Business Rescue, Restructuring & Insolvency

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SOUTH AFRICA

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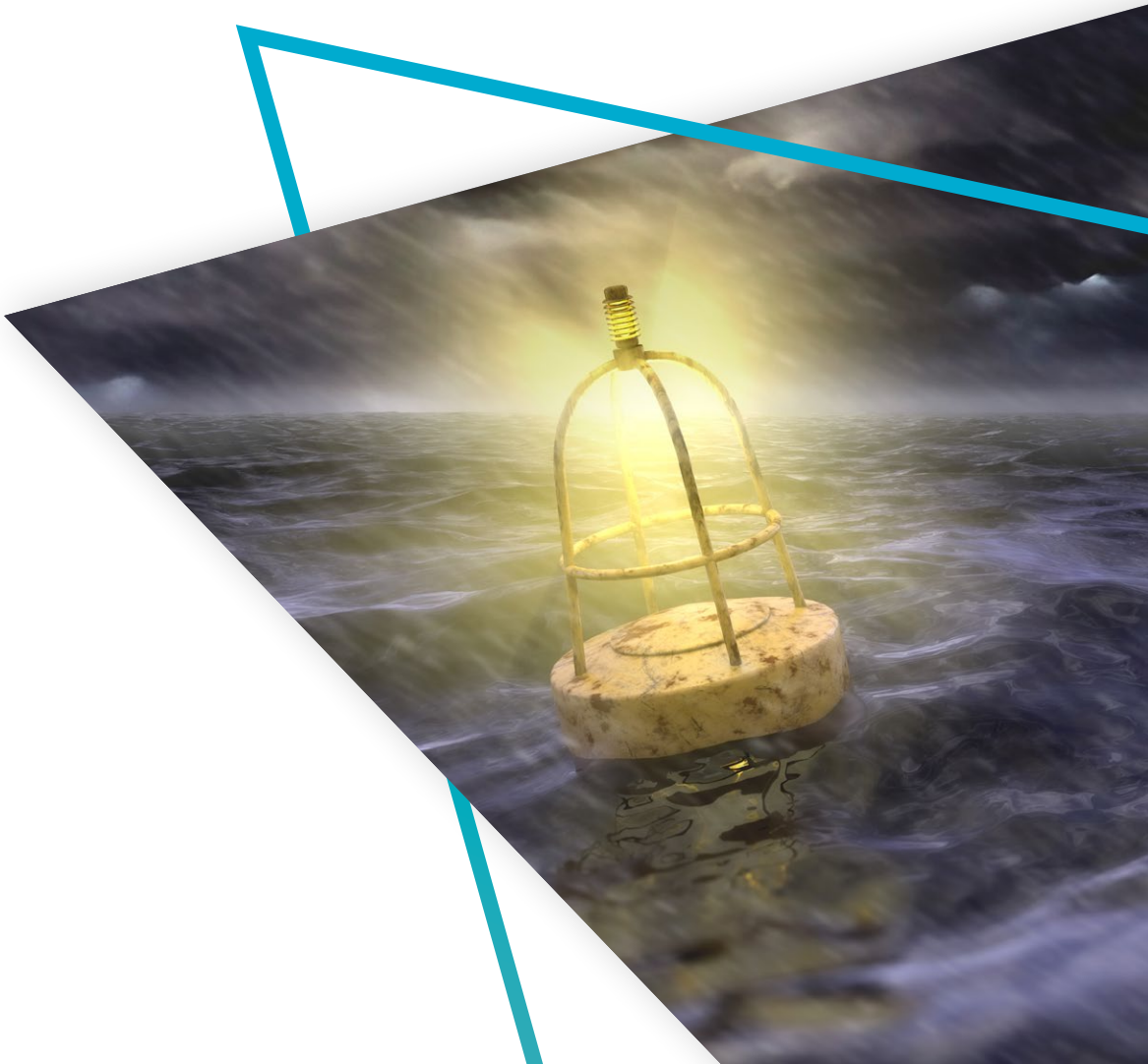
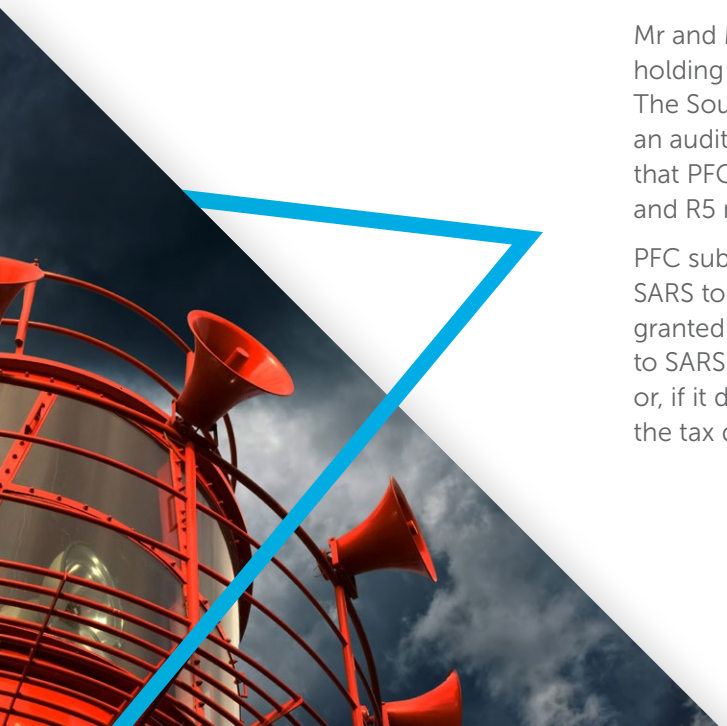


