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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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Spring has sprung and for many it is a time to gladly put away the jackets, heaters and hot water bottles and a moment to bring out the braai stand and embracing social gatherings with friends and family. It thus feels very fitting for Heritage month to be coupled with the Rugby World Cup as the Springboks attempt to retain the Webb Ellis Cup. The Springboks opened their Rugby World Cup defence with a victory against Scotland in Marseille. Many braais will be had, and the nation will be hoping that the Boks can build further momentum after disposing of their northern hemisphere counterparts.

As mentioned, September is Heritage month. Heritage Day on 24 September recognises and celebrates the cultural wealth of our nation. South Africans celebrate the day by remembering the cultural heritage of the many cultures that make up the population of South Africa. With the Rugby World Cup here, we can't help but draw parallels between the fierce determination of rugby players and our resolve as a diverse, multicultural nation through the current economic landscape.

Our country recently hosted the fifteenth annual BRICS summit, an international relations conference with the purpose largely driven by a desire to increase cooperation and collaboration among the major emerging economies on economic, political, and global governance issues. Our nation will be hoping for positive outcome of achieving greater cooperation between countries in areas such as investment, financing for development and efforts to combat challenges in our nation as a whole.

Current data from Stats SA shows that 140 businesses in South Africa were liquidated in July. 127 businesses were closed down voluntarily, while 13 companies did so on a compulsory basis. This takes the total number of liquidations in South Africa since the start of the year to 942 as at 29 August 2023. In spite of this, it is worth noting that, South Africa's liquidations have declined significantly since 2022. This could be linked to many industries becoming more resilient to load shedding, leading to the underlying positivity reflected in the liquidation statistics.

In other news, The U.S. Commodity Futures Trading Commission (CFTC) has reached an agreement with the South African liquidators of Mirror Trading International not to pursue a R33 billion claim against the estate. While the CFTC had described the scheme as an unregistered commodity pool, the Western Cape High Court had declared it an unlawful scheme akin to a pyramid and Ponzi-type scheme.

In this month's edition of the newsletter, Belinda Scriba and Loyiso Bavuma explore the recent judgment in *Ragavan and Others v Optimum Coal Terminal (Pty) Ltd and Others* [2023] ZASCA 34, where the Supreme Court of Appeal had to decide if the board or business rescue practitioners (BRPs) hold the power to vote on the business rescue plan of another company which it is a creditor. Further, Roxanne Webster, Nseula Chilikhuma and Jessica Osmond discuss the recent matter of *Firm-O-Seal CC v Wynand Prinsloo & Van Eeden Inc and Another* 2022 (4) SA 205 (Ml) which dealt with the effect of business rescue proceedings on directors.

As spring breathes new life into the world around us, we're committed to helping you find fresh opportunities in the face of financial challenges. Just as South Africans unite behind the Boks, our Business Rescue, Restructuring & Insolvency team stands firmly behind our clients, ready to tackle whatever obstacles may come our client's way.

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Evolving power dynamics between a board and business rescue practitioners: It's a balancing act

As a result of the decision from the Supreme Court of Appeal (SCA) in the case of *Tayob and Another v Shiva Uranium (Pty) Ltd and Others* [2020] ZASCA there have been, and will continue to be, burning questions surrounding which powers shift from the board to the business rescue practitioners (BRPs) once a company has been placed under business rescue supervision. In the Shiva case, the court found that certain administrative powers were retained by the board. For more on the Shiva case see our articles here and here.

Recently, in *Ragavan and Others v Optimum Coal Terminal (Pty) Ltd and Others* [2023] ZASCA 34, taken on appeal from the Gauteng Local Division of the High Court, the SCA had to decide the following legal question:

> *"When a company in business rescue (Company A) is a creditor of another company in business rescue (Company B), and Company B is a wholly-owned subsidiary of Company A, [does] the right to cast a vote on any matter contemplated under [subsection] 151 and 152 of the Companies Act [71 of] 2008, [vest] in Company A's business rescue practitioners or its board of directors?"*

Background

In this case, Company A was Tegeta Exploration and Resources (Pty) Ltd (in business rescue) (Tegeta) and Company B was Optimum Coal Terminal (Pty) Ltd (in business rescue) (OCT). Tegeta and OCT, along with the BRPs of both entities, were respondents in the appeal. The appellants are Tegeta's directors.

