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Business Rescue, Restructuring & Insolvency

NEWSLETTER

DISPUTE RESOLUTION

CLIFFE DEKKER HOFMEYR

INCORPORATING
KIETI LAW LLP, KENYA

IN THIS ISSUE

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Restructuring & Insolvency

As we step into a new month filled with renewed optimism and empowerment, we also celebrate entering Women's Month and the indelible mark women have left on our nation and in the legal fraternity. This year marks the sixty-seventh anniversary of the mass march of women to the Union Buildings to petition against the pass laws of the country at the time.

Once again Banyana Banyana has made the entire nation proud, as they had the odds stacked against them at the ninth edition of the FIFA Women's World Cup. Banyana exceeded expectations after being placed in yet another so-called *"group of death"* alongside Sweden, Argentina and Italy. Despite the tough group, Banyana became the first South African senior national side, male or female, to advance to the Round of 16 at a football world cup. Although they suffered defeat to a strong Dutch team, Banyana are expected to receive a heroes' welcome back home.

The South African Restructuring and Insolvency Practitioners Association (SARIPA) hosted a SARIPA Young Bloods Women's Day Champagne Breakfast in celebration of not just Women's Month but women in the insolvency and legal fraternity. The event was MC'd by CDH's own Kylene Weyers and Roxanne Webster and was well attended with over 100 women in attendance.

On the other side of the coin, the S&P Global South Africa Purchasing Managers' Index declined from 48,7 in June to 48,2 in July, remaining below the 50-mark due to the slump in new businesses as declining household spending power and weak business confidence continues to impact the economy. Rising fuel prices also haven't helped as consumers further feel the pinch of the economy. However, it isn't all doom and gloom as the strengthening of the rand against the US dollar also brought some reprieve to local entities.
In other news, 22 nations have formally asked to become full-time members of BRICS and a further 20 have submitted informal requests to become full-time members.

In insolvency news, the Prudential Authority and the South African Reserve Bank issued an urgent liquidation application to have Habib Overseas Bank wound up.

The Reserve Bank stated that Habib Overseas Bank was insolvent and that its financial position was far more severe than initially reported. However, on the brighter side of things, the latest figures released by Statistics South Africa indicate that although the number of liquidations in South Africa increased by 128 in June, it should be noted that the number of liquidations in the country has decreased substantially compared to last year.

In this month's edition of the newsletter, Director, Thabile Fuhrmann and Senior Associate, Nomlayo Mabena-Mlilo consider the test for insolvency by considering the recent judgment of *The Commissioner for the South African Revenue Service v Nyhonyha and Others* (1150/2021) [2023] ZASCA 69 (18 May 2023). Further, Director Vincent Manko and Candidate Attorney Buhle Duma consider the role of shareholders in business rescue proceedings.

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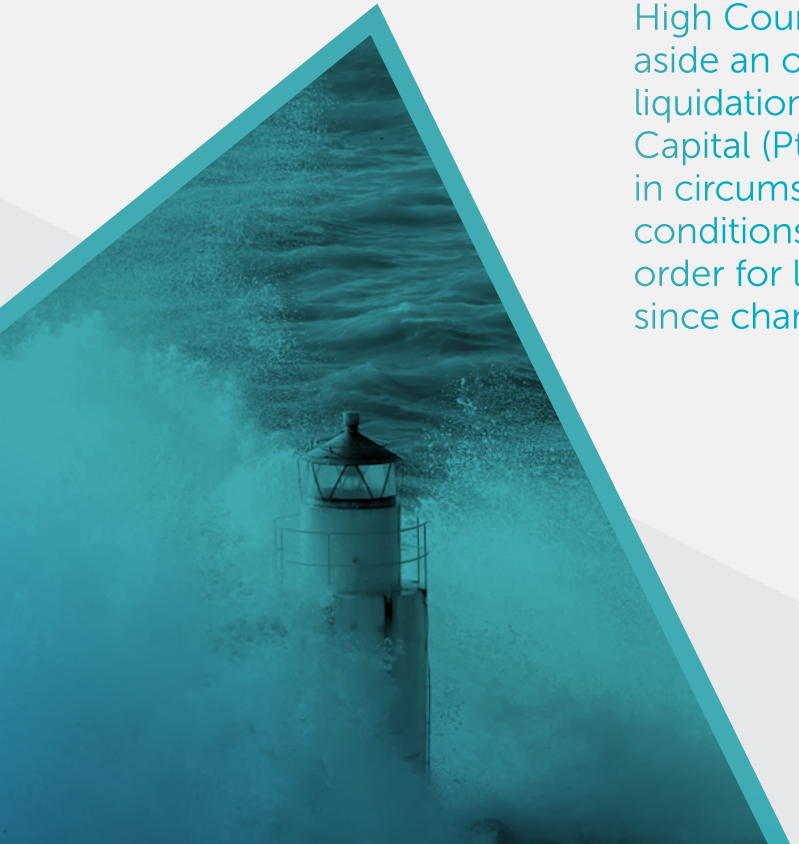
The test for insolvency revisited: Setting aside liquidation proceedings



