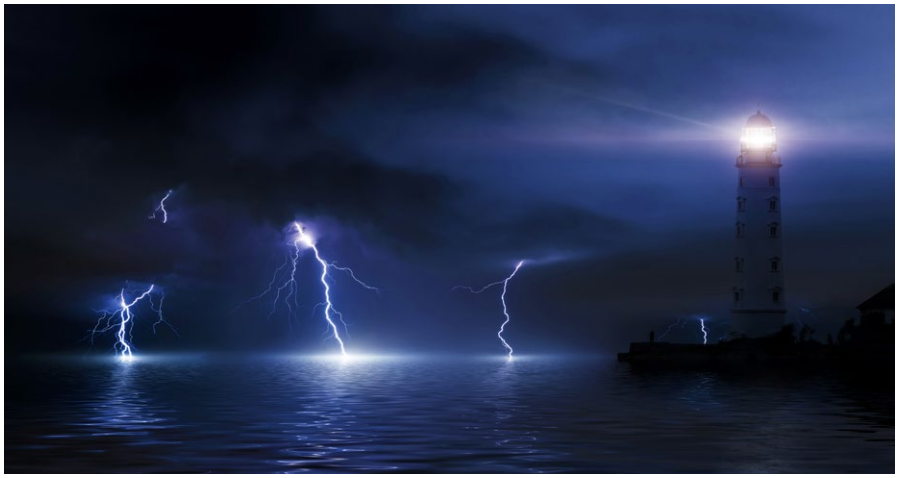
Purpose of the enquiry

An insolvency enquiry allows a liquidator to obtain the necessary information and details from relevant parties to assist them in properly winding up the affairs of the company. In many instances the documents and information required by the liquidator are highly confidential and an insolvency enquiry makes provision for this. All information obtained during the enquiry, whether in the form of documents or oral evidence, remains private and confidential, unless the court or Master orders otherwise. In the event that litigation by the company in liquidation could potentially be instituted – with the aim of recovering funds to the benefit of the company's creditors , it is also important that the liquidator is able to gather the necessary information without such information becoming available prematurely to the persons against whom the potential litigation will be instituted. The enquiry also allows the Master to authorise the investigation into the affairs of a company without the involvement of the courts, especially in cases where an investigation needs to happen urgently.

Requirements for convening an enquiry

An enquiry may only be convened in respect of a compulsory winding-up of a company, made by application to the court. In the event that a company is placed in voluntary liquidation and an application is subsequently made to court to convert the liquidation to a compulsory liquidation, an insolvency enquiry may also be convened. The Act, in section 415, already makes provision for the interrogation of persons at the meeting of creditors, and therefore an applicant for an insolvency enquiry must satisfy the court or the Master that such an insolvency enquiry is preferable. The applicant should also convince the court that there is a reasonable suspicion that the person/s being called to the enquiry has access to the necessary information.

Shedding light on a sunken ship: The why, what and how of insolvency enquiries...*continued*



The court has a discretion to grant an insolvency enquiry application and in doing so, has to consider the liquidator's needs in winding up the company, in relation to the rights of the person/s to be examined under the enquiry. While the right to privacy plays an important role in the court's determination, it must balance this against the importance of the information required by the liquidator. In the event that the information is essential to potential future litigation, it is likely that the court will lean towards granting the application. The applicant is, however, not required to make out a *prima facie* case that there are grounds for future litigation, but merely needs to prove that there is a reasonable suspicion.

Process for convening an enquiry

It is usually the liquidator who would make the application to the court or the Master, but this does not preclude any other person with in interest in the company from bringing such an application. In practice it is often disgruntled creditors who bring the application with the assistance of the liquidator. Once such application is granted, it will likely not be the court or the Master who presides over the enquiry, but instead a commissioner will be appointed for this purpose. Technically the court may appoint anyone as a commissioner, but given the potential complexity involved in such an enquiry it should usually be either a retired judge or senior advocate who is appointed.

The costs involved in the appointment of a commissioner and the running of an enquiry must be paid by the person who made the application, but the court or the Master may direct that these costs are paid out of the assets of the estate.

Once an enquiry has been convened, the commissioner may, on request by the applicant, subpoena any persons whom it deems able to provide necessary information into the business dealings and affairs of the company in liquidation, to attend the enquiry and testify as to its knowledge. The request could either be for documentary evidence alone, or to appear before the commissioner to present oral evidence, or both. The attorney representing the applicant has the right to, along with the commissioner, question any of the witnesses who appear at the enquiry.

