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Business Rescue, Restructuring & Insolvency

NEWSLETTER

DISPUTE RESOLUTION

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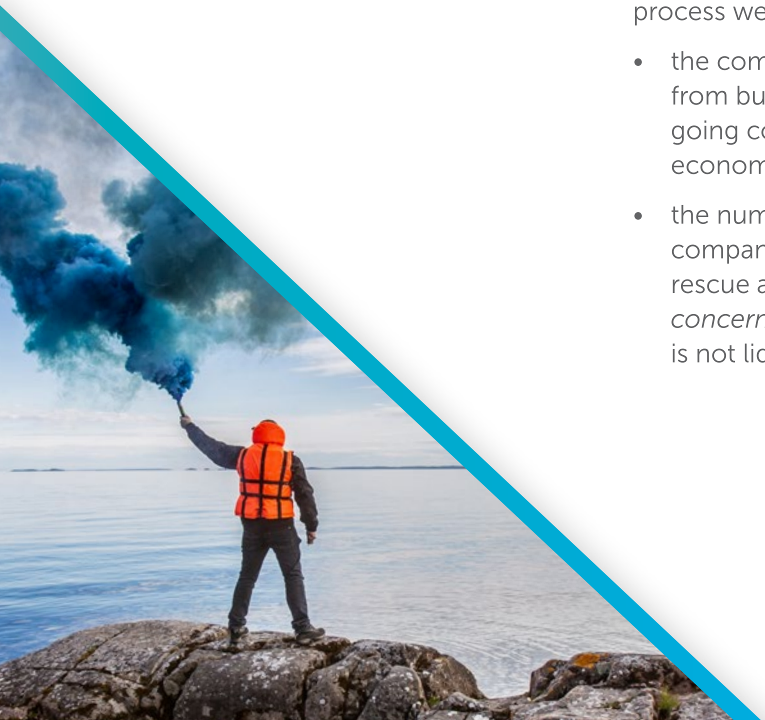
This is our last business rescue and insolvency newsletter for 2023. With that in mind, we decided to take a look in the rear-view mirror at some of the successes, challenges and influences in the sector over the last year.



A journal article titled *Business rescue: How can its success be evaluated at company level?* published in the Southern African Business Review, investigated how business rescue is evaluated internationally in order to be viewed as successful. When the research started there appeared to be no fixed criteria, so the aim was to develop a set of appropriate success indicators for the South African business landscape, while complementing the goals of the country's business rescue laws. In summary, the most relevant indicators that guided the evaluation process were:

- the company must emerge from business rescue as a going concern, and remain economically viable;
- the number (or percentage) of companies that exit business rescue as a going concern – "*going concern*" is implied if the company is not liquidated;
- the restored profitability of the company – measured by profit margins, return on assets and cash flows;
- return to economic viability – measured by the number of subsequent times the company re-filed for business rescue;
- a better return to creditors than immediate liquidation;
- successful implementation of the approved plan (to maximise the return to creditors);
- the return received under business rescue proceedings compared to the return that would have been received from immediate liquidation;
- the protection of all stakeholders;
- an evaluation of the change in asset size; and
- an evaluation of whether key operations were kept in one company.

Against this background we revisit the Status of Business Rescue Proceedings in South Africa report published by the Companies and Intellectual Property Commission (CIPC) in June 2022. In that report, the CIPC recorded that only 20% of all business rescues from 2011 to June 2022 had reached "*substantial implementation*". It found that 22% had ultimately led to liquidation. That said, 38% were still active business rescues – i.e. their fate was yet to be determined. Unfortunately we do not yet have such accurate statistics for 2023. However, looking at the above criteria, we can see if there were some 2022/23 success stories. It may well be that, given the advantages, a 20% success rate is an achievement not to be dismissed as nominal or insignificant.

The Ster-Kinekor story

A stand-out story of success comes from Ster-Kinekor Theatres Proprietary Limited (STK).

On 26 January 2021, the stakeholders of STK passed a resolution by a simple majority of the directors for the company to be placed into business rescue in terms of section 128 and 129 of the Companies Act 71 of 2008.

Like all business rescues from early 2020, the move to place STK into voluntary business rescue was followed swiftly by the onset of the COVID-19 pandemic and subsequent lockdowns.