In the case of *The Commissioner for the South African Revenue Service v Nyhonyha and Others* (1150/2021) [2023] ZASCA 69 (18 May 2023) the Supreme Court of Appeal (SCA) was confronted with the question of whether the High Court erred in setting aside an order for the liquidation of Regiments Capital (Pty) Ltd (Regiments) in circumstances where the conditions that led to the order for liquidation had since changed.

The purpose of liquidation is to wind up an insolvent company's affairs by selling its assets and allocating the proceeds and surplus among its creditors and shareholders. Hence, the object of a liquidation is to ensure that a company is wound up equitably and fairly.

In this case, the National Department of Public Prosecutions (NDPP) obtained a provisional restraint order under the Prevention of Organised Crime Act 121 of 1998 (POCA) which related to Regiments' assets. Section 26(1) of POCA provides that the NDPP may by way of an *ex parte* application apply to a competent High Court for an order prohibiting any person, subject to such conditions and exceptions as may be specified in the order, from dealing in any manner with any property to which the order relates. In terms of the restraint order, Regiments was interdicted from participating in an unbundling transaction in respect of the shares it held in Capitec Bank Holdings Limited. The restraint order was eventually discharged. However, prior to the discharge, Regiments was placed in final liquidation at the instance of an unpaid creditor.

Pursuant to the discharge, Regiments and others brought an urgent application to the court *a quo* for an order to set aside the final liquidation order, on the basis that the circumstances leading to the final winding-up had since changed. The application was brought in two parts, the first for an order staying the winding-up of Regiments and authorising the execution of the unbundling transaction, and the second to set aside the liquidation. The aim of the first part of the urgent application was to realise funds for the benefit of Regiments. The rule nisi was granted authorising the implementation of the unbundling transaction under the supervision of an independent attorney, together with an order granting the South African Revenue Service (SARS) leave to intervene in the proceedings.

The test for insolvency revisited: Setting aside liquidation proceedings

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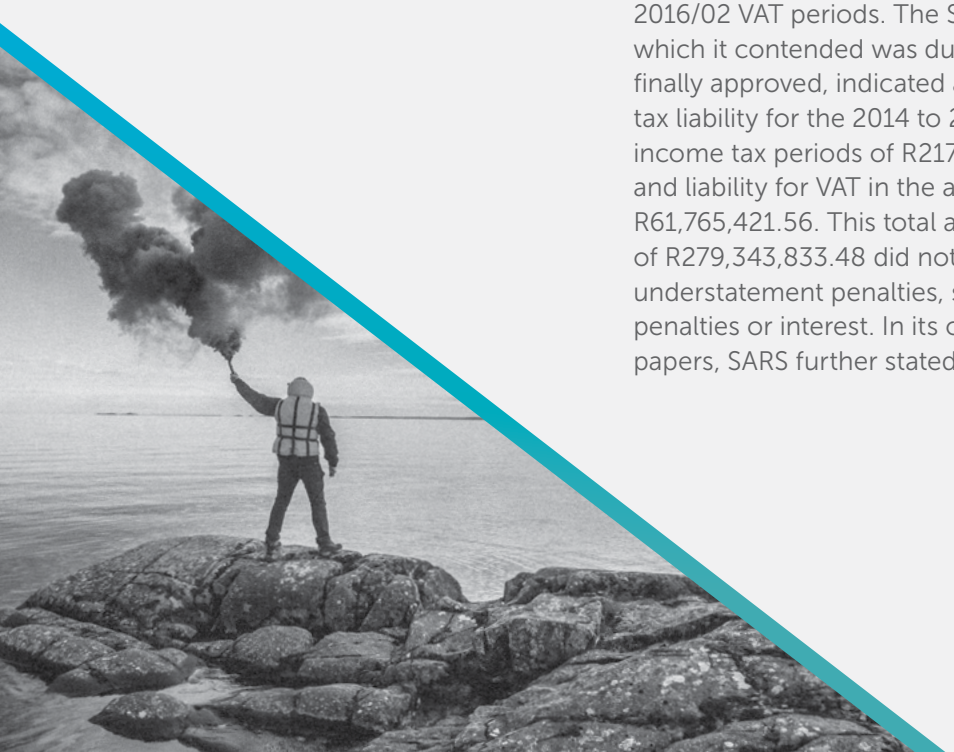

