



www.accountingacademy.co.za



SAA | ACCOUNTING
ACADEMY
Connect. Partner. Succeed.



Companies Act, No 71 of 2008

Session 7: Business Rescue and Insolvency

Presented by : Caryn Maitland CA(SA) RA

Approach to today's session

- Aimed at accountants and auditors
- Looking at risks when dealing with clients, red flags etc
- Responsibilities, reporting obligations and areas to focus on
- What does the law say?

INTRODUCTION

IRBA vs SAICA Guides

- SAICA Guide was written in 1999 and updated in 2007
 - Companies Act 2008
 - Auditing Professions Act, 2005 (S45)
 - NOCLAR
- IRBA released a guide for comment in July 2016
 - Withdrew proposed guide in July 2017
 - As a result of commentary, topic requires more research...

Can we talk about insolvency openly?

- Risk being held accountable under defamation law
- Self fulfilling prophecy
- Warning signs??

Where does the law stand?

General Considerations

- Type of Government – Constitutional democracy
- Political System – constitutional with provision for an independent judiciary
- Legal system – Independent executive, legislature and judiciary
 - Common law runs second to the constitution

Company Act S4: Solvency and Liquidity

These are now defined:

Section 4(1) For any purpose of this Act, a company satisfies the solvency and liquidity test at a particular time if, considering all reasonably foreseeable financial circumstances of the company at that time—

(a) the assets of the company, as **fairly valued**, equal or exceed the liabilities of the company, as fairly valued; and

Company Act S4: Solvency and Liquidity

(*b*) it appears that the company will be able to pay its debts as they become due in the ordinary course of business for a period of—

(i) 12 months after the date on which the test is considered; or

(ii) in the case of a distribution contemplated in paragraph (*a*) of the definition of “distribution” in section 1, 12 months following that distribution.

Beware: IFRS 13 Fair value Measurement

Insolvency Tests

- Factual insolvency
 - Liabilities exceed its assets
- Commercial insolvency
 - Cannot pay debts as and when they fall due (liquidity)
 - Boschpoort Ondernemings (Pty) Ltd v Absa Bank Ltd (936/12) [2013] ZASCA 173 (28 November 2013)

Financial Distress Test

- It appears to be reasonably unlikely
- That the company will be able to pay all of its debts
- As they become due and payable
- Within the immediately ensuing 6 months
- OR
- Become factually insolvent in the impending 6 months

Insolvency and restructuring procedures

- Formal insolvency procedures
 - Placed in liquidation per Chapter 14 of **Companies Act, No 61 of 1973** (Old Act still regulates)
 - Involuntary liquidation
- Formal restructuring procedures
 - Chapter 6 of Companies Act 2008
 - Business Rescue (S128 to S154); and
 - Compromise arrangements (S155)
 - International trend in line with UK and USA

Insolvency and restructuring procedures

- Informal insolvency and restructuring procedures
 - Get ALL creditors together and make a plan
 - All creditors must agree and agreement must be binding on all
 - Creditors enter into an undertaking not to make an application to court to place company in liquidation or business rescue

Liquidation

- Aim
- Process – Solvent or insolvent (voluntary??)
 - Old Act: position and powers of liquidator, administration of liquidated estates
 - Insolvent Company - can be done
 - voluntarily by Board of Directors
 - Formal application by the company, a shareholder or creditor (among others)
 - Solvent
 - Initiated by company voluntarily and conducted by company/creditors
 - By Court Order

Commencement of Liquidation

- Involuntary: insolvent (Old Act)
 - Process commences when resolution lodged with companies registered office
 - Court order – on presentation to court of application, when order is finally granted
- Voluntary: solvent (New Act)
 - On resolution lodged with registered office
 - When court order granted

Court involvement

- Compulsory liquidation require involvement by the Court
- Voluntary liquidation – no Court involvement required
- Court involvement
 - Litigation on-going before liquidation
 - Liquidator wants to recover assets that were not disposed of for value

