

**The impact of the business rescue  
provisions on the rights of creditors**

By

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Submitted in partial fulfillment of the requirements for the degree

**LLM coursework in Mercantile Law**

**In the Faculty of Law,**

**University of Pretoria**

**November 2015**

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## **SUMMARY**

Prior to the enactment of the Companies Act 71 of 2008 (the 2008 Act), financially troubled companies were either liquidated or placed under the supervision of a judicial manager who was trusted with rehabilitating or restoring the company to a profitable going concern. Judicial management, as the process was called, did not achieve the results that were anticipated by the legislature and hence became a dismal failure. One of the reasons advanced for its failure was the fact that it was creditor-oriented. As a result of its failure, new legislation (Companies Act 71 of 2008) was promulgated and came into effect in May 2011. Chapter 6 of the 2008 Act introduced the business rescue regime in line with other international jurisdictions as a replacement for judicial management and this was seen as a major improvement as the new business rescue regime does not only seek to save the company as a going concern, but also aims at maintaining a proper balance between the interests of different stakeholders. This research will analyze the impact of business rescue on creditors by assessing the effectiveness of business rescue proceedings and also focus on the extent to which Chapter 6 has embraced debtor-friendliness by scrutinizing the requirements for the proceedings and the procedure itself.

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## Chapter 1

### GENERAL BACKGROUND

#### 1.1 Background information

South African law has provided for the rescue of financially distressed companies since 1926 when the statutory procedure of judicial management was introduced by the Companies Act 24 of 1926.<sup>1</sup> However, judicial management as provided for under Act 61 of 1973 remained relatively unchanged since it was introduced in the 1926 Act. It, as a matter of fact, failed to obtain the level of success that the legislators may have envisioned.<sup>2</sup> Judicial management's failure has mainly been attributed to the fact that its emphasis was on the interests of creditors,<sup>3</sup> and this resulted in most companies being liquidated. In his judgment in *Le Roux Management (Pty) Ltd v E Rand (Pty) Ltd*,<sup>4</sup> Josman J referred to judicial management as "a system which has barely worked since its initiation in 1926".

It is, therefore, not surprising that the introduction of the new business rescue provided for in the Companies Act 71 of 2008, has been welcomed as a significant improvement on judicial management. Chapter 6 of the 2008 Act<sup>5</sup> provides for the business rescue of financially distressed companies. The term 'business rescue' is defined in section 128(1) (b) of the Companies Act 71 of 2008 as proceedings to facilitate the rehabilitation of a company that is financially distressed<sup>6</sup> by providing for: "(i) the temporary supervision of the company, and

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<sup>1</sup> Loubser, A. 'Some comparative aspects of corporate rescue in South African company law'. (LLD thesis, University of South Africa, 2010).

<sup>2</sup> Museta, GM. 'The development of business rescue in South African law'. (LLM dissertation, University of Pretoria, 2011) at page 1.

<sup>3</sup> Loubser, A. 'Judicial Management as a business rescue procedure in South African corporate law.' 2004. *South African Mercantile Law Journal*, Volume 16 at page 162.

<sup>4</sup> [2001] 1 All SA 223 (C) at page 238.

<sup>5</sup> Companies Act 71 of 2008.

<sup>6</sup> Financially distressed company is defined in section 128 (1) (f) as a company that, at any particular time, appears to be unreasonably unlikely to pay all its debts as they become due and payable within the immediately ensuing six months; or it appears reasonably likely that the company will become insolvent within the immediately ensuing six months.



the management of its affairs, business and property; (ii) a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; (iii) the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equities in a manner that maximizes the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company.”

## **1.2 Problem statement and research objectives**

Prior to the commencement of the new Companies Act 71 of 2008 (hereinafter referred to as “the Act”), which came into effect on the 1<sup>st</sup> of May 2011, financially distressed companies were either liquidated or placed under judicial management.<sup>7</sup> Chapter 6 of Act 71 of 2008, however, introduced business rescue which, to say the least, reflects a more genuine concern for helping a struggling business back onto its feet than was evident in the preceding judicial administration.<sup>8</sup> As a matter of fact, the new business rescue model emerged at a time when South African business environment found itself in a recession, with liquidation statistics increasing every month.<sup>9</sup>

As its name suggests, business rescue recognizes the value of the business entity as a going concern, rather than the entity itself and while the primary aim of business rescue under the new dispensation is to preserve the business, it also offers creditors a greater prospect of recovering in full. However, it still remains

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<sup>7</sup> Section 427 of the Companies Act 61 of 1973.

<sup>8</sup> Bradstreet, R. ‘The new Business rescue: Will creditors sink or swim?’ 2011. *South African Law Journal*, Volume 128(2), at page 358-380. (Accessible through the Sabinet).