OCT and Tegeta were placed under voluntary business rescue. The OCT BRPs published a business rescue plan (plan) and notified OCT's affected persons of the meeting to vote on the proposed plan for OCT. One such affected person was Tegeta, as a **creditor** of OCT.

The directors of Tegeta (appellants) contended that the power to vote on OCT's plan lay with them, not with the BRPs of Tegeta. The BRPs felt differently.

Therefore, the question before the court *a quo* was: who had the power to exercise Tegeta's right to vote on OCT's proposed plan? OCT's meeting was interdicted, pending the decision on this right to vote.

Evolving power dynamics between a board and business rescue practitioners: It's a balancing act

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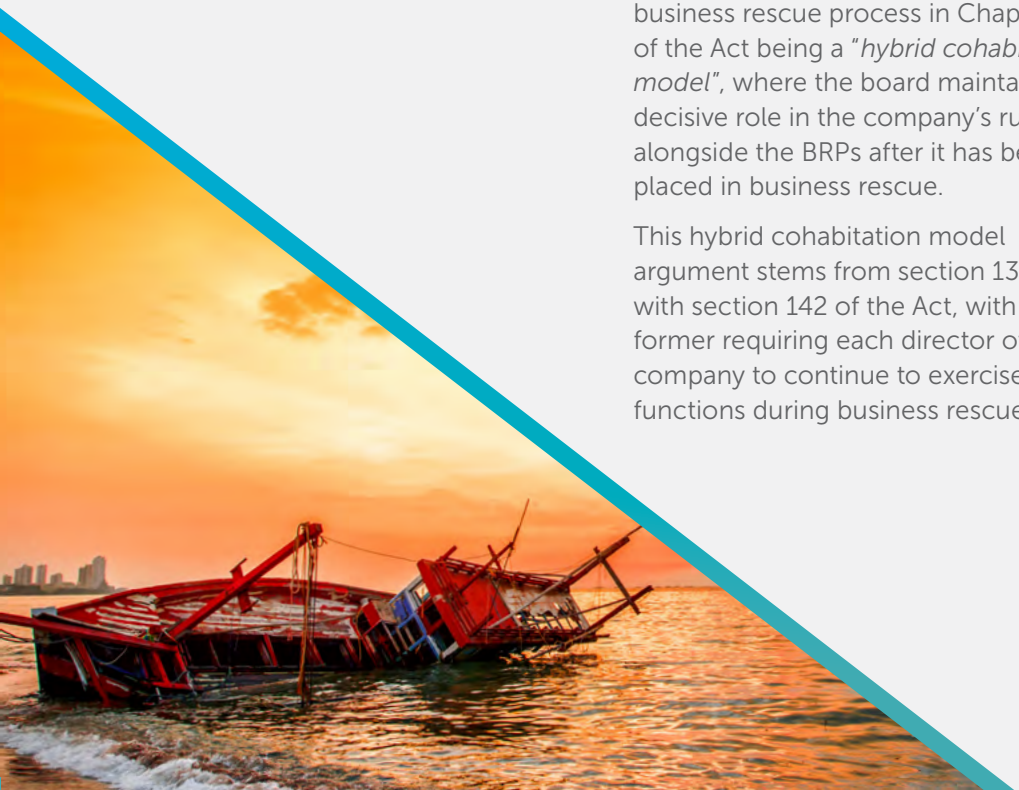

The court *a quo* found in favour of Tegeta's BRPs, ruling that they held the right to vote as they were given full management control under Chapter 6 of the Companies Act 71 of 2008 (Act). Tegeta's directors then brought the matter on appeal to the SCA.

Tegeta's directors' argument

Relying on section 66(1) of the Act, Tegeta's directors averred that the board of directors holds the plenary powers of the company, with the business rescue process in Chapter 6 of the Act being a "*hybrid cohabitation model*", where the board maintains a decisive role in the company's running alongside the BRPs after it has been placed in business rescue.

This hybrid cohabitation model argument stems from section 137 read with section 142 of the Act, with the former requiring each director of the company to continue to exercise their functions during business rescue, subject to the authority of the BRPs and the latter dealing with the duty of the directors to co-operate with and assist the BRPs.