Rights of the witnesses

A witness who has been subpoenaed to provide information or documents in an insolvency enquiry has the right to legal representation. However, the witness and their legal representative may only be present during the witness' own interrogation and do not have access to information or evidence provided by any of the other witnesses in the enquiry. While the witness may request that questions are posed prior to the enquiry in order to allow them time to obtain the necessary information, a witness does not have a right to this prior information and such a request may be refused. Witnesses may be required to sign the transcript of their evidence, but have the right to review it and make amendments if necessary, prior to signing.

Due to the exceptional nature of the proceedings, a witness may not refuse to answer a question on the basis that it may incriminate them and may be forced by the court/Master/commissioner, in consultation with the Director of Public Prosecutions, to answer. However, a witness may claim legal professional privilege and may refuse to answer a question on that basis. A general claim that certain documents or information are confidential will not be sufficient to withhold such information. Thus, if there is reason to believe that the information will be relevant to the affairs of the company, the commissioner may request access to them.

Where a witness who has been served with a subpoena is of the opinion that they may suffer prejudice as a result of the enquiry, they may apply to court to set aside the subpoena. Prior to an insolvency application having been granted, a potential witness may also oppose the application itself, albeit on limited grounds relating to jurisdiction, prejudice or certain exceptional circumstances.

Conclusion

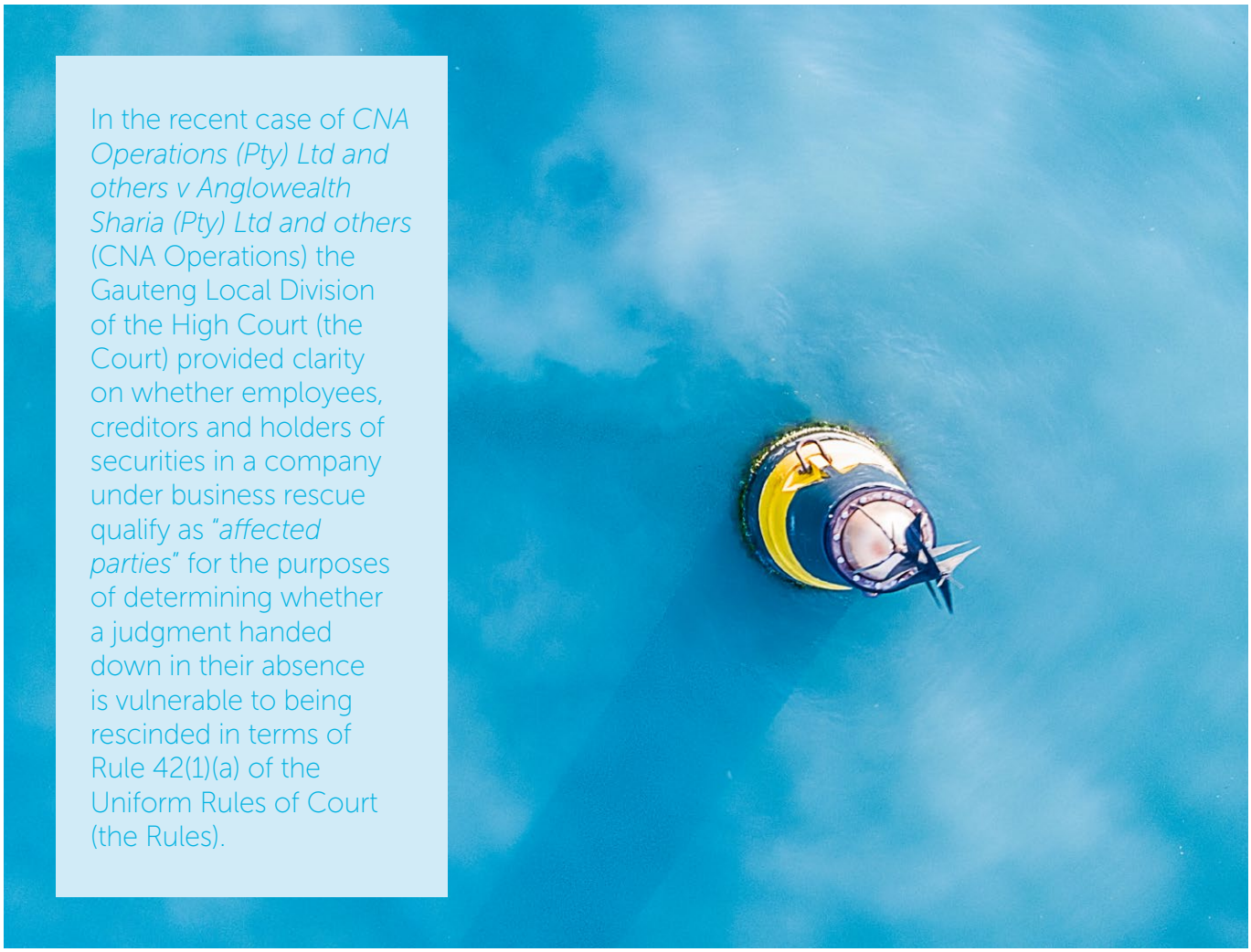
The quasi-judicial nature of an insolvency enquiry makes it a useful tool for liquidators and interested parties alike to uncover potentially unscrupulous behaviour by directors and managers of a company. Specifically, it allows creditors to determine whether there is potential cause to recover its losses directly from persons involved in the affairs of the company, without having to make out a much more difficult case for piercing of the corporate veil.

