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BUSINESS RESCUE, RESTRUCTURING & INSOLVENCY

NEWSLETTER

DISPUTE RESOLUTION

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"And breathe". We are in the final stretch of the year, which has simultaneously felt long and has gone by in a flash. December heralds not only the appearance of mince pies, an endless number of socks as Christmas presents and copious amount of food and drinks to enjoy but also the final push before most people close for the year. As the year draws to a close, we can end off 2022 as another successful year for the Business Rescue, Restructuring & Insolvency team at CDH. The busy period is wrapping up and in our latest instalment of this newsletter we take one last look at 2022, and all that it has taught us.

For the first time since the COVID-19 pandemic, we were able catch-up face-to-face with our colleagues in the sector, at the annual SARIPA conference, which was held during mid-November at the Fancourt in George. A valuable interaction that has been sorely missed as we were able to gain insights from key voices and practitioners in the industry. There was also an appearance by the judiciary, through Judges Ingrid Opperman and Owen Rogers, conducting an especially insightful discussion over MS Teams.

The closure of 2022 has also provided some good news with the movie house Ster-Kinekor is exiting business rescue after receiving an injection of R250 million from two investment capital firms - some much-needed good news to the entertainment industry in South Africa, and adding another success story on the business rescue front.

Further good news has surfaced in preparation for 2023, with supplier consortium, NewCo's interest to invest in sugar giant, Tongaat-Hulett, in order to protect the industry from collapse. This follows the shock announcement that they were entering into business rescue in mid-October. Furthermore, most of Tongaat-Hulett's creditors have approved an extension to date publication date of the business rescue plan to 31 January 2023.

In this, our last newsletter of the year, CDH Kenya Managing Partner, Sammy Ndolo considers receivership of an insolvent Kenyan Bank, and the different set of rules applied to an insolvent bank in the region, as opposed to any other ordinary company. In addtion, Director Thabile Fuhrmann and Candidate Attorney, Dean Tennant discuss the recent case of *Infinitum Holding and Another v Hugo Lerm and Others* (26799/2017) [2022] ZAGPJHC 341 (18 May 2022) which dealt with the effects of noncompliance with section 129(2)(a) of the Companies Act 71 of 2008, and whether a resolution to place a company in business rescue, which falls foul of this section, is without more void *ab initio*.

We would like to thank our readers for keeping up to date with our newsletter throughout the year and thank our colleagues and clients for their support during a year where we have all adapted to the *"new normal"*. We hope that each one of our clients and readers has a fantastic festive season and a happy New Year and we look forward to engaging and collaborating again in 2023.

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Receivership of an insolvent Kenyan bank

An insolvent bank in Kenya is subject to a different set of rules from the ordinary company. This differentiation in treatment seems to be partly informed by the fact that the failure of one or more banks may cause severe disruption to the financial system. According to the Insolvency Act, 2015 an administrator may not be appointed in respect of a company that is a bank. On the other hand, the Kenya Deposit Insurance Act, 2012 prohibits the appointment of a liquidator except with the approval of the High Court and upon prior certification by the Central Bank of Kenya (CBK) that it will not appoint the Kenya Deposit Insurance Corporation (Corporation) as the liquidator.

Undergoing a company voluntary arrangement or obtaining a statutory moratorium by an insolvent bank pursuant to the Insolvency Act, while not expressly prohibited, remains a theoretical possibility never to be exercised by a bank as it would inevitably result in a bank run and accelerate the likelihood of its receivership or liquidation by the CBK through the Corporation.

The Corporation is granted power by the CBK to be the sole and exclusive receiver of a bank if the CBK determines, among other things, that the bank's assets are less than its obligations to its creditors or that the bank is likely to fail to meet any financial obligation or meet depositors' demands in the normal course of business. Upon the appointment of the Corporation as receiver, the bank's activities remain suspended until the receivership process ceases. The Corporation's appointment is for a period not

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exceeding 12 months and this can be extended by the CBK for a further period of six months if it appears justified. Under exceptional circumstances the appointment may be extended by a further 12 months by the Cabinet Secretary.

The Corporation assumes control of the bank following written notice from the CBK that the bank has ceased or is likely to cease to be viable. Upon assuming control the Corporation is entitled to appoint any person as manager. The powers of the bank and its directors are vested in the Corporation or the person that is appointed as manager for the duration of the bank's receivership. Where the Corporation has assumed control, a moratorium is triggered and no injunction or legal proceeding can be commenced in respect of the assumption of control and no agreement may be terminated or payment accelerated.

The Corporation also has the power to declare a moratorium on the payments due to depositors and other creditors.

The outcome of the receivership is that the Corporation may recommend to the CBK that the bank is liquidated in which case the Corporation shall be appointed as liquidator. Alternatively, the Corporation may require additional capital from the bank's shareholders in order to restore its financial condition. It can also decide to commence an exclusion and transfer process whereby part or all of the assets and relevant liabilities are transferred to another solvent and well managed bank and the liquidation of the insolvent bank with its the residual assets and liabilities. The exclusion and transfer must be completed within 60 days of the receivership, failing which the Corporation is obligated to recommend to the CBK that the insolvent bank should be liquidated. The transfer of such assets and liabilities is irrevocable and the consent of debtors, creditors or security holders is not required.