In November 2022, after continued talks and co-operation with relevant stakeholders, the business rescue plan was successfully implemented following an investor injection of R250 million. Some 800 jobs were retained, landlords retained the STK business, and the general public was assured of still being able to enjoy their beloved, popcorn-fuelled big screen experiences. The mammoth achievement of this task must not be overlooked. The rescue required, according to various media sources, engagements and approvals from the South African Reserve Bank and the Competition Commission. Negotiations had to take place with some 20 landlords. All this while still navigating the ongoing pandemic and intermittent lockdowns.

A hearty round of applause goes out to the business rescue practitioners and their team. Saving an institution such as STK in the economic climate plaguing the globe and, in its own unique ways, South Africa, deserves our admiration. This is why business rescue exists and, in the right circumstances, can achieve great things. Against the criteria listed above, this is a huge success story, and we hope will not be the last.

Looking to 2024

So, how do things look going forward? There is no getting around it, 2024 is going to be tough:

- Eskom sees no short-term end to load-shedding. This in and of itself has, and will continue to have, massive ramifications for the South Africa economy.
- The continued war in Ukraine and the Israel-Gaza conflict that has again reared its head will have an impact on both food and energy security, not to mention on the political landscape.
- Add to this the impact that the recent avian influenza has had on the chicken industry. Chicken and eggs used to be one of the least expensive sources of nutrition. Even before the avian influenza devastated chicken numbers in South Africa, chicken had already become more expensive than other sources of meat. With the impact of influenza we are still feeling the ramifications in the economy and for consumers. More than 20% of the chicken population has died or had to be culled. Farmers and producers have lost more than R335 million, and counting. The price of chicken meat and eggs has obviously increased astronomically as a result of this recent disaster.

The long and the short of it is that it’s going to be a tough year for everyone, including business. Through it all, we need to remain the resilient South Africans that we are. Batten down the hatches and, when in financial distress, seek help as soon as possible. One of the primary reasons rescues fail is because businesses wait too long to seek help.

One silver lining 2024 holds is that it is an election year and Government needs to proactively be looking to find solutions to our ailing economy – there is also hope that these solutions will bear long-term economic fruit for all.

We hope you will enjoy the articles published in this issue of our newsletter, dealing with the pitfalls for directors not taking the required steps when a business is financially distressed, as well as the remedies available and issues to look out for when challenging a decision by the Master of the High Court not to admit a claim. Our Kenyan colleagues also delve into the envisaged fast tracking of insolvency administration.

When all else fails, remember the success stories and strive to be one of them – with the helping hand of your business rescue team.

Belinda Scriba and Lucinde Rhoodie

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Fast-track administration

The Insolvency (Amendment) Bill, 2023 (Bill) proposes to introduce a fast-track administration process. This process will be applicable to companies that qualify as small companies under the Companies Act, 2015 and other companies with assets and turnover, class of creditors, amount of debt, or type of company that the Cabinet Secretary may prescribe.

The Bill leaves a lot of the process and procedures to be determined by the Cabinet Secretary through regulations and it does little to explain how it is proposing to fast track the administration process. It is noted that a fast-track administration process pursuant to the Bill must be court approved. Secondly, the application must be accompanied by evidence of default by the company that is subject of the application. The nature or type of default is not indicated and it introduces a further and potentially confusing classification of circumstances that can result in a company being subject to an insolvency procedure.

It is proposed in the Bill that the fast-track administration process must be completed within 18 months from the issuance of an administration order. Regular administration is already required to be concluded within a prescribed period of 12 months, which can be extended by a further six months.

According to the Bill, the process for regular administration set out in the Insolvency Act, 2015 is to apply a fast-track administration process with the necessary modifications and it is left to the Cabinet Secretary to prescribe regulations. This suggests that a moratorium (providing temporary relief against creditor enforcement) will be available to a company undergoing fast-track administration.

According to the statement accompanying the Bill, the intention of the Bill is to allow for maximisation of value of distressed assets by allowing for a quick sale or re-organisation. However, the Bill fails to set out the framework to achieve this. Some of the ways that this can be done is to specifically allow for pre-packs (an arrangement to sell or otherwise restructure the business that is agreed before insolvency is declared) or to authorise the directors to continue to manage the company during the fast-track administration process under the supervision of an insolvency practitioner.