In his report, the supervising attorney stated that he received an amount of R36,348,950 as proceeds of the unbundling transaction, which he held in trust for the benefit of Regiments. However, SARS filed an application to oppose Regiments' application to set aside the winding-up order. The basis of SARS' opposition was that it was in the process of conducting an audit in respect of the liability of Regiments for income tax for the 2014 to 2019 income tax periods, as well as its liability for value-added tax (VAT) in respect of the 2013/03 to 2016/02 VAT periods. The SARS audit, which it contended was due to be finally approved, indicated an income tax liability for the 2014 to 2016 income tax periods of R217,578,411.92 and liability for VAT in the amount of R61,765,421.56. This total amount of R279,343,833.48 did not include understatement penalties, statutory penalties or interest. In its opposing papers, SARS further stated that the audit in respect of the 2017 to 2019 income tax periods had not been completed in relation to Regiments. All of this meant that assessments in the amount of circa R279,343,833 were imminent and that this amount was a conservative estimation of Regiments' liability towards SARS.

SARS contended that Regiments' cash on hand in the amount of R36,348,950 from the unbundling transaction, and the value of the shares it held in Capitec worth R350 million, being the liquid and realisable assets, would not be sufficient to pay the income tax and VAT liability due to SARS as well as the unrelated creditors of Regiments, whose combined debt amounted to R278,011,795. The related creditors whose combined debt amounted to R113,920,106 had given the undertaking that they would not seek payment of the debts owed to them until the unrelated creditors were paid in full.

The court *a quo* accepted from various valuation reports, which were not confirmed under oath nor qualified by an expert, that Regiments had various interests in two other entities, Kgoro Consortium (Pty) Ltd and Little River Trading 191 (Pty) Ltd to the value of R513 million and R32 million respectively. Consequently, the court *a quo* found that Regiments' total assets, although not all liquid, would exceed its total liabilities. The court *a quo* therefore found that Regiments was commercially insolvent – *"asset rich but cash poor"* – and that the winding-up order fell to be set aside. The court directed SARS to issue its tax assessment, which was to be paid by Regiments before payment to the unrelated creditors. Essentially, the court ordered a court-designed winding-up.

The test for insolvency revisited: Setting aside liquidation proceedings

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The SCA, pursuant to an appeal against the order of the court *a quo* by SARS, disagreed with the findings of the High Court. The SCA had to determine whether the setting aside of the winding-up order under section 354 of the Companies Act constitutes the exercise of a true discretion by the court *a quo* and whether, based on the available facts, Regiments was commercially solvent at the time of the hearing in the court *a quo*.

The SCA reiterated that a true discretion is one which provides a court with a range of permissible options. If the impugned decision lies within a range of permissible decisions, an appeal court may not interfere *"unless it is clear that the option applied by the lower court is at odds with the law"*. The court found that where, as was the case here, the setting aside of a winding-up order is sought based on subsequent events, the test is whether the facts show that the continuance of the winding-up would be unnecessary or undesirable. As this does not involve a choice between permissible and impermissible alternatives, the test is either satisfied or it is not. It therefore follows that the decision of the court *a quo* did not constitute the exercise of a true discretion.

In respect of the order setting aside the winding-up order, the SCA found that the court *a quo* had failed to apply this test, i.e., whether the facts demonstrated that the continuance of the winding-up would be unnecessary or undesirable. The court had in any event erred in factually including the valuation of the interest of Regiments in Kgoro and Little River, which was not valued by an expert or confirmed under oath. On the facts before the court *a quo*, Regiments was unable to pay its debts, which was the basis for the liquidation in the first place. Consequently, Regiments was factually insolvent at the time of the hearing in the court *a quo*.