Business rescue with an ulterior purpose

A financially distressed company facing a liquidation application may be tempted to try and avoid or delay the inevitable by launching a business rescue application in order to suspend the liquidation process. However, if there is no merit in such an application, it will inevitably be found by the courts to be an abuse of process and the stratagem will thus be doomed to failure. The Supreme Court of Appeal in the case of *PFC Properties (Pty) Ltd v Commissioner for the South African Revenue Services and Others* (543/21; 409/22) [2023] ZASCA 111; [2024] (1) SA 400 (SCA) (21 July 2023) adjudicated precisely this scenario.



Factual background

Mr and Mrs De Robillard were directors of an asset holding company called PFC Properties (Pty) Ltd (PFC). The South African Revenue Service (SARS) had conducted an audit of PFC and issued an assessment which revealed that PFC owed SARS R52 million in value-added tax (VAT) and R5 million in income tax.

PFC submitted a request for suspension of its tax debt to SARS to halt the enforcement of SARS' claim, which was granted by SARS. In support thereof, PFC offered security to SARS in the form of an undertaking not to sell its assets or, if it did, to pay the proceeds to SARS in satisfaction of the tax debt.

By 2019, PFC had stripped itself of all of the immovable properties it owned, despite the security in favour of SARS, as well as two luxury yachts. As a result, SARS revoked the suspension of payment in respect of PFC's VAT and income tax in 2021 and in the same year launched an application to have PFC wound up.

PFC did not file papers to oppose the winding-up application and instead moved its registered address from Gauteng to an address within the jurisdiction of the Pietermaritzburg High Court, where an application to place PFC under business rescue was launched by the trustees of the De Robillard Family Trust (the DRFT trustees).

The moratorium

PFC sought to invoke section 131(6) of the Companies Act 71 of 2008 in terms of which bringing an application for business rescue will suspend the liquidation process until either the court has adjudicated the application, or the business rescue proceedings end. This, PFC argued, triggered the general **moratorium** on the institution of legal proceedings against entities in business rescue, which would prevent the liquidation application from continuing. To this the court said that the trustees knew or ought to have known that there were no prospects of success in the business rescue application.