<sup>9</sup> Le Roux, N. and Duncan, K. ‘The naked truth: creditor understanding of business rescue: A small business perspective’. 2013. *Southern African Journal of Entrepreneurship and Small Business Management*, Volume 6.

doubtful whether creditors will still be adequately protected under chapter 6.<sup>10</sup> The research seeks to analyze the impact of business rescue on creditors by assessing the effectiveness of business rescue proceedings. The research will further focus on the extent to which Chapter 6 has embraced debtor-friendliness by scrutinizing the requirements for the proceedings and the procedure itself.

### **1.3 Delineations and Limitations**

In this research I will highlight the differences between judicial management in the old Companies Act<sup>11</sup> and business rescue in the new Companies Act,<sup>12</sup> this will assist in determining whether or not the new regime has so far achieved its objective in terms of section 7(k) of the Act. In order to better understand the expectations required by Chapter 6 of the Act, principles from comparable international regimes will also be identified. I will further deal with the major issues and concerns regarding the provisions of Chapter 6 and their implications on the rights of creditors, the main focus being the possible abuse that the procedure may bring about when rendering the company temporarily immune to actions by creditors. Although it is not the main aim of this research to discuss the requirements of business rescue, I will highlight them briefly to indicate how misinterpreting those provisions could affect creditors in the long run.

### **1.4 Key focus of the study**

Entrepreneurs and small business owners are potential creditors of businesses in rescue, therefore, when these businesses are under moratorium because of filing for rescue, creditors are at risk of potential “knock-on effects” when it comes to their own business liabilities pertaining to debtor businesses facing a turnaround.<sup>13</sup> This research aims at analyzing the effectiveness and

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<sup>10</sup> *Supra* note 8.

<sup>11</sup> Act 61 of 1973.

<sup>12</sup> Act 71 of 2008.

<sup>13</sup> *Supra* note 9 at page 58.

appropriateness of business rescue as compared to judicial management, while focusing on establishing its impact on the rights of creditors as “affected persons”<sup>14</sup> in terms of the Act. This will be done by looking at how far Chapter 6 goes in protecting the interests of creditors in practice and by comparing the South African regime with several international regimes such as Australia, the United States of America and the United Kingdom.

## **1.5 Research Methodology**

The research paper will be structured into four (4) chapters in order to give a comprehensive analysis of Chapter 6 of the Act.

Chapter one (1) is the present one introducing the topic, research problem and key references. This chapter aims at giving a brief background of the topic, stating the problem statement and what the research seeks to achieve and also give definitions of terms that will be used throughout the dissertation.

Chapter two (2) will deal with the historical background of the corporate rescue in South Africa and also a transition from judicial management to business rescue. The aim of this chapter is to establish the differences between business rescue in the new Act and judicial management in the 1973 Act.

Chapter three (3) will focus on business rescue as defined in the Act, analyzing its requirements and the procedure at large. This chapter seeks to explore the possibility of creditors being abused by the procedure and whether or not the Act adequately protects the interests of creditors.

Chapter four (4) will look at the shortcomings and strengths of South African business rescue regime as compared to corporate rescue in foreign international countries and the conclusion will be included here. This chapter is intended to

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<sup>14</sup> An affected person, in terms of section 128(1) (a) of the Act, includes shareholders or creditors of the company, any registered trade union representing employees of the company and/or unrepresented employees.

analyze whether or not the South African regime complies with international standards and if there is a need for reform.

## 1.6 Key References, terms and definitions

The following definitions are derived from both the Companies Act 61 of 1973 and the Companies Act 71 of 2008 and will be used throughout the research:

**“Business rescue”**<sup>15</sup> is defined in the Act as proceedings that facilitate the rehabilitation of a company that is financially distressed by providing for

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- i. The temporary supervision of the company, and of the management of its affairs, business and property;
- ii. The temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and
- iii. The development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equity in a manner that maximizes the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the company’s creditors or shareholders than would result from the immediate liquidation of the company;

**“Business rescue plan”**<sup>16</sup> means a plan contemplated in section 150 of the Companies Act 71 of 2008.

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<sup>15</sup>Section 128(1)(b).

<sup>16</sup> Section 128(1)(c).

**“Judicial Management”**<sup>17</sup> is not defined in both Act 61 Of 1973 and Act 61 of 2008. However, section 427(1) of 1973 Act provides that ‘when any company by reason of mismanagement or for any other cause –

- a) Is unable to pay its debts or is probably unable to meet its obligations; and
- b) Has not become or is prevented from becoming a successful concern, and there is a reasonable probability that, if it is placed under judicial management, it will be enabled to pay its debts or to meet its obligations and become a successful concern, the court may, if it appears just and equitable, grant a judicial management order in respect of that company.

