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Business Rescue, Restructuring & Insolvency

NEWSLETTER

DISPUTE RESOLUTION

IN THIS ISSUE

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March has arrived, and the sun is rising a little later and setting a little bit earlier. As the year progresses, many South Africans are similarly hoping for progress within the nation. Progress has been far from linear with the recent state of affairs in the nation.

The month has started with South Africa being greylisted by global financial crime watchdog, The Financial Action Task Force (FATF). The cause of the greylisting is due to South Africa not fully complying with international standards around the prevention of money laundering, terrorist financing and proliferation financing. The most likely repercussion of the greylisting will be the reduction in foreign investment into the nation, as investors have doubts over the uncertainty and stability of our economy. Fortunately, greylisting does not signify an increase rating downgrade, however the longer South Africa stays greylisted, the more likely the risk of downgrade increases.

Government recently declared a National State of Disaster for the current electricity crisis. The Presidency believes the state of disaster will enable government to provide practical measures that are needed to support businesses in food production, storage and retail supply chain, including for the rollout of generators, solar panels and uninterrupted power supply.

In Business Rescue news, Tongaat Hulett's (Tongaat) business rescue practitioners (BRPs) have been afforded an extension of the publication of its business rescue plan until the end of March. The plan was initially meant for publication by the end of February however creditors of the sugar company have given their approval for the extension. The BRPs are in the process of sourcing a strategic equity partner and this will be integral to the rescue of Tongaat.

In this month's edition, Director Lucinde Rhoodie, Associate Muwanwa Ramanyimi and Candidate Attorney, Claudia Grobler consider the effect of liquidation on judicially attached property. Lastly, Director, Kylene Weyers, Associate, Jessica Osmond and Candidate Attorney, Thato Makoaba consider the recent judgment of *Engen Petroleum Limited v Jai Hind EMCC t/a Emmarentia Convention Centre (ECC) and Others* (2022/046904) [2023] ZAGPJHC 38 (24 January 2023), where the court had to determine whether a resolution as adopted by a board of trustees was null and void in the face of the statutory requirements as set out in Section 129 of the Companies Act of 71 of 2008.

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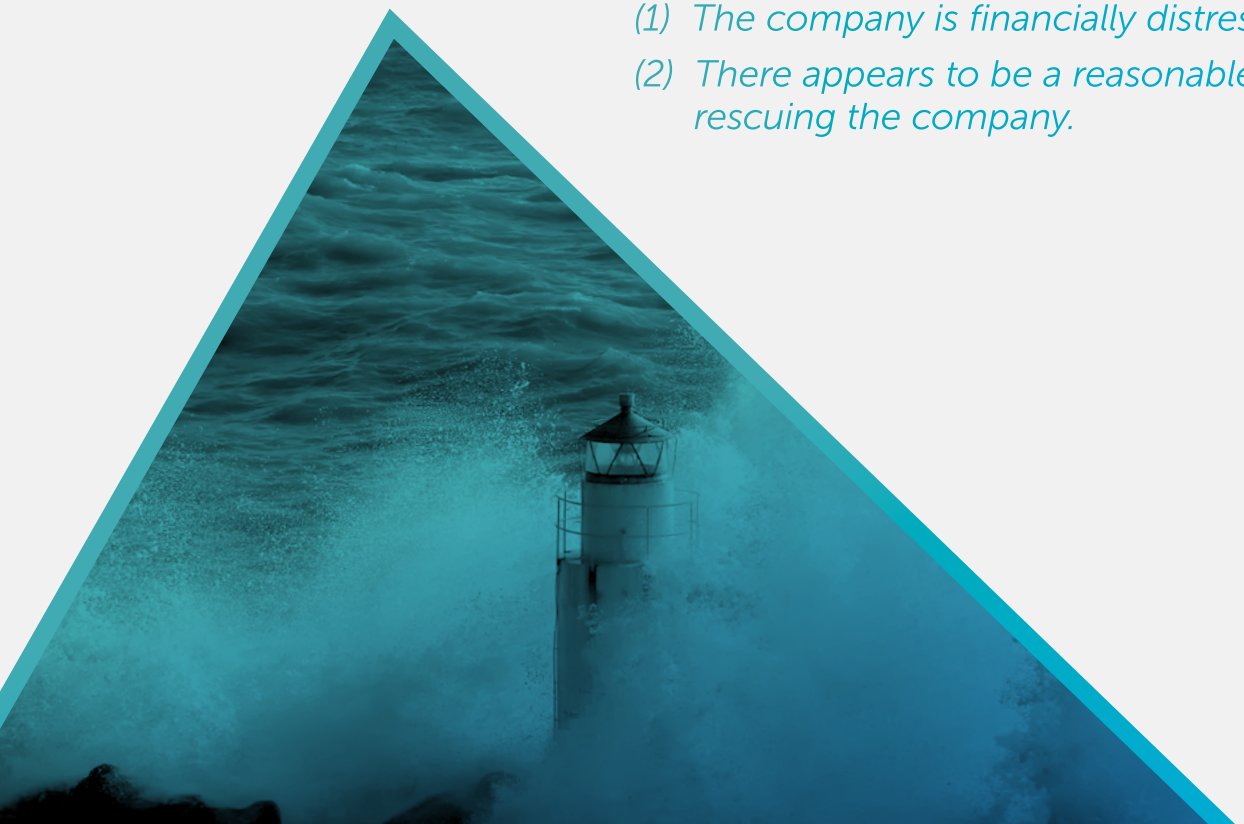
Love all, trust a few – trust issues lead to no resolution

