SARS' preference on business rescue

By Alastair Morphet

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An important judgment was handed down in the Western Cape High Court on 31 October, 2012. This was in the matter of Commissioner: SARS vs Mark Beginsel NO and Others. Readers will no doubt be aware of SARS' statutory preference legislated in Section 99 of the Insolvency Act, No 24 of 1936. The fact that SARS is a preferred creditor in a winding up has often gutted the estate, leaving pennies for the concurrent creditors.

Accordingly, it was with interest that the legal community waited to see what SARS' position would be when a company sought business rescue in terms of s128 of the Companies Act, No 71 of 2008. In this matter that came before Fourie J, the business rescue practitioners had sought an extension for the submission of their proposed business rescue plan, but at the meeting of creditors SARS had insisted that it should be ranked as a preferent creditor and that the business rescue practitioners should accordingly take into account SARS' attitude based on the additional weight it would carry as a creditor. The business rescue practitioners refused to do this saying that they had taken senior counsel's advice to the effect that the classification of creditors in the Insolvency Act was not applicable to Chapter 6 of the Companies Act, which contains no statutory preferences such as are found in s96 to s102 of the Insolvency Act.

Liquidation requested

SARS applied to court for an order declaring unlawful and invalid the decision taken at the meeting of creditors to approve the business rescue plan. Moreover, they sought to interdict the business rescue practitioners from distributing any monies of the company pursuant to the business rescue plan. Following from this, the court was asked to declare that the business rescue practitioners must put the company into liquidation.

The legal issue really turned on the interpretation of s145(4)(a) and (b) of the Companies Act, which stipulates that in respect of any decision, secured or unsecured creditors would have a voting interest equal to the value of their claim in the company, and that a concurrent creditor who would be subordinated in a liquidation has a voting interest independently and expertly appraised equal to the amount that they could reasonably expect to receive in a liquidation. SARS' argument was that its status as a preferent creditor under s99 of the Insolvency Act meant that its claims would rank ahead of ordinary concurrent creditors under s103 of the Insolvency Act. As such, it is an unsecured creditor in s145 and had a voting interest at the creditors meeting equal to the value of its claim against the company. SARS' argument was that ordinary concurrent creditors under s103 are included in the class of concurrent creditors who would be subordinated in a liquidation. Essentially, SARS was looking to be considered to be a preferent unsecured creditor under s145(4)(a) of the Companies Act and to have a voting interest equal to the value of its claim. The remainder of the non-preferent concurrent creditors, would have been disenfranchised concurrent creditors in terms of the provisions of s145(4)(b). In such an event the vote of SARS would have carried the day and the business rescue plan would have been rejected at the meeting, contrary to the wishes of the majority of the company's creditors.

An illogical result

The judge's view was that SARS' construction was not only contrary to the ordinary grammatical meaning of the words, but also led to an illogical result that failed to balance the rights and interests of the relevant stakeholders. The judge's view was that no statutory preferences were created in Chapter 6 of the Companies Act and if the intention of the legislature had been to confer such a preference on SARS in business rescue proceedings, it would have made such intention clear. No

trace of such an intention could be found in the Act. On the reading of the judge, and having regard to the purpose of business rescue proceedings, only one conclusion was justified, namely that SARS is not by virtue of its preferent status in s99 of the Insolvency Act a preferent creditor for the purposes of business rescue proceedings. The judge referred to Mars' Law of Insolvency and to Henochsberg on the Companies Act, concerning the notion of a preferent creditor whose claim is not secured, but who ranks above the claims of concurrent creditors. These are those who have the statutory preferences in s96 to s102 of the Insolvency Act. The judge considered at length the argument put forward by Henochsberg, which was the same interpretation as that put forward by SARS. The judge noted that Henochsberg accepted that this interpretation that a concurrent creditor who would be subordinated in a liquidation in terms of s145(4)(b) of the Companies Act would be grossly unfair to the concurrent creditors. Fourie J said that, in his mind, the ordinary meaning of the concept of subordination meant that a creditor's claim that was subject to a subordination or back ranking agreement, was what is being considered in sub paragraph (b). The judge said that in his view s144(2) of the Companies Act did not lend any support for the interpretation contended for by Henochsberg.

Accordingly, SARS would enjoy no greater voting interest than the other concurrent creditors of the company with the result that there is no basis on which to impeach the voting procedure that had been followed by the business rescue practitioners.

In the writer's view the provisions of the Companies Act are most likely to be amended.

ABOUT THE AUTHOR

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