Management of Company

- Company remains a corporate body and retains its power
- From commencement of liquidation
 - Cease to carrying on its business, except winding up
- Voluntary winding-up, directors powers cease except if sanctioned by liquidator or
 - Creditors (if wind up requested by them)
 - Members (if wind up requested by them)
- Master appoints a suitable Liquidator on receipt of Court Order or Special Resolution

Filing of Claims

- Creditors claims are filed with support and affidavit
- File claims with liquidator
- Call a meeting with liquidator
- Costs for the creditors account
- Only creditors that have proved their claims will benefit from a distribution
- Liquidations can take between 6months to 2 years to wrap up

Effect on Employees

- Employment contracts – immediately suspended
- Liquidator may cancel in due time after due consideration
- All suspended contracts not already terminated, will be automatically terminated 45 days after final appointment of liquidator
- Employees not required to render services once process commenced and company not required to pay for any services received
- Employees have a limited but preferred claim in liquidation process

Effect on Contracts

- Unless there is an express statutory provision to the contrary
- Contracts remain in effect when company placed in liquidation
- Liquidator needs to timeously make a decision as to whether or not the executory contracts will continue

Effect on Creditors

- Claims will be ranked and paid in out in accordance with preference determined by law
- After winding up costs, creditors paid in their pro-rata share.
- Preferential creditors paid before concurrent creditors
- Secured creditors paid from disposal of secured asset
- Concurrent (plus partly settled secured and preferential creditors) paid from residual

Effect on Shareholders

- Paid last....

Pending claims, litigation, arbitration

- All civil proceedings against the company shall be suspended until liquidator appointed, and
- Any attachment or execution put in force against the estate or assets of the company after the commencement of the winding up shall be void

Pending claims, litigation, arbitration

- Every person that has or intends to institute litigation against the company for claims before the liquidation
 - Must inform liquidator within 4 weeks of appointment
 - And give liquidator 3 weeks before commencing proceedings
- No notice given – action deemed to be abandoned unless court otherwise directs

Voidable transactions

- Any transaction entered into by the debtor company before the liquidation
- whereby it has disposed of property belonging to it for no value or
- a manner that has the effect or intention of prejudicing creditors or preferring one above the other
- is a voidable or undue preference transaction and may be set aside

Directors or prescribed officer liability

- A director (including alternate), a prescribed officer,
- or a person who is a member of a committee of the board, or of the audit committee
- Is prohibited from trading with a company recklessly, with gross negligence, with the intent to defraud any person or for any fraudulent purpose

Directors or prescribed officer liability

- Can be held personally liable
 - Jointly and severally
 - Criminal offence S214
 - 10 years imprisonment or max of R1 million fine

Bellini v Paulsen and others (17096/209) 2012 ZAWCHC 199 (28 Nov 2012)

- Contravention of the Act: personal liability
- When is a business person reckless?
- “... The defendant, with reckless disregard of his duties, allowed this situation to continue... ..well knowing that the company had no assets and no way of servicing the debt.”

NB: S218(2) of Companies Act

- Compliance through personal liability
- S218(2)
 - Any person who contravenes the provisions of this Act
 - Is liable to any other person
 - For any loss or damage suffered by that person as a result of that contravention

Consider the differences

- Reckless trading
- Gross negligence
- Group scenario...
- Common law fraud
- Statutory fraud
- Financially distressed

Directors Responsibilities

- S4 Solvency and Liquidity Test
- Maintain accounting records (S28)
- Financial Statements (S29 and S30)
- Declaration of personal interests (S75)
- Act with fiduciary care (S76)
- Consider business rescue if in financial distress S129(7)

Business Rescue

- Where is the accounting professional?
- NOCLAR?
- Reportable irregularities
 - Companies Act
 - Auditing Professions Act
- Tyre Corporation Cape Town (Pty) Ltd and others vs GT Logistics(Pty) Ltd and others (2016)
 - Commercial and/or factual insolvency an absolute bar for business rescue, or is there still hope?
 - Can the company be saved??