Section 129 of the Companies Act 71 of 2008 (the Act) provides for the process of commencing voluntary business rescue proceedings and placing a financially distressed company under supervision by way of a board resolution. The section provides for grounds upon if a company's board of directors may elect to resolve such, and these are in instances where the board reasonably believes that:

(1) The company is financially distressed; and

(2) There appears to be a reasonable prospect of rescuing the company.



In the matter of *Engen Petroleum Limited v Jai Hind EMCC t/a Emmarentia Convention Centre* (ECC) *and Others* (2022/046904) [2023] ZAGPJHC 38 (24 January 2023), the High Court had to determine whether such a resolution as adopted by the board of trustees of the JHG02 Trust (the Trust) (the purported owner of the ECC), intending to commence business rescue proceedings, was in fact null and void as alleged by one of the ECC's major creditors and the applicant in this matter – Engen Petroleum Limited (Engen).

The application was brought by Engen on an urgent basis wherein it sought to obtain an order declaring that the resolution placing ECC under business rescue was null and void and further declaring that the business rather be placed under liquidation.

Love all, trust a few – trust issues lead to no resolution

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The court thus had to determine the validity of the resolution in the face of the statutory requirements as set out in section 129 of the Act. The court also had to consider whether the financial state of the business necessitated for the business to be placed into liquidation rather than business rescue.

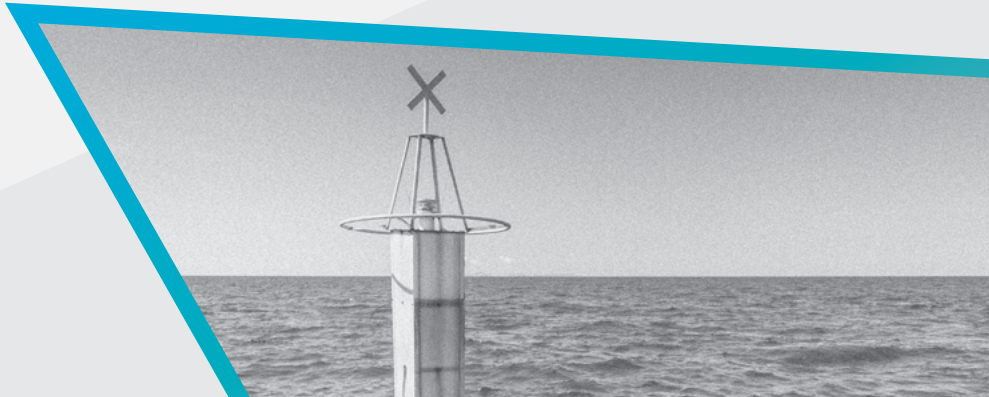
Background facts

The ECC (the First Respondent in this case), trading as a close corporation, dealt in the trading of petroleum products (both petroleum and diesel), selling of consumer goods and providing car wash services.

In September 2022, due to the ECC's inability to meet its financial obligations, the board of trustees of the Trust, as the purported owner of the ECC, resolved to place the ECC under voluntary business rescue.The resolution was signed by Mr Avishkar Harilal Dukhi (Mr Dukhi) and Mr Desigan Naidoo (Mr Naidoo) in their respective capacities as duly authorised trustees of the Trust.

This initially raised concern insofar as compliance with the provisions of section 129(1) of the Act was concerned, as only Mr Dukhi was in fact a member of the ECC at the time that the resolution was taken, and even so, signed in his capacity as a Trustee Member - the meaning of which was never explained.

Further, section 129 of the Act provides for a board of a company to resolve that the company voluntarily commence with business rescue. As such, considering that the ECC is a close corporation and does not have a board of directors, the resolution to place ECC into business rescue should have been passed by the members of the ECC, and not the Trust. The only known member at the time of the passing of the resolution was Mr Dukhi.



Love all, trust a few – trust issues lead to no resolution

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The Business Rescue Practitioner (the BRP), however, sought to rebut this concern by submitting that the trustees were in fact members of the close corporation by virtue of the Trust's alleged member standing as the purported owner of the ECC. The BRP went further to state that the trustees, as members of the close corporation, and by virtue of holding such office, are in fact directors of the ECC.