Lucinde Rhoodie
Director

Kara Meiring
Associate Designate

The call should come from inside the house: Some clarity on when judgments involving a company under business rescue can be rescinded

In the recent case of *CNA Operations (Pty) Ltd and others v Anglowealth Sharia (Pty) Ltd and others* (CNA Operations) the Gauteng Local Division of the High Court (the Court) provided clarity on whether employees, creditors and holders of securities in a company under business rescue qualify as "*affected parties*" for the purposes of determining whether a judgment handed down in their absence is vulnerable to being rescinded in terms of Rule 42(1)(a) of the Uniform Rules of Court (the Rules).



Briefly, the facts in *CNA Operations* are that Anglowealth Sharia (Pty) Ltd (Anglowealth) registered a general notarial bond (the GNB) over the moveable assets of CNA Operations (Pty) Ltd (in business rescue) (CNA), as security for a cost-plus financing agreement that it had entered into with CNA in January 2021. Shortly after CNA was placed under business rescue in June 2021, CNA's erstwhile business rescue practitioners (BRPs) consented to the granting of a court order perfecting the GNB (the Order), pursuant to a perfection application that had been brought by Anglowealth. The terms of the Order were severely restrictive on CNA's business operations in that they provided that CNA's BRPs could not:

- sell CNA's assets unless the entire debt owing to Anglowealth had been paid; or
- use the proceeds from stock sold to pay for any expenses for buying more stock.

In August 2021, subsequent to the granting of the Order, CNA's erstwhile BRPs resigned and were replaced by its current BRPs.

However, due to the stranglehold placed on CNA's moveable assets by the Order, CNA's current BRPs were ultimately rendered unable to pay CNA's ongoing operational expenses; such as its suppliers' costs, store rental fees and employees' salaries. Consequently, CNA, together with its BRPs and employees' representatives, brought an urgent application to rescind the judgment granting the Order in terms of Rule 42(1)(a) of the Rules (the Rescission Application). The Rescission Application was brought on the basis of the undisputed fact that there

The call should come from inside the house: Some clarity on when judgments involving a company under business rescue can be rescinded...*continued*

had been a failure to notify CNA's creditors and employees of Anglowealth's perfection application that had resulted in the judgment granting the Order.

Requirements for the rescission of a judgment

Rule 42(1)(a) of the Rules provides *inter alia* that a court may: "*rescind or vary an order or judgment erroneously sought or granted in the absence of any party affected thereby*". With reference to the case of *Mutebwa v Mutebwa and Another 2001* (2) SA 193 (TkH), the Court considered and set out the requirements for the rescission of a judgment, which are:

1) firstly, the judgment must have been erroneously sought or erroneously granted;
2) secondly, the judgment must have been granted in the absence of the applicant for the rescission of the judgment; and
3) lastly, the rights and interests of the applicant for the rescission must be affected by the judgment.