Using the Shiva case, Tegeta's directors tried to distinguish between "*management*" and "*governance*", holding that management is restricted to the day-to-day affairs of a company, where the BRPs' powers are superior to those of directors. Governance, however, they contended, relates to the strategic positioning of the company, where the directors maintain their authority.

Continuing with the line of a "*hybrid cohabitation model*" Tegeta's directors further contended that the authority of the BRPs must be considered in two phases, being (i) before; and (ii) after the adoption of the plan. Prior to the adoption of the plan, the business rescue process is not yet certain, so the BRPs must defer to the directors' strategic positioning of the company. Following the adoption of a plan, the dynamic would change, and the BRPs would be empowered in line with the plan.

The court's decision

The court held that Tegeta's directors' argument regarding the powers of the board must be determined through the appropriate interpretation of the Act by first looking at the language in the relevant provision, which should not change depending on the facts of the case.

The court noted that although section 66(1) of the Act authorises the board to manage the business affairs of the company and to exercise all the company's powers and perform its functions, it is "*except to the extent that [the] Act … provides otherwise*", ruling that Chapter 6 is one such exception. Chapter 6 provides the BRPs with full management powers for the duration of the business rescue.

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The court held that the question of who had the right to vote was determined by whether that power fell within the ambit of the "*full management control*" of the BRPs as contemplated in section 140(1)*(a)*. As "*management*" is not defined in the Act, the court had regard to the ordinary meaning of the word, with "*full management control*" signifying control of the property of the company, which would include the company's debtors' book. The court found that as a creditor, the vote on the plan of a debtor simply entails a decision over the company's property.

The court went on to refer to provisions of the Act which support the view that "*full management control*" entails the BRPs' exercise of control over the property of the company, such as:

- section 128(1)(b), which describes business rescue as providing for "*the temporary supervision of the company, and of the management of its affairs, business and property*";
- a practitioner is defined in the Act as a person appointed "*to oversee a company during business rescue*";
- section 133(1)(a) states that:

  "*during business rescue proceedings, no legal proceedings, including enforcement action, against the company, or in relation to any property belonging to the company, or lawfully in its possession, may be commenced and proceeded with in any forum, except – (a) with the written consent of the practitioner*",

which demonstrates the practitioner's control in relation to claims by third parties to the property of the company; and

- in terms of section 134(1)(c) "*no person may exercise any right in respect of any property in the lawful possession of the company, irrespective of whether the property is owned by the company, except to the extent that the practitioner consents in writing*".

In highlighting the above, the court concluded that the range of powers afforded clearly envisage the BRPs having the power to vote on the plan of a debtor company to determine the extent to which a particular debt would be recovered under that plan or not.