The court dismissed this submission on the grounds that the ECC, as a close corporation, is not capable of appointing directors; further, that the resolution was taken by the Trust and not the ECC itself, and it was taken by a member, in conjunction with a non-member of the ECC. The question as to the validity of the resolution was thus at issue.

In considering the second issue before the court, as to whether the ECC should be finally wound up, the court noted that on the version put forward by Mr Dukhi in his sworn statement, as well as the BRP in the proposed Business Rescue Plan (the Plan), the ECC's debts far outweighed its assets with the only motivating factor for reasonable rescue being attributed to a supported contention of the applicant that the ECC is unlawfully selling diesel as a wholesaler. As such, the court was not convinced of the averments of a reasonable prospect of rescue of the business.

The Court's Findings

Validity of the Resolution

Based on the above, the court found firstly, that the resolution as taken by the trustees of the Trust to commence business rescue proceedings of the ECC did not comply with the provisions of section 129 of the Act and is thus null and void and should be set aside on the ground provided for in section 130(1)(a)(iii) of the Act (being that the ECC has failed to satisfy the procedural requirements set out in section 129).

There were further concerns regarding the business rescue proceedings, however, given the conclusion that the resolution was not taken by the ECC, the court did not deal further with these.

Love all, trust a few – trust issues lead to no resolution

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Winding-up of the ECC

It was common cause that the ECC was unable to meet is financial obligations. According to the BRP, the ECC had assets to the value of R147,834.30 and faced claims of approximately R19 million.

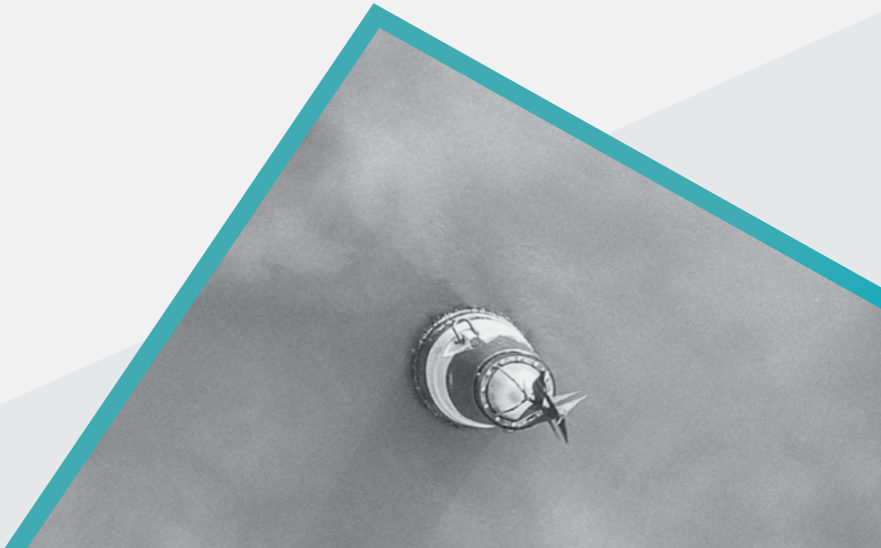
The court found that on the versions presented by Mr Dukhi and the proposed Plan of the BRP, the ECC was in fact hopelessly insolvent with little to no rational basis to believe that the ECC could be rescued. As such, the court held that it would be just and equitable to grant Engen its relief sought by winding-up the ECC.

Conclusion

The above judgment emphasises the importance of complying with the statutory requirements as provided for in the Act when commencing business rescue proceedings. Failure to do so places the company at risk of having the proceedings being declared null and void and the business rescue proceedings set aside, which is a time consuming and expensive consequence - detrimental to the survival of an already struggling business.

Further to this, the case demonstrates the importance of pragmatically and reasonably assessing the viability of placing a company under business rescue, to ensure compliance with the provision of proving that there is a reasonable prospect of rescuing the business. This case also signals a warning to companies not to abuse the business rescue process and file for rescue, when actually the company is a candidate for a liquidation, as a court may order that the company be wound up.

Kylene Weyers, Jessica Osmond and Thato Makoaba



So close, yet so far: The effect of liquidation on judicially attached property

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So, you have your court order, writ of execution and have judicially attached the movable assets of your debtor, and you are only one step away from finally recovering what you are owed; what could possibly go wrong? We have all been warned never to ask that question, because, like in the movies, that is when it all seems to start going wrong. It often happens that default judgment is obtained; a writ of execution is issued and the sheriff judicially attaches the debtor's movable assets and draws up the inventory. However, before the sheriff can remove the assets for a sale in execution, another creditor brings a liquidation application against the same debtor and a provisional liquidation order is granted.