The CBK and the Corporation in dealing with insolvent banks has had a mixed bag. The wide-ranging powers granted to the Corporation to turn around an insolvent bank suggest that there should be more success than failure, but perhaps some of the failing banks that have been placed under receivership were already irredeemable. The timing of the appointment by the CBK and the execution of the mandate by the Corporation remain key cogs in the successful rescue of insolvent Kenyan banks.

SAMMY NDOLO

Does non-compliance with section 129(2)(a) of the Companies Act render a resolution void without more?

A party to a contract must not be allowed to have its cake and eat it – such is the doctrine of approbation and reprobation, long recognised in our law. In *Hlatshwayo v Mare and Deas* [1912] AD 242, the Appellate Division held that "*The doctrine is based upon the application of the principle that no person can be allowed to take up two positions inconsistent with one another, or as is commonly expressed to blow hot and cold, to approbate and reprobate*". In that vein, our court frowns upon a sole director of a company who, acting in their capacity as such, passes a resolution and when the legal consequences of such resolution no longer suit their motives, contends that it is invalid.

It is important to note that non-compliance with a statutory prescript does not always result in automatic invalidity. In line with this principle and in the context of business rescue, the Gauteng High Court in *Infinitum Holding and Another v Hugo Lerm and Others* (26799/2017) [2022] ZAGPJHC 341 (18 May 2022) made noteworthy comments regarding the effects of noncompliance with section 129(2)(a) of the Companies Act 71 of 2008 (Companies Act) and whether a resolution to place a company in business rescue, which falls foul of this section, is without more void *ab initio*.

LOAN AGREEMENT

Briefly, this dispute has its roots in an oral loan agreement concluded between Infinitum Holding (Pty) Ltd (Infinitum), and Mrs Nelia Lerm, in terms of which Infinitum borrowed

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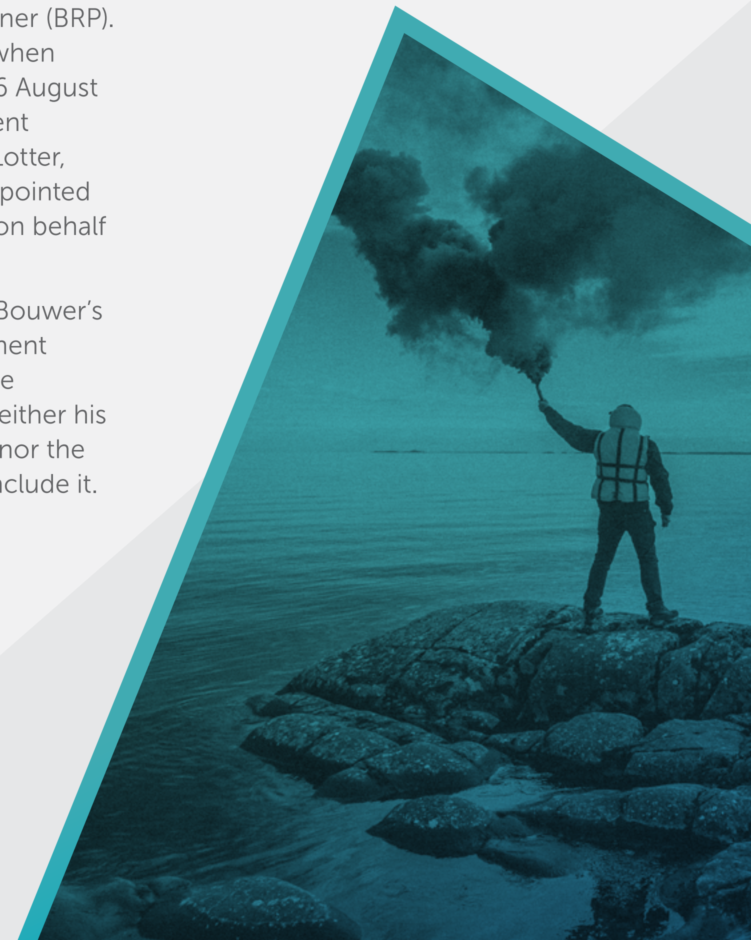
an amount of R1 million from Lerm. Infinitum failed to repay the loan in accordance with the agreed terms and Lerm instituted legal action for recovery of the outstanding loan amount, which Infinitum defended. The matter was heard on 26 and 27 August 2019. While awaiting judgment, on 28 August 2019 the parties entered into a settlement agreement in terms of which Infinitum not only explicitly and unequivocally admitted liability to Lerm for the amount claimed, but also committed to specific repayment terms.

During the period leading up to the trial and in an apparent effort to circumvent compliance with Infinitum's obligation arising from the loan agreement, on 7 August 2019 Mr Bouwer in his capacity as the sole director, passed a resolution to place Infinitum under supervision and commence business rescue proceedings. In the very same resolution, which he duly filed with the Companies and Intellectual Property Commission, Bouwer appointed Mr Johan Christo Lotter as the business rescue practitioner (BRP). The upshot of this was that when the matter went to trial on 26 August and the subsequent settlement agreement was concluded, Lotter, in his capacity as the duly appointed BRP, represented and acted on behalf of Infinitum.