The court reiterated that the nature of commercial insolvency is not something to be measured at a single point in time by asking whether all debts that are due up to that day have been or are going to be paid. The test is whether the company *"is able to meet its current liabilities, including contingent and prospective liabilities as they come due"*. Determining commercial insolvency requires an examination of the financial position of the company at present and in the immediate future to determine whether it will be able in the ordinary course to pay its debts, existing as well as contingent and prospective, and continue trading. In any event, section 345(2) provides that: *"In determining for the purposes of section (1) whether a company is unable to pay its debts, the court shall also take into account the contingent and prospective liabilities of the company."*

The test for insolvency revisited: Setting aside liquidation proceedings

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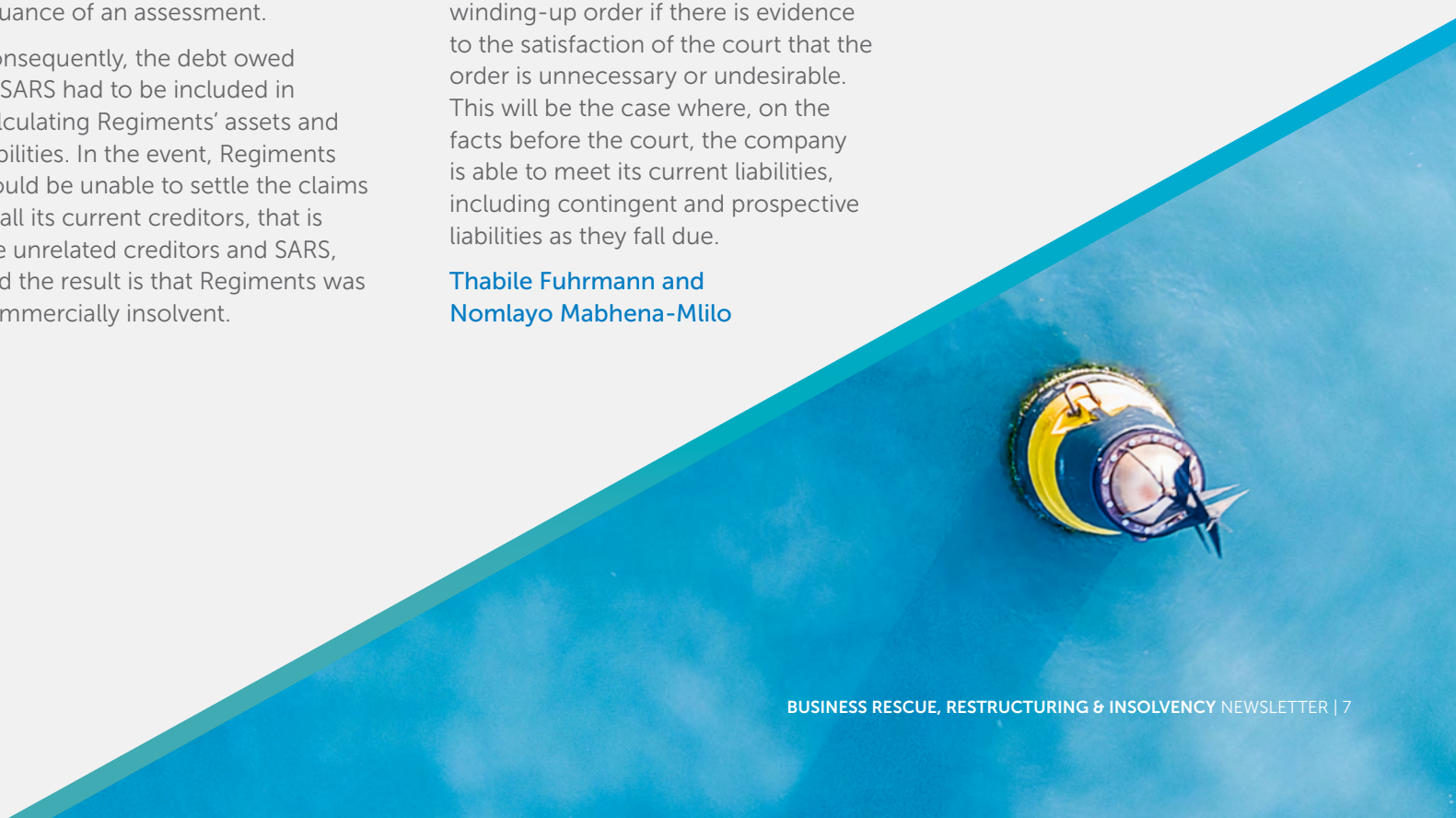
The SCA held that the court *a quo* misdirected itself in finding that because SARS had yet to issue tax assessments for R279,343,833, this amount was not yet due and payable and thus could not be considered in computing the liabilities of Regiments. The court expounded that a tax liability arises at the end of a tax year at the very latest and that this liability is not conditional upon the issuance of an assessment.