Sammy Ndolo

Aggrieved by the decision of the Master of the High Court? Remedies should be considered carefully

What happens when the Master of the High Court (Master) accepts or rejects a creditor's claim in liquidation proceedings and the affected person wishes to challenge the decision?

This was the issue before the Eastern Cape Division of the High Court, Makanda (High Court). The High Court determined that a creditor's claim which had already been proved and accepted by the Master could not be lawfully contested in court proceedings, other than in terms of the Insolvency Act 24 of 1936 (Act), which allows for a review of the Master's decision.

That decision was taken on appeal to the Supreme Court of Appeal (SCA) in *Mantis Investments Holdings v De Jager N O* (696/2022) [2023] ZASCA. Werner De Jager N.O. and Carol-Ann Schröder N.O. were the liquidators of No. 1 Watt Street (Pty) Ltd (Watt Street).

During 2005, the Eastern Cape Development Corporation (ECDC) advanced a loan to an entity called Bushman Sands Development (Pty) Ltd (Bushman Sands). Watt Street, before it went into liquidation, bound itself as surety and co-principal debtor, with Bushman Sands, to the ECDC. Bushman Sands failed to repay the loan to the ECDC, which led to the ECDC instituting action proceedings in the Eastern Cape Division of the High Court, Gqeberha (Gqeberha High Court) against both Watt Street and Bushman Sands for payment of the amount of R19 million (the action proceedings). Watt Street defended the action proceedings.

However, shortly before the commencement of the trial in the action proceedings, Mantis Investments Holdings (Pty) Ltd (Mantis), represented by Mr Gardiner, brought an application in the Gqeberha High Court for the liquidation of Watt Street on the basis that Mantis was the creditor of Watt Street for an amount of about R2,5 million arising from loans advanced to Watt Street. Mantis was also a shareholder of Watt Street.

In November 2014, Watt Street was finally wound-up. Subsequently, both the ECDC's and Mantis's claims against Watt Street were approved by

Aggrieved by the decision of the Master of the High Court? Remedies should be considered carefully

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the Master in terms of section 44 of the Act. Mantis disputed the ECDC's claim, but did not seek to review the decision.

Challenging the Master's decision

For various reasons, however, Mantis sought to challenge the decision by the Master to approve the ECDS's claim, denying that the amount claimed by the ECDC was due, owing and payable to the ECDC.

The liquidators filed a replication in which they contended that (i) the Master's decision to admit the ECDC's claim constituted an administrative action which existed as a fact and had legal effect until set aside, (ii) neither of the appellants sought to review the Master's decision and thus (iii) any determination in the proceedings that the ECDC did not have a claim against Watt Street was precluded. The appellants sought to answer these contentions in a rejoinder where they argued that they were not bound, in these proceedings, by the decision of the Master to admit the claim, as it was made in the context of a claim by the ECDC against Watt Street. They also submitted that in law it was incumbent upon the liquidators to establish, as a prerequisite to a claim based on collusive dispositions that, as at the date of the institution of the action, the ECDC was, and is, a creditor of the company in liquidation, being Watt Street.

There were several issues before the High Court, and it made an order separating the issues for determination. The relevant issue, and the one that came before the SCA, was whether the appellants were entitled to (i) contest the claim of the ECDC as against the principal debtor, being Bushman Sands, and (ii) revisit the indebtedness and quantum of the ECDC's claim against the surety, being Watt Street.

The High Court found that the decision of the Master to accept a claim under section 44 of the Act constituted administration action, which exists and continues to have legal consequences until it is reviewed and set aside in terms of section 151 of the Act. As the appellants had not sought to review the Master's decision in terms of section 151, the High Court made an order declaring that the appellants were not entitled to (i) revisit the indebtedness of Watt Street; and (ii) to continue to contest the claims proven by the ECDC in the liquidation proceedings of Watt Street. The appellants took this order and judgment by the High Court on appeal to the SCA.

The SCA highlighted that section 44 of the Act deals comprehensively with the procedure for the proof of liquidated claims against insolvent estates. It provides that the Master must examine the proof of claims'

Aggrieved by the decision of the Master of the High Court? Remedies should be considered carefully

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documents to determine whether they disclose the existence of an enforceable claim on the face of it. Where the Master admits a claim, the Master cannot subsequently alter that decision. However, at this stage, the admission of the claim is provisional. It is then open to the liquidator to dispute the claim by following the procedure envisaged in section 45(3) of the Act, which entails a written report by the liquidator to the Master stating their reasons for disputing the claim. Thereafter, the Master may confirm, reduce or disallow the claim.