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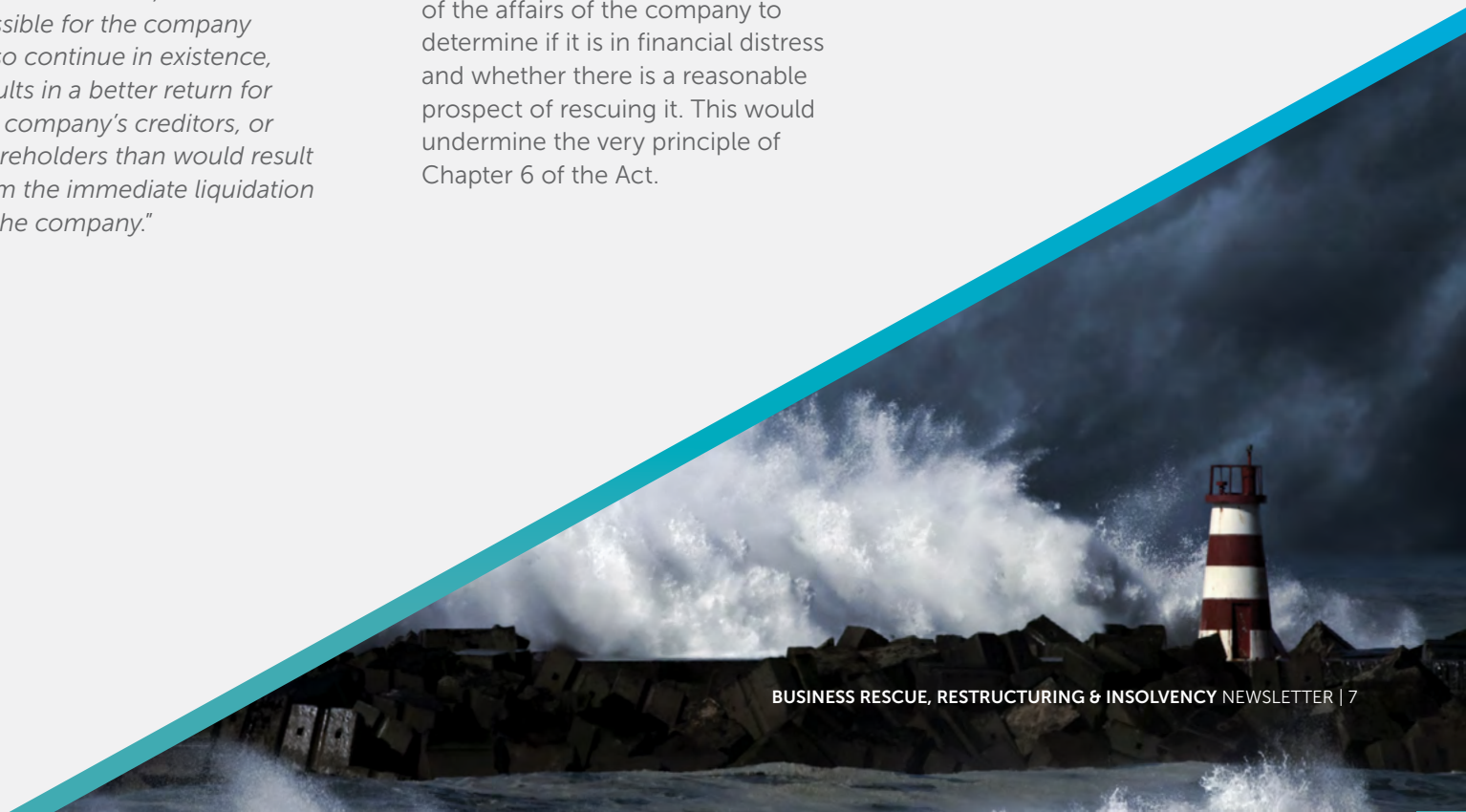
The court further held that the primary purpose of business rescue is to enable the BRPs to prepare and implement a plan as well as to:

> *"rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the company's creditors, or shareholders than would result from the immediate liquidation of the company."*

The court found that determining what the company's assets are and whether debts can be recovered form an integral part of the process of preparing a plan. The court asserted that it would be illogical to not provide the BRPs with the power to vote on the plan of a debtor, as the BRPs would then not meet the requirements of section 141(2)(a) and (b), in terms of which the BRPs must undertake a proper investigation of the affairs of the company to determine if it is in financial distress and whether there is a reasonable prospect of rescuing it. This would undermine the very principle of Chapter 6 of the Act.

Interpreting *"full management control"*

Thus, the court found that the words *"full management control"* in section 140(1)(a) must be interpreted as including the power to vote on a plan for a debtor company and so the question of whether the board retains any power on strategic matters of the company during business rescue does not need to be determined.