Consequently, the debt owed to SARS had to be included in calculating Regiments' assets and liabilities. In the event, Regiments would be unable to settle the claims of all its current creditors, that is the unrelated creditors and SARS, and the result is that Regiments was commercially insolvent.

On this basis alone, given that Regiments was both factually and commercially insolvent, there was no basis for the finding that the continuation of its winding-up was unnecessary or undesirable. Therefore, where there is a change in the circumstances of an insolvent company, which led to the winding-up of the entity, a court will only grant an order to set aside the winding-up order if there is evidence to the satisfaction of the court that the order is unnecessary or undesirable. This will be the case where, on the facts before the court, the company is able to meet its current liabilities, including contingent and prospective liabilities as they fall due.

Thabile Fuhrmann and
Nomlayo Mabhena-Mlilo



The role of shareholders in business rescue proceedings

One of the stated purposes of the Companies Act 71 of 2008 (Companies Act) is to promote innovation and investment in South African markets and provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders, including shareholders. Business rescue is therefore widely accepted as an alternative to liquidation for financially distressed companies, with the intention of giving such companies the opportunity to reorganise and restructure their affairs for them to regain their solvency. To this end, the definition of "*affected persons*" includes creditors, employees (or their representative), a registered trade union and shareholders. The role played by each "*affected person*" is unique in many ways but can have an impact on the failure or success of any business rescue proceedings.

While the role of creditors, employees (or their representative) and registered trade unions cannot, and should not, be devalued, the role of shareholders is often overlooked in successful business rescue proceedings. In the main, shareholders enjoy two categories of rights in business rescue proceedings, namely the right to participate in the business rescue proceedings and the right to be consulted in the preparation of the business rescue plan.

Participatory rights

The rights of shareholders to participate in business rescue proceedings are codified in section 146 of the Companies Act. This provision provides that during business rescue proceedings, shareholders are entitled to some of the following rights: notice of any relevant event concerning the business rescue proceedings; participation in the company's

The role of shareholders in business rescue proceedings

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business rescue, as provided for; voting to approve or reject a proposed business rescue plan, if the plan would alter the rights associated with the class of securities; and, if the business rescue plan is rejected, proposing the development of an alternative plan and presenting an offer to acquire the interests of any or all of the creditors.

The fulcrum of these rights remains that shareholders are permitted to vote on the business rescue plan **only** when the plan seeks to change the rights associated with the class of securities they hold or as creditors in instances where they have made loans to the company. During proceedings, any alteration in the classification or status of any of the issued securities of the company except by way of transfer of securities in the ordinary course of business is invalid, unless a court otherwise directs or such alteration has been approved in the business rescue plan.

When it comes to the adoption of a business rescue plan, shareholders are permitted to vote only when the plan purports to alter rights associated with the class of securities they hold, or as creditors in instances where they have made loans to the company. However, they will not be construed as independent creditors.

Consultative rights

In addition to the above rights, it is arguable that perhaps the most important role of shareholders lies in the fact that they are required to be consulted (as with all other affected persons) by the business rescue practitioner in preparing the business rescue plan for consideration and possible adoption. This right is codified in section 150(1) of the Companies Act. The provision provides that the business rescue practitioner, "***after consulting*** *the creditors,* ***other affected persons****, and the management of the company,* ***must prepare a business rescue plan*** *for consideration and possible adoption*". As stated above, affected persons are defined to include shareholders.