Process for disputing a claim

If the liquidator followed the peremptory procedure set out in section 45(3) of the Act and is still dissatisfied with the Master's decision to admit or refuse the claim of a creditor, they may apply to court to review the Master's decision in terms of section 151 of the Act. However, section 151 of the Act may be relied on by *"any person aggrieved by any decision, ruling, order or taxation of the Master"*. Accordingly, a **creditor** dissatisfied with the Master's decision to admit or refuse the claim of a creditor may also apply to court to review the Master's decision.

Where no steps are taken in terms of section 151 to review the Master's decision to admit or reject a proved claim, that claim becomes conclusive and enforceable in law against the company in liquidation and the Master's decision stands.

As the appellants before the SCA did not challenge the Master's decision to admit the ECDC's claim in terms of section 151 of the Act, the Master's decision stood. Accordingly, the ECDC was factually and legally a creditor of Watt Street and the appellants were not entitled to challenge this in the present proceedings. The SCA further held that the appellants' contention that the liquidators had to establish that the ECDC was, and is, a creditor at the institution of the action proceedings negated the comprehensive set of measures provided for in the Act to protect creditors. The appeal was dismissed with costs.

It is important to note from the SCA's judgment that creditors dissatisfied with the decision of the Master to accept or refuse a creditor's claim are not left without recourse. The Act provides for a specific avenue available to both liquidators and creditors to take the Master's decision on review before a court of law. However, where a creditor or liquidator has failed to assert the remedies available to them under the Act, they will lose their right to those remedies and to challenge decisions made by the Master.

It is therefore always important to investigate remedies made available under applicable legislation, as one may be limited to those remedies and lose the right to them if the relevant procedures are not followed. This is not only applicable in liquidations and sequestrations, but any instances where there is legislation governing particular areas of law.

Belinda Scriba and Claudia Grobler

Vulnerability caused by compliance: Section 129(7) of the Companies Act 71 of 2008 and the risk of being wound up

A lot has been said and written about directors' fiduciary duties and the pitfalls directors expose themselves to when making business decisions, almost daily. The circumstances which may lead a director to breaching their fiduciary duties are broad, and to determine whether a director actually breached their fiduciary duties often requires an extensive factual enquiry.

The spotlight on directors and compliance with their fiduciary duties often comes under scrutiny when a company finds itself in financial distress.

The Companies Act 71 of 2008 (Companies Act) defines financially distressed as meaning, in reference to a particular company at any particular time, that (i) it appears to be reasonably unlikely that the company will be able to pay all its debts as they become due and payable within the immediately ensuing six months, or (ii) **it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months**.

Section 129 of the Companies Act deals with financially distressed companies and the duty on directors to place a company in business rescue, by adopting a resolution placing the company in voluntarily business rescue.

A section which is often overlooked by directors is section 129(7) which specifically states that:

> *"If the board of a company has reasonable grounds to believe that the company is financially distressed, but the board has not adopted a resolution contemplated in this section, the board must deliver a written notice to each affected person, setting out the criteria referred to in section 128(1)(f) that are applicable to the company, and its reasons for not adopting a resolution contemplated in this section."*

Section 128(1)(f) is the section defining "*financially distressed*" and directors are required, in the section 129(7) notice, to play open cards with all affected persons, explaining the basis of the company being financially distressed, and more importantly, why the directors, despite the company being financially distressed, have elected not to commence business rescue.

Vulnerability caused by compliance: Section 129(7) of the Companies Act 71 of 2008 and the risk of being wound up