Abuse of process

The court stated that the purpose of business rescue is to restore a company to solvency and that it is not to be used to stall the winding-up of a company which has no prospects of becoming viable again.

Business rescue with an ulterior purpose

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To that end, the court quoted the dictum of Unterhalter AJ in *Villa Crop Protection (Pty) Ltd v Bayer Intellectual Property GmbH* [2022] ZACC 42; [2023] (4) BCLR 461 (CC), emphasising that a litigant who uses the legal process for an ulterior purpose, or who seeks to subvert the rule of law would be committing an abuse of process. As such, the court has the power to safeguard its process when a litigant's conduct is found to be abusive.

The court held that there were certain indicators that PFC was commercially and factually insolvent, including the disposal of all of its immovable property despite being an "*asset holding company*"; the fact that it owed Mr De Robillard in excess of R90 million, which it sought to disguise by alleging that he was in fact a debtor of the company; and, most strikingly, the fact that the registered address of PFC was suddenly moved from Gauteng to KwaZulu-Natal so that the business rescue application could be heard in the Pietermaritzburg High Court.

Consequently, the court found that the DRFT trustees had abused the court's process in that they sought to use "*the legal process provided for companies which may legitimately be rescued... to thwart the winding-up proceedings*". It stated that the business rescue application was a "*stratagem*" in that the trustees had no actual intention of prosecuting it to its conclusion. It held further that there was no doubt that PFC was insolvent in light of the dissipation of its assets and that it was just and equitable for the company to be wound up.

Reasonable prospects of success are necessary for the court to find in favour of a business rescue application. The court here cited *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others* [2013] ZASCA 68; [2013] (4) SA 539 (SCA) and reiterated that such prospect must go beyond mere speculation. Here, PFC attempted to demonstrate its prospects by arguing that Mr De Robillard was in fact its creditor and that certain properties were going to be re-transferred to it. However, the court was wholly unconvinced and held that the disposal of assets had defeated the purpose of PFC's existence as an asset holding company. There were accordingly no reasonable prospects of rescuing the business.

Conclusion

The position is clear – business rescue proceedings exist to allow a financially distressed company to become viable again, not to delay the inevitable. Accordingly, a business rescue application should only be brought where there is a reasonable prospect of saving the company.

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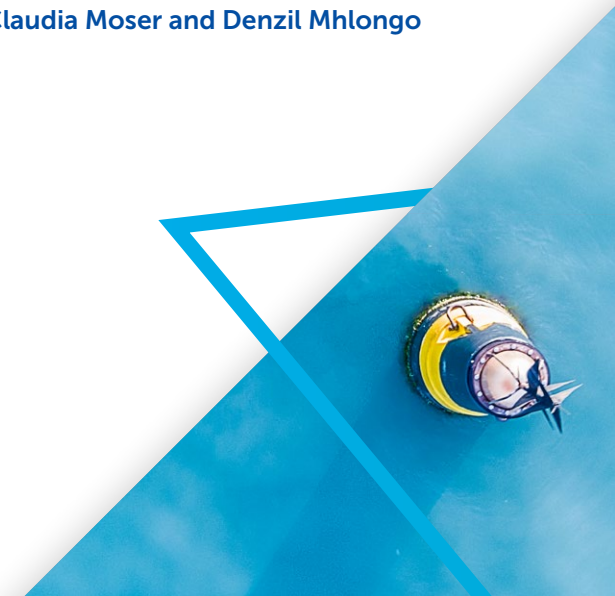

The extent of business rescue practitioners' powers to suspend a company's contractual obligations

Chapter 6 of the Companies Act 71 of 2008 (Companies Act) confers various powers on business rescue practitioners (BRPs) once they have assumed their responsibilities to restructure the affairs of a company that has been placed under business rescue. This is achieved through the temporary supervision of the company, and the management of its affairs, business and property, by the BRP; a temporary moratorium on the rights of claimants against the company or in respect of property belonging to the company or lawfully in the possession of the company; and the development and implementation, if approved, of a business rescue plan to rescue the company by restructuring its affairs, amongst other things.