Business Rescue

- Board initiates if Company financially distressed with rescue prospects.
- Resolution only effective when filed and can't be passed during liquidation proceedings.
- Within 5 business days of filing resolution notice must be given to every 'affected person' (i.e. SH, Cred. & Employees) and appointing Practitioner.
- Within 2 business days of notice Business Rescue Practitioner (BRP) appointment must be filed and within 5 further business days, notice given.
- Failure to comply leads to lapsing, 3 month break.
- Resolution bars liquidation.
- If no resolution then board must advise affected persons.

Business Rescue

- An affected person can oppose resolution up until adoption of BR Plan.
- An affected person may apply to court for BR Plan .
- BR Proceedings begin with resolution and end with, adoption or rejection of BR Plan, conversion to liquidation and have an extendable period of 3 months.
- During proceedings there are limitations on legal proceedings against co. and ability of co. to dispose of property. Also, doesn't affect employment and Practitioner can suspend contracts.

Business Rescue

- Within 10 business days of appointment the practitioner must convene a first meeting of creditors and / or employees.
- After consultation with affected persons, Practitioner must propose BR Plan
- Within 10 business days of BR Plan Practitioner must convene affected persons meeting to consider BR Plan.
- BR Plan must be published within 25 business days of appointment of Practitioner.
- BR Plan must be adopted by 75% of creditors and 50% of Ind Creditors.

Business Rescue

- If BR Plan is rejected then Practitioner or Affected Person's may vote to revise plan or to apply to court to set aside vote.
- Affected Person's may make binding offer to buy out dissenting voters interests.
- BR Plan may provide for cancellation of part of creditors' claims.
- Compromise is similar but no need for financial distress and simpler process

Security

- Mortgage Bond
 - registered with Title Deed Office
- Movable and intangible property
 - Pledges, Cessions, general and special notarial bonds and landlords hypothec
- Pledge
 - Only effective on default
- Cessions
 - securitatem debiti
 - Out and out

Security

- General Notarial Bonds
 - Mortgage by mortgagor of all its movable property
 - In absence of attachment of asset - just obtain limited statutory preference. This attaches a secured right (in event of insolvency)
- Special Notarial Bonds
 - Up front registers right with mortgagee – creates secured right per Security by Means of Movable Property Act
- Landlords Hypothec
 - Rent becomes due, but unpaid – landlord can attach tenants assets in lieu of payment
- Guarantees

Statutory Prescribed forms of Security

- Aircrafts and South African Ships
- Intellectual Property
 - Trademarks, designs, Patents, copyrights
- Commercial Security or Quasi Security
 - Sale and leaseback/Hire purchase/finance lease/instalment sale agreements
 - Factoring
 - Repurchase agreements

Taking Security

- Security SPV
 - Most robust for secured creditors when there are multiple lenders
 - Seen as an insolvency remote structure
 - Ring fenced company
- Security Trusts
 - Validity of trust challenged (role of trustees)

Security vulnerable to attack

- Expropriation by Government
 - Attacks most secure form – mortgage bond
 - Expropriation Act releases all mortgage bonds except over land
- Compromises and business rescue
- Insolvency Act
 - Goes as far as to set aside some mortgage bonds
 - 6 months...

Challenges to enforcing security

- Exchange control approval
 - Foreign creditors
- Competition laws
 - Competitor becomes dominant in the market
- Financial assistance requirements
 - Requirements and related party transactions
 - Distributions???

Recognition of foreign judgements

- Will the RSA court recognise the foreign court order?
 - If duly obtained it will be enforceable provided it accords with ordinary procedures in SA law for enforcement
- Requirements for recognition for foreign judgement
 - Must be final, conclusive and unalterable
 - Court must have had jurisdiction (similar RSA)
 - Not contrary to public policy or law of natural justice
- Our law does not recognise foreign representatives
 - Must be SA qualified

QUESTIONS

THANK YOU FOR YOUR PARTICIPATION



SAA | ACCOUNTING
ACADEMY

Connect. Partner. Succeed.