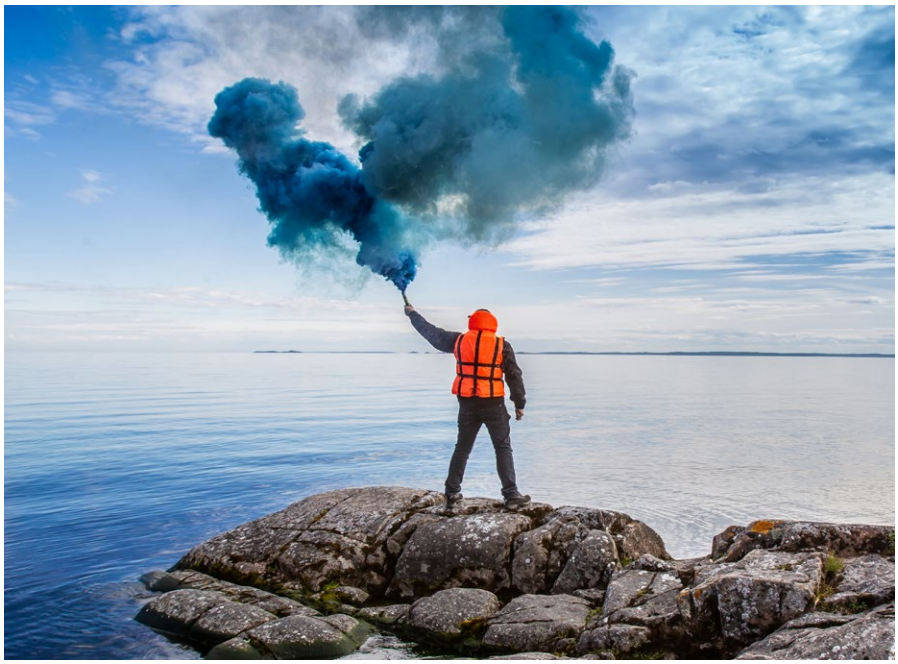
The Court seemed to work its way from the bottom up in considering these requirements, by starting with the determination of whether CNA's creditors and employees qualified as "*affected parties*" for the purposes of the third requirement. The Court observed that this requirement was traditionally applied in circumstances where the applicant for the rescission had a more obviously recognisable legal relationship to the parties to the judgment sought to be rescinded; thereby clearly qualifying them as an "*affected party*". However, in *CNA Operations*, the impact of the relevant judgment on the rights and interests of CNA's creditors and employees was ostensibly more remote than would otherwise had been the case had their rights and interests derived from, for example, a direct contractual relationship with Anglowealth. Accordingly, the legal question to be determined by the Court was whether this apparent remoteness prevented CNA's creditors and employees from qualifying as "*affected parties*" for the purposes of Rule 42(1)(a).

To this end, the Court looked to the business rescue provisions of the Companies Act 71 of 2008 (Companies Act), and specifically those dealing with the rights of employees, creditors and holders of securities in a company under business rescue. In this regard, the Court found that sections 144(3), 145(1) and 146(a) and (b) of the Companies Act provide employees, creditors and holders of securities in a company under business rescue, respectively, with the rights to:

- receive notice of each court proceeding concerning the business rescue proceedings; and
- participate in any court proceedings arising during business rescue proceedings.

After having considered the above provisions of the Companies Act, the Court essentially found that there is a clear statutory recognition of the fact that legal proceedings can result in outcomes that have an effect on the other constituencies

The call should come from inside the house: Some clarity on when judgments involving a company under business rescue can be rescinded...*continued*



of a company under business rescue; such as its employees, creditors and holders of securities. Consequently, the Court confirmed that these constituencies qualified as *"affected parties"* for the purposes of Rule 42(1)(a).

Accepting that these constituencies qualified as *"affected parties"* under Rule 42(1)(a), Anglowealth counter-argued that it had no obligation to notify these constituencies of its perfection application as South African case law has established the principle that creditors of a company under rescue are not required to notify other affected parties of court proceedings instituted during the business rescue (*Timasani (Pty) Ltd* (in business rescue) *and Another v Afrimat Iron Ore (Pty) Ltd* (91/2020) [2021] ZASCA 43).

Significantly, both CNA's current BRPs and the Court agreed with Anglowealth on this point. However, the Court found that this was a novel situation in that although it was not Anglowealth's obligation to have notified these constituencies, it was an obligation incumbent on CNA's erstwhile BRPs; who held their positions at the time that Anglowealth's perfection application was instituted. The Court further found that it was an undisputed fact that CNA's erstwhile BRPs had failed to notify the creditors and employees of the perfection application.

Considering the undisputed fact that CNA's employees and creditors were not given notice of Anglowealth's perfection application, the Court held that second of the requirements for a rescission had necessarily been satisfied as the judgment was consequently undeniably given in their absence.