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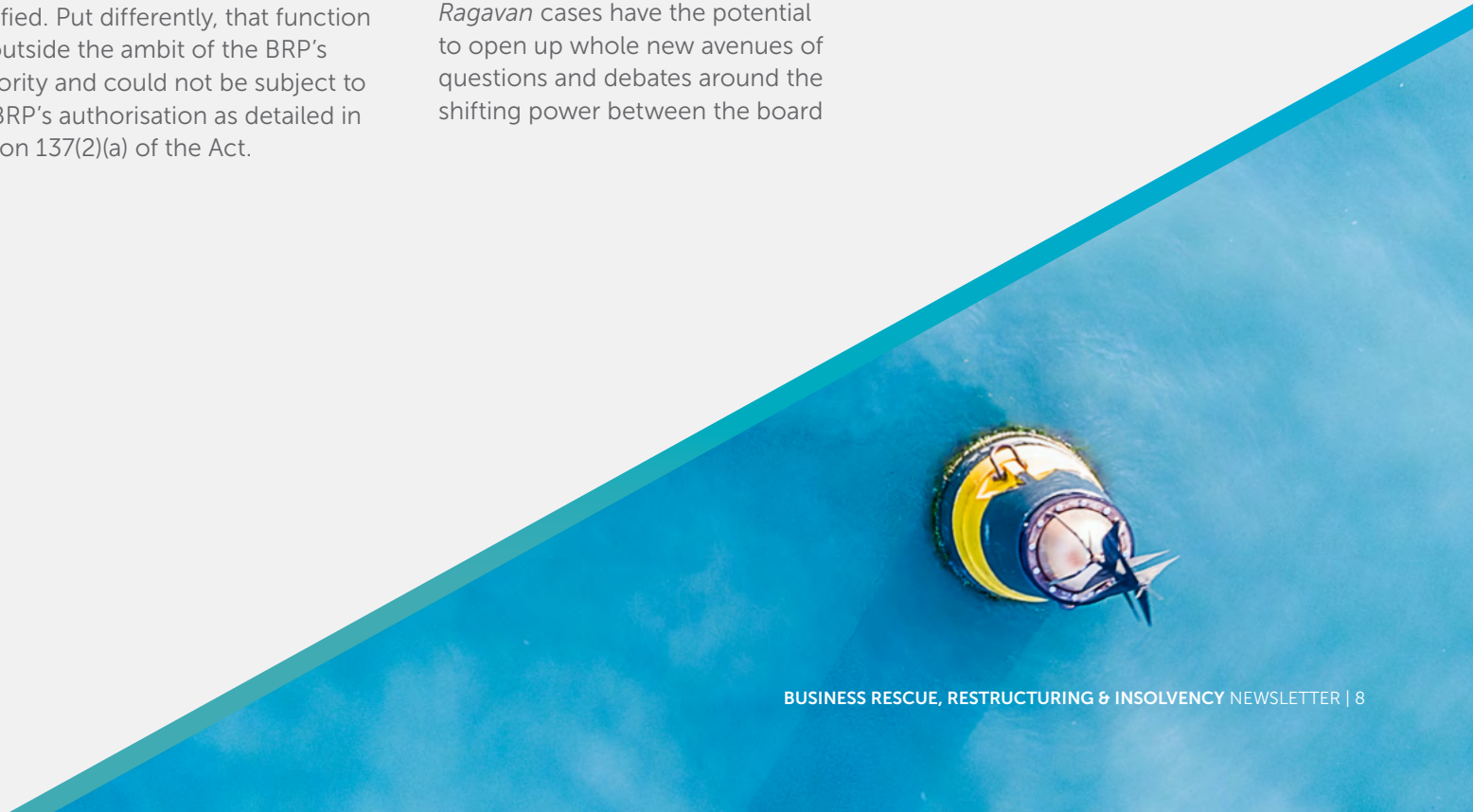
The court also held that Tegeta's directors' reliance on *Shiva* was incorrect, as that case dealt with a narrower issue, relating to whether the board of an affected person represented "*the company*" in appointing a new BRP in terms of section 139(3) of the Act in situations where a BRP dies, resigns, or is removed from office. In *Shiva*, the power of the board was found in section 139(3) and was not expressly qualified. Put differently, that function fell outside the ambit of the BRP's authority and could not be subject to the BRP's authorisation as detailed in section 137(2)(a) of the Act.

The court further held that the "*hybrid cohabitation model*" distinction between pre- and post-adoption of the plan has no foundation in the provisions of Chapter 6 of the Act, as that concerns the creditors' right to vote as contemplated in section 151 read with section 152.

Accordingly, the court dismissed Tegeta's directors' appeal with costs.

There is no doubt that the *Shiva* and *Ragavan* cases have the potential to open up whole new avenues of questions and debates around the shifting power between the board of directors and the BRPs. However, as long as the answers result in advancing the spirit of Chapter 6 – the rescuing of companies in distress – they are most welcome.

Belinda Scriba and Loyiso Bavuma



BRP take the wheel: The effect of business rescue proceedings on directors

One of the areas of uncertainty which is often raised by individuals and entities alike when it comes to business rescue proceedings, is that of the division of function and duty between a duly appointed business rescue practitioner (BRP) and a company's board of directors.

As directors of a company in business rescue, there is often seemingly a tug-of-war for control over the business, with directors under the reasonable belief that they are obliged to continue to manage the business in accordance with their fiduciary obligations, while the appointed BRP, as an officer of the court, is expected to act in accordance with the provisions as set out in Chapter 6 of the Companies Act 71 of 2008 (Companies Act).