One of the BRPs' powers is the ability to entirely, partially or conditionally suspend, for the duration of the proceedings, *"any obligations"* of the company that arise under an agreement to which the company was a party at the commencement of business rescue that otherwise become due and payable during those proceedings. The extent of the BRPs' power to suspend certain contractual obligations has troubled stakeholders for some time and was recently considered in the judgment of *Tongaat Hulett Limited (In Business Rescue) and Others v South African Sugar Association and Others* [2023] JDR 4959 (KZD) (3 December 2023). The issue at hand was determining the scope of the BRPs' powers under section 136(2) to suspend Tongaat Hulett's contractual obligations to the South African Sugar Association (SASA).

Factual matrix

The genesis of this matter emanated from the Sugar Industry Agreement (SI Agreement) governing the sugar industry, which obliges Tongaat Hulett and other members of the sugar industry to pay SASA certain levies as a form of revenue sharing where those members have over-produced for their quota in the South African sugar market. When Tongaat Hulett was placed into business rescue, its BRPs sought to suspend the payment of these levies to SASA in terms of section 136(2) of the Companies Act.

SASA is statutory body created in terms of the Sugar Act 9 of 1978 (Sugar Act) whose sole purpose is to act as the regulator in the sugar industry. It derives its powers from subordinate legislation, namely the Sugar Act, which is given effect to through the SI Agreement.

As a result of the sugar industry being highly competitive and saturated, quotas were introduced, through the SI Agreement, that determined and controlled the production of sugar, whether refined or otherwise, that industry players were allowed to sell. Based on these quotas, industry players such as Tongaat Hulett could, and would be, penalised should they over or under produce in respect of their domestic and export quotas.

The extent of business rescue practitioners' powers to suspend a company's contractual obligations

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Tongaat Hulett overproduced in respect of its domestic quota and 'undersold' in respect of its export market quota, leading to Tongaat Hulett having to pay redistribution penalties, levies and interest to SASA in the amount of just over R1,7 billion.

Despite courteous requests and reminders for payment from SASA, the BRPs for Tongaat Hulett refused to pay and evoked their powers under section 136(2) and suspended the obligation to pay the redistribution penalties and levies in terms of the SI Agreement.

It is on this basis that Tongaat Hulett and the BRPs approached the High Court to seek an order *inter alia* declaring that they were empowered to suspend, for the duration of the business rescue proceedings, any obligation of Tongaat Hulett which arose under the SI Agreement.

The power to suspend *ex lege* obligations

In interpreting the provisions and having regard to the ordinary meaning of the words used and the ordinary rules of grammar and syntax, the court rejected the BRPs' reliance on section 136(2) of the Companies Act, stating that the ongoing obligations of Tongaat Hulett towards SASA were simply the costs of doing business, and thus, could not be suspended. In essence, the court held that it is plain that what the legislature regards as an *"agreement"* for the purposes of the Companies Act, is a set of rights and obligations that are founded or created by, and derive their legal power from, a *"contract"*, *"arrangement"* or *"understanding"* *"between or among"* the persons who are party to it. These obligations are private law obligations arising from consensus between contracting parties (i.e. obligations *ex contractu*). As the SI Agreement constitutes subordinate legislation and its obligations arise as a matter of law (i.e. obligations *ex lege*), the BRPs had no power to suspend Tongaat Hulett's obligations towards SASA.

In support of this reasoning, the court drew a comparison to value-added tax (VAT) and stated that, just as the obligation to pay VAT to the South African Revenue Service is not capable of being suspended, neither are the levies due to SASA in terms of the SI Agreement.

Conclusion

While business rescue is geared towards flexibility in the restructuring of a financially distressed business, the judgment in this case demonstrates that there should be a careful and thorough analysis in each case by all stakeholders as to whether or not some obligations are capable of being entirely, partially or conditionally suspended for the duration of the proceedings so as to enable the company to restructure and reorganise its affairs.

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