In such an instance these questions arise: Does the judicially attached property automatically form part of the insolvent estate? If so, what type of claim will the judgment creditor have against the insolvent estate? And, in the end, where does all of this leave the creditor who has spent money on legal fees to obtain a judgment and judicially attach the movable assets?

Does the attached property form part of the insolvent estate?

Section 359(1) of the Companies Act 61 of 1973 (1973 Companies Act) provides that where the court has made an order winding-up a company, all civil proceedings by or against the company concerned are suspended until the appointment of a liquidator, and any attachment or execution put in force after the

So close, yet so far: The effect of liquidation on judicially attached property

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commencement of the winding-up shall be void. A liquidation order is made retrospectively, therefore, the liquidation order will be valid from the date upon which the application for liquidation was made. Thus, any attachment or execution put in force after the date on which the application for liquidation was made will be rendered void.

Section 359(2) of the 1973 Companies Act provides that every person who instituted legal proceedings against a company which was suspended by the winding-up order, and every person who intends to institute legal proceedings may, within four weeks after the appointment of a liquidator, give the liquidator not less than three weeks' notice in writing that they want to continue or commence the proceedings.

In an instance where movable assets have been attached by the sheriff (whether they have been removed from the debtor's premises or not), the process is also suspended unless the creditor gives the liquidator notice and the liquidator gives their consent. Section 5(2) of the Insolvency Act 24 of 1936 (Insolvency Act) provides that the estate of an insolvent **includes** property or the proceeds thereof which are in the hands of a sheriff under a writ of attachment.

The court in *Ex Parte Spartan SME Finance (Pty) Ltd: In re Insurance Underwriting Managers (Pty) Ltd v Zululand Bus Services and others* [2022] JOL 57187 (GP) stated that it is trite that a judgment creditor acquires no rights to any property under attachments other than to the proceeds of any sale in

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execution. Similarly, the court in *Simpson v Klein NO and Others* [1987] (1) SA 405 (W) found that ownership only transfers from the debtor to the creditor once the property has been sold in execution proceedings. Thus, while the property is merely attached, it would still form part of the debtor's insolvent estate.

If a creditor nonetheless elects to proceed with a sale of execution after the issuing of a provisional or final liquidation order, the proceeds of the sale must be paid over to the liquidator, and will be administered in terms of the Insolvency Act.

The claim of the judgment creditor to the insolvent estate

We have established that the judicially attached assets still form part of the insolvent estate. What then is the status of the court order and writ of execution if the creditor elects not to seek consent from the liquidator to proceed with the sale in execution? The creditor will have the option to submit a claim against the insolvent estate. There are different classes of creditors in an insolvent estate: secured, preferred and concurrent creditors. If the judgment creditor was a concurrent creditor, does the court order and writ of execution and the fact that they had judicially attached the insolvent's estate elevate the class of the creditor to being at least a preferred creditor?

The court in *Pols v R Pols-Bouers en Ingenieurs (Edms) Bpk* [1953] (3) SA 107 (T) held that, "*if the money is still under attachment, the creditor is not entitled to it, but is entitled only to a preference for his costs of execution. But if the money had passed to the creditor before winding up commenced, the liquidator has no claim to it.*" It must be noted that preference as to costs does not appear to extend to costs of obtaining the court order and writ of execution but appears to only apply to the sale in execution costs.

Section 95(2) provides that the attachment of any property in execution of any judgment shall not have the effect of conferring upon the judgment creditor any preference other than the preference provided for in subsection 1, which is for costs of the execution.

So close, yet so far: The effect of liquidation on judicially attached property

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Where does this leave the creditor?

In the end we see that a judgment creditor who has not completed the sale in execution, or who has not received the proceeds of the sale, prior to the issuing of a liquidation application is in a rather weak position once the debtor has been placed in liquidation. Not only will the attached property or the proceeds thereof form part of the insolvent estate, but the judgment creditor also does not enjoy any preference in the proceeds of the insolvent estate.

This is a rather unfortunate position for the creditor that has spent time and money in following the recovery process and subsequently obtaining a court order and writ of execution. This begs the question of whether the creditor would have been better off having applied for the liquidation of the debtor instead of following the normal court process, especially bearing in mind that the costs of the liquidation application will eventually be costs of the insolvent estate and may be recoverable by the creditor. Bearing this in mind, a big risk will be that creditors may start attempting to use liquidation proceedings as a debt collection mechanism, and we believe, this would negatively impact the integrity and purpose of the procedure. The lesson to be learned is to act as fast as possible if any of your debtors fall in arrears with their payment obligations towards you.

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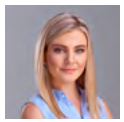

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BBBEE STATUS: LEVEL ONE CONTRIBUTOR
Our BBBEE verification is one of several components of our transformation strategy and we continue to seek ways of improving it in a meaningful manner.

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