At the heart of this case lies Bouwer's challenge against the settlement agreement. One of his bizarre grounds of attack was that neither his erstwhile attorney of record nor the BRP had the authority to conclude it.



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He argued that on this ground, the settlement agreement was invalid, and the corollary therefor was a rescission of the judgement granted against Infinitum. One other ground for the rescission sought was that Infinitum did not receive the funds advanced by Lerm and therefore could not be held liable for the debt. However, a fact placed before the court, which remained unassailable, was that the bank account into which Lerm paid the loan amount of R1 million was furnished to her by Bouwer himself acting in his capacity as the sole director of Infinitum.

THE HIGH COURT'S ANALYSIS

In its analysis, the court firstly assessed the law related to rescission of judgment, citing the Constitutional Court in *Zuma v Secretary of the Judicial Commission of Inquiry into Allegations of State Capture, Corruption and Fraud in the Public Sector Including Organs of State and Others* 2021 ZACC 28. In *Zuma*, the Constitutional Court restated the principle that when bringing an application of rescission of judgment in terms of Rule 42, the applicant must show both that judgment was granted in their absence and that it was granted erroneously. The Constitutional Court then went on to explain that, in terms of our common law, in order to successfully rescind a judgment an applicant must, firstly, provide a reasonable and satisfactory explanation for its default and, secondly, must demonstrate a *bona fide* defence which presumptively carries some prospect of success.

Turning to the present case, Bouwer essentially argued that the judgment should be rescinded because (i) his erstwhile attorney of record acted without instructions, (ii) the business rescue practitioner did not have the mandate to sign the agreement on behalf of Infinitum, and (iii) Infinitum was unable to consent to the agreement being made an order of court because it was in liquidation at the time. This fact about Infinitum being in liquidation arose for the first time during the rescission application.

COMPLIANCE WITH SECTION 129(2)(A)

In this article we examine Bouwer's argument that the resolution, which he passed in his capacity as the sole director, to place Infinitum under business rescue was invalid *ab initio* on the ground of noncompliance with section 129(2)(a) of the Companies Act. This section provides that:

> *"(1) Subject to subsection (2)(a), the board of a company may resolve that the company voluntarily begin business rescue proceedings and place the company under supervision if the board has reasonable grounds to believe that:*
>
> *(a) the company is financially distressed; and*
>
> *(b) there appears to be a reasonable prospect of rescuing the company.*

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(2) A resolution contemplated in subsection (1):

(a) may not be adopted if liquidation proceedings have been initiated by or against the company; and

(b) has no force or effect until it has been filed."

In support of his argument that the resolution in terms of which Infinitum was effectively placed in business rescue was void ab initio, Bouwer contended, we submit incorrectly so, that a party confronted with a resolution passed in terms of section 129 which was not compliant with the above provisions, had no legal recourse.

In response, Lerm argued that the legislature would have phrased section 129(2)(a) differently if it intended to automatically invalidate every resolution adopted to place a company into business rescue proceedings where liquidation proceedings had already commenced.

FINDINGS

In agreeing with Lerm's argument, the court, held that contrary to Bouwer's contention, section 130 of the Companies Act does in fact provide a mechanism through which one could seek to set aside a resolution which falls foul of the procedural requirements set out in section 129. The court emphasised that it cannot be that a resolution placing a company in business rescue is without more, automatically void ab initio if liquidation proceedings have already commenced. The correct process to invalidate such a resolution would be to apply to court for an order setting such impugned resolution aside in terms of section 130 of the Companies Act.

This approach was also followed by *Davis J in Henria Beleggings CC v Changing Tides 17 (Pty) Ltd NO; Changing Tides 17 (Pty) Ltd v CIPC and Others* (5412/2008; 43912/2016) [2022] ZAGPPHC 378 (1 June 2022) where the court held that:

"… in terms of section 130(5)(a), a court considering an application for setting aside a resolution to place a corporation in business rescue, may set aside such a resolution, with reference to section 130(1)(a), on the grounds that there is no reasonable prospect for rescuing the company or, with reference to section 130(5)(a)(ii), if, having regard to all of the evidence, the court considers it is otherwise just and equitable to do so."

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Consequent to the findings illustrated above, the court held that the applicants failed to make out a case for the rescission of the court order primarily since the resolution adopted to place Infinitum under business rescue was not void *ab initio*. Additionally, the court delivered a punitive cost order at the expense of Bouwer due to his abuse of court process.

It is clear from the above case that noncompliance with section 129(2)(a) of the Companies Act does not automatically invalidate a resolution taken in this respect. Rather, the resolution maintains legal effect until a court makes an order to set it aside. Therefore, if an interested party is of the view that a company has taken a resolution in contravention of section 129(2)(a), it is imperative that they do not sit idly with the assumption that the resolution is automatically void. Rather, the interested party must approach the court in terms of section 130 of the Companies Act in order to set the resolution aside.

THABILE FUHRMANN AND
DEAN TENNANT

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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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