Turning to the first, and paradoxically final, of the requirements, the Court held that the requirement did not mean that the judgment sought to be rescinded had to be found to be substantively incorrect in law. Instead, the requirement that the judgment had been erroneously sought is satisfied in circumstances where there was, *"no proper notice to the absent party, irrespective of whether the order or judgment is otherwise correct."*

Accordingly, the Court ultimately concluded that all three of the requirements for a rescission under Rule 42(1)(a) had been satisfied, and that the judgment had to be rescinded on the basis that it had been given in the absence of affected parties.

From the perspective of a party wishing to institute legal proceedings against a company under business rescue, as well as the BRPs of a company under business rescue faced with impending legal proceedings, this case has underlined the importance of ensuring that the BRPs notify all affected parties of any such legal proceedings. A failure to do so would otherwise render any resulting judgment vulnerable to being rescinded in terms of Rule 42(1)(a). Importantly, this judgment further reiterates that the obligation to notify affected parties sits with the BRPs of the company under rescue.

Tobie Jordaan
Sector Head

Joshua Geldenhuys
Candidate Attorney

Lesedi Mathumetse
Vacation Work Student

OUR TEAM

For more information about our Business Rescue, Restructuring & Insolvency sector and services in South Africa and Kenya, please contact:

Tobie Jordaan
Sector Head
Business Rescue, Restructuring & Insolvency
T +27 (0)11 562 1356
E tobie.jordaan@cdhlegal.com

Thabile Fuhrmann
Chairperson
Director
Dispute Resolution
T +27 (0)11 562 1331
E thabile.fuhrmann@cdhlegal.com

Sammy Ndolo
Managing Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E sammy.ndolo@cdhlegal.com

Richard Marcus
Director
Dispute Resolution
T +27 (0)21 481 6396
E richard.marcus@cdhlegal.com

Kgosi Nkaiseng
Director
Dispute Resolution
T +27 (0)11 562 1864
E kgosi.nkaiseng@cdhlegal.com

Mongezi Mpahlwa
Director
Dispute Resolution
T +27 (0)11 562 1476
E mongezi.mpahlwa@cdhlegal.com

Desmond Odhiambo
Partner | Kenya
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E desmond.odhiambo@cdhlegal.com

Lucinde Rhoodie
Director
Dispute Resolution
T +27 (0)21 405 6080
E lucinde.rhoodie@cdhlegal.com

Belinda Scriba
Director
Dispute Resolution
T +27 (0)21 405 6139
E belinda.scriba@cdhlegal.com

Vincent Manko
Senior Associate
Dispute Resolution
T +27 (0)11 562 1660
E vincent.manko@cdhlegal.com

Lerothodi Mohale
Senior Associate
Dispute Resolution
T +27 (0)11 562 1175
E lerothodi.mohale@cdhlegal.com

Kylene Weyers
Senior Associate
Dispute Resolution
T +27 (0)11 562 1118
E kylene.weyers@cdhlegal.com

Nomlayo Mabhena
Associate
Dispute Resolution
T +27 (0)11 562 1743
E nomlayo.mabhena@cdhlegal.com

Christine Mugenyu
Associate
T +254 731 086 649
+254 204 409 918
+254 710 560 114
E christine.mugenyu@cdhlegal.com

Jessica Osmond
Associate
Dispute Resolution
T +27 (0)11 562 1067
E jessica.osmond@cdhlegal.com

Muwanwa Ramanyimi
Associate
Dispute Resolution
T +27 (0)21 405 6093
E muwanwa.ramanyimi@cdhlegal.com

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.

JOHANNESBURG
1 Protea Place, Sandton, Johannesburg, 2196. Private Bag X40, Benmore, 2010, South Africa. Dx 154 Randburg and Dx 42 Johannesburg.
T +27 (0)11 562 1000 F +27 (0)11 562 1111 E jhb@cdhlegal.com

CAPE TOWN
11 Buitengracht Street, Cape Town, 8001. PO Box 695, Cape Town, 8000, South Africa. Dx 5 Cape Town.
T +27 (0)21 481 6300 F +27 (0)21 481 6388 E ctn@cdhlegal.com

NAIROBI
Merchant Square, 3rd floor, Block D, Riverside Drive, Nairobi, Kenya. PO Box 22602-00505, Nairobi, Kenya.
T +254 731 086 649 | +254 204 409 918 | +254 710 560 114 E cdhkenya@cdhlegal.com

STELLENBOSCH
14 Louw Street, Stellenbosch Central, Stellenbosch, 7600.
T +27 (0)21 481 6400 E cdhstellenbosch@cdhlegal.com

CLIFFE DEKKER HOFMEYR

INCORPORATING
KIETI LAW LLP, KENYA