As a starting point, section 137(2) of the Companies Act stipulates that, during business rescue proceedings, directors are still required to continue to exercise their functions. The exercising of their duties is, however, subject to the authority and instructions of the BRP.

The recent matter of *Firm-O-Seal CC v Wynand Prinsloo & Van Eeden Inc and Another* [2022] (4) SA 205 (Ml) dealt with the effect of business rescue proceedings on directors.

Facts

On 5 June 2019 Firm-O-Seal CC (Firm-O-Seal) was placed under business rescue and Mr Mahier Tayob was appointed as the BRP. During this tenure, the directors of Firm-O-Seal resolved to issue a summons commencing the present action on the instructions of its directors without the approval of the duly appointed BRP.

Initially, the BRP had indicated his intention to withdraw the action. However, the BRP subsequently signed a power of attorney in an attempt to authorise the continuance of the action and ratify any steps already taken in the proceedings.

On consideration of section 137(2), the court found that the action taken by the directors in instructing Firm-O-Seal's attorneys to issue a summons was void for not having been approved by the BRP and that their decision was incapable of being ratified retrospectively.

BRP take the wheel: The effect of business rescue proceedings on directors

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Firm-O-Seal, as the plaintiff, issued a summons in which numerous claims were sought against the defendants. The defendants raised several special pleas relating to prescription and a special plea of *locus standi* due to the institution of proceedings without the consent of the BRP.

The special plea focusing on *locus standi* is the focus of this alert.

Understanding section 137(2)

As previously mentioned, the directors of Firm-O-Seal decided to issue proceedings against the defendants without obtaining the prior consent of the BRP. At the time that the proceedings were instituted, the BRP was not even aware of the summons that was issued. Once the BRP became aware, he instructed his legal representative to forward a letter to Firm-O-Seal's attorneys instructing them to withdraw the action.

In a turn of events, the BRP concluded a power of attorney ratifying the institution of proceedings. This ratification was to address the authority that was lacking at the time of instituting proceedings, however, the court had to consider whether the belated approval was compliant with the Companies Act.

The court affirmed that it is well-settled law that there can be no ratification of an agreement which a statutory prohibition has rendered *ab initio* void in the sense that it is to be regarded as never having been concluded.

The court found it necessary consider the intention of the Legislature from the wording of the statute. Section 137(2) of the Companies Act provides that a company director must continue to exercise the functions of director, **subject to the authority of the BRP**. In addition, a director has a duty to the company to exercise any management function within the company in accordance with the **express instructions or direction of the BRP**, to the extent that it is reasonable to do so.

Although section 137(4) states that, "*if, during a company's business rescue proceedings, the board, or one or more directors of the company, purports to take any action on behalf of the company that requires the approval of the practitioner, that action is void unless approved by the practitioner*", the court concluded that

BRP take the wheel: The effect of business rescue proceedings on directors

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it could not have been the intention to allow a director to run a company in business rescue proceedings without a BRP's knowledge, participation or approval, in the hope that the BRP would retrospectively ratify their decisions. Further, the court agreed with the approach adopted in *Neugarten and Others v Standard Bank of South Africa Ltd* [1989] (1) SA 797 (A), that an act that is void is incapable of being ratified, as it is regarded as having not taken place.

Ultimately the court found that Firm-O-Seal did not have the approval of the BRP when issuing the summons against the defendants. Further, the court found that the action by the directors of Firm-O-Seal in instructing their attorneys to issue summons was void for not having been approved by the BRP, and that their decision was incapable of being ratified retrospectively.

Conclusion

It is imperative that directors of a company have a good understanding of the duties and obligations expected of them in circumstances where a company is in business rescue. It is equally imperative to ensure that a symbiotic relationship exists between the directors of the company and the BRP. This can only be achieved through the understanding of each's obligations and duties in the circumstances.

To interpret the requirement for the approval by the BRP as allowing approval retrospectively negates the *prima facie* purpose of the legislation in respect of the powers granted to a BRP. Allowing retrospective approval would also undermine the BRP and has the potential to defeat the whole purpose of business rescue proceedings. Although directors must at all times conduct themselves in a manner that is in the best interest of the company and in line with their fiduciary duties, these duties are subject to the approval of the BRP when the company is placed into business rescue.

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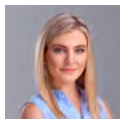

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Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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