The role of shareholders in business rescue proceedings

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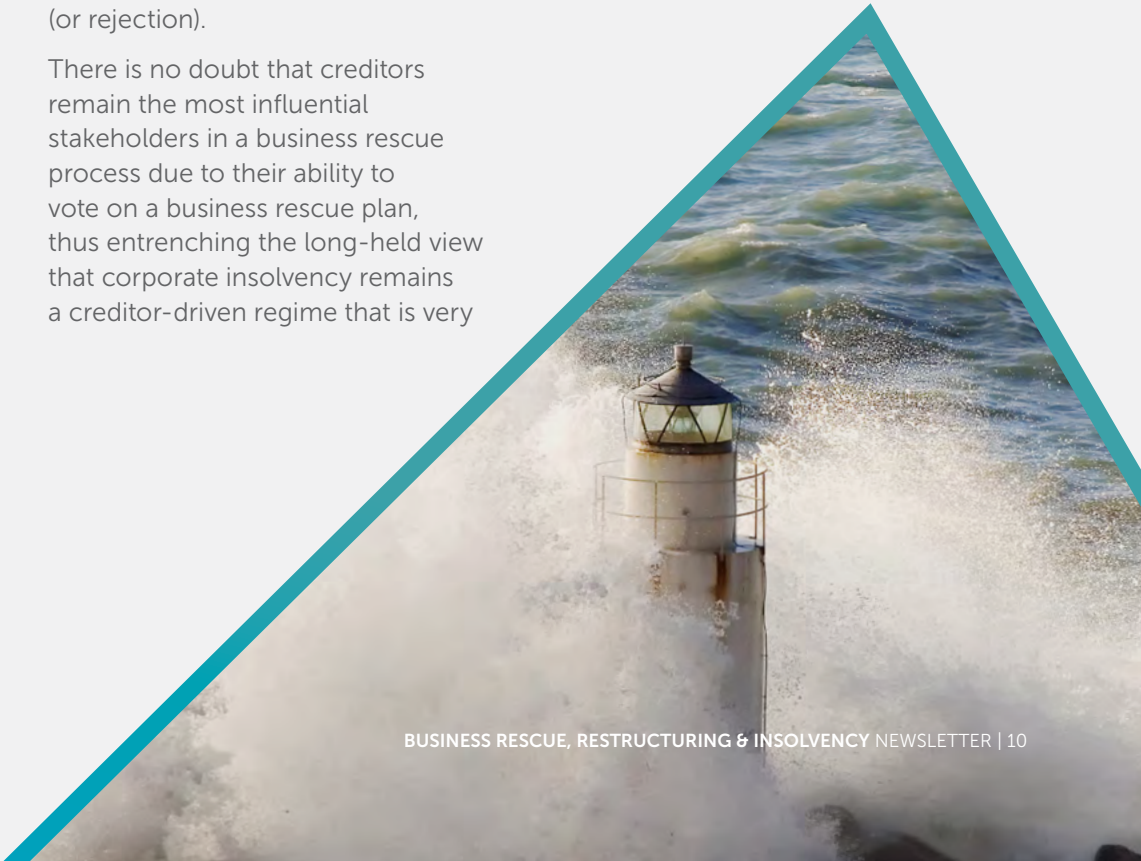
So what does this consultation envisage? In the context of administrative justice, consultation has been described as entailing a genuine invitation to give advice and a genuine receipt of that advice. It is not to be treated perfunctorily or as a mere formality, and that engagement after the decision-maker has already reached their decision, or once their mind has already become unduly fixed, is not compatible with true consultation. Shareholders should therefore jealously guard their consultative rights and consult with the business rescue practitioner at the first available opportunity before the preparation of the business rescue plan, as this is one of the few ways shareholders can possibly influence an outcome that is favourable to them, and ultimately to the company in business rescue.

The diminished role played by shareholders in business rescue proceedings has been subject to some heavy criticism in the past in that even though shareholders are seen as affected persons and have a right to participate in the business rescue proceedings, they have restricted rights in that where the business rescue plan has no effect on shareholders' rights, they are precluded from voting for its adoption (or rejection).

There is no doubt that creditors remain the most influential stakeholders in a business rescue process due to their ability to vote on a business rescue plan, thus entrenching the long-held view that corporate insolvency remains a creditor-driven regime that is very much still controlled by creditors. Shareholders should, however, jealously guard their rights and consult with the business rescue practitioner at the first available opportunity in the development of the business rescue plan.

Vincent Manko and Buhle Duma



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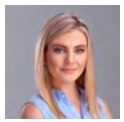

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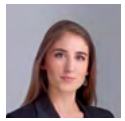

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BBBEE STATUS: LEVEL ONE CONTRIBUTOR
Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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