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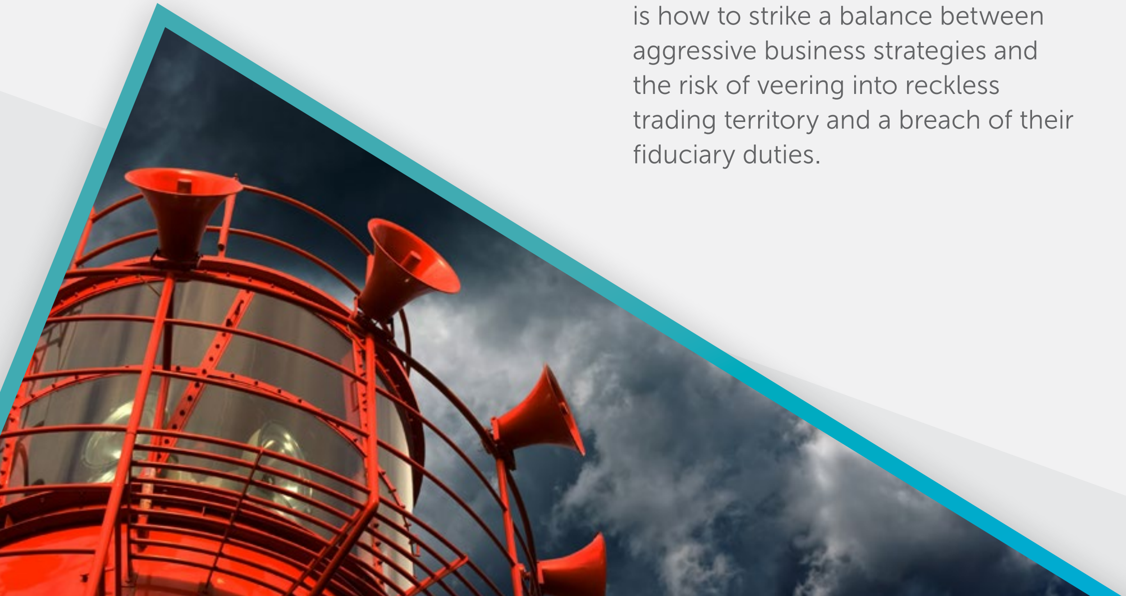

Striking a balance

The directors of a financially distressed company do not have the luxury of keeping the company's financial situation 'under wraps' due to the requirement in section 129(7). In striving for growth and shareholder returns, directors often have to make hard choices. A director will always want to believe that they can turn around the business and improve the financial position of the company and they do not necessarily want to pull the trigger too quickly. There is, however, a difference between false optimism and reasonably believing that the company can be turned around by adopting a turnaround strategy. The challenge for directors is how to strike a balance between aggressive business strategies and the risk of veering into reckless trading territory and a breach of their fiduciary duties.

Failure to send a section 129(7) notice may be regarded as a breach of one of the most important fiduciary duties directors have, which is to act in the best interests of the company. Failing to adopt the necessary resolution placing a company in business rescue, when financially distressed, will cause the company to continue trading in financially distressed circumstances, which may constitute reckless trading by the company, which is prohibited by section 22 of the Companies Act.

Assessing recklessness

Recklessness implies the existence of an objective standard of care. In considering whether there is reckless trading, a court will consider the conduct and assess the extent to which there is a departure from the objective standard.

Recklessness has been defined as "*not an error of judgement but a disregard for the consequences of one's actions*"; "*a serious departure from the standard of the reasonable man*"; and "*conduct which evinces a lack of genuine concern for the prosperity of the company*".

Unfortunately, and probably fortunately for others, the Companies Act sometimes operates as a spiderweb, you untangle yourself from one web and find yourself tangled in another. This is to say that once the directors issue a section 129(7) notice, the company becomes vulnerable to creditors looking to bring winding-up applications against the company. The creditors may use the notice as evidence that the company is unable to pay its debts as and when they become due and payable and that its liabilities exceed its assets, which makes it insolvent.

Vulnerability caused by compliance: Section 129(7) of the Companies Act 71 of 2008 and the risk of being wound up

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As already mentioned, failure to issue the section 129(7) notice may veer into reckless trading territory, and reckless trading attracts certain liabilities for directors. Section 77(3) provides specifically that a director would be liable for any loss, damage or costs sustained by the company as a direct or indirect consequence of acquiescing in the carrying on of the company's business despite knowing that it was being conducted in a manner prohibited by section 22(1) i.e. recklessly.

Although directors may be hesitant to issue a section 129(7) notice and would ideally want to quietly try to turn the business around, the consequences, if the turning around does not succeed, can be dire not only for the company but for the directors personally. Although a section 129(7) notice may make the company vulnerable to winding-up applications, failure to file it may result in worse outcomes. There is no detour when it comes to compliance with the Companies Act. When in doubt, directors are encouraged to seek legal advice on whether any decision could be in breach of their fiduciary duties.

Lucinde Rhoodie and
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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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