**“Financially distressed”**<sup>18</sup> means any particular company, which, at any particular time –

- i. 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 six months; or
- ii. Appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months;

**“Affected persons”**<sup>19</sup> refers to a shareholder or creditor of a company, any registered trade union representing employees of the company and/or if any employees of the company are not registered by a registered trade union, each of those employees or their respective representatives.

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<sup>17</sup> Section 427(1).

<sup>18</sup> Section 128(1)(f).

<sup>19</sup> Section 128(1)(a).

## Chapter 2

### HISTORICAL BACKGROUND

#### 2.1 A historical overview of the rescue culture in South Africa

South Africa has traditionally relied on liquidation as a procedure to be followed when a company was in financial trouble and was faced with insolvency.<sup>20</sup> The concept of judicial management had always been regarded as a progressive step towards the corporate rescue of ailing companies.<sup>21</sup> The granting of a liquidation order meant not only the demise of the corporate entity and the attendant loss of jobs, but also an invariably unsatisfactory pro rata share in the residue for unsecured creditors, and the abandonment of claims when such are not proved.<sup>22</sup>

Whereas a liquidation aims at extracting whatever money or value remains from a failed debtor-business in order to settle claims against it, corporate rescue legislation provides for a restructuring of the financial structure of an ailing debtor involving the issuance of a new debt and equity in accordance with the claimant's priorities<sup>23</sup> to save the business as a going concern and to facilitate, among other things, the settlement of claims against the business in full.<sup>24</sup>

Traditionally, insolvency law emphasized the settlement of creditors' claims, however, central to the philosophy of contemporary trends is the idea that 'insolvency law should generally reflect the hypothetical agreement that creditors would reach if they were to bargain amongst themselves before extending credit to the company',<sup>25</sup> thus also placing emphasis on the protection of creditors'

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<sup>20</sup> *Supra* note 2.

<sup>21</sup> Swart, WJC. 'Business rescue: Do employees have better (reasonable) prospects of success?' Commentary on *Employees of Solar Spectrum Trading 83 (Pty) Limited v AFGRI Operations Limited*. 2014. (North Gauteng High Court, Pretoria (unreported) 2012-05-16 Case no 6418/2011; 18624/2011; 66226/2011; 66226A/11). *Obiter* at page 406-420.

<sup>22</sup> *Supra* note 8.

<sup>23</sup> Smits, A. 'Corporate administration: A proposed model'. 1999. *De Jure*, Volume 32 at page 81.

<sup>24</sup> *Supra* note 22.

<sup>25</sup> McCormack, G. 'Corporate rescue Law: An Anglo-American Perspective'. 2008 at page 23.

individual rights *vis-à-vis* one another.<sup>26</sup> South African company law has made provision for a formal corporate business rescue procedure in the form of judicial management since its inception of the Companies Act 46 of 1926.<sup>27</sup>

However, judicial management was never regarded as an effective rescue measure for companies in financial distress.<sup>28</sup> One of the reasons for its failure was the conservative and restrictive approach of courts to the interpretation of the provisions relating to judicial management, especially section 427(1) of the 1973 Act.<sup>29</sup> Loubser<sup>30</sup> stipulates, moreover, that a large part of its failure may be attributed to the judiciary continuing to rely on cases decided under the Companies Act of 1926 as those judgments were based on differently worded provisions. Furthermore, judicial management may have failed due to the fact that its main emphasis has been placed on the protection of interests of creditors, similar to the situation in a winding-up, rather than on the rescue of the business itself.

## **2.2 Judicial management in terms of Companies Act 61 Of 1973**

Although the 1973 Act does not provide for a definition of judicial management, section 427(1) of the 1973 Act stipulates that,

‘when a company by reason of mismanagement or for any other cause... is unable to pay its debts or probably unable to meet its obligations... and... has not become or is prevented from becoming a successful concern, and there is a reasonable probability that, if it is placed under judicial management, it will be enabled to pay its debts or to meet its obligations

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<sup>26</sup> *Supra* note 22.

<sup>27</sup> *Supra* note 1.

<sup>28</sup> *Le Roux Hotel Management (Pty) Ltd v E Rand (Pty) Ltd* [2001] 1 All SA 223(C) at 238.

<sup>29</sup> See *Silverman v Doornhoek Mines Ltd* 1935 TPD 350 at 353.

<sup>30</sup> *Supra* note 3.

and become a successful concern, the court may, if it appears just and equitable, grant a judicial management order in respect of that company.’

The purpose of judicial management was, therefore, to enable a company suffering a temporary set-back due to mismanagement or other special circumstances,<sup>31</sup> to once more become a successful business concern by placing it in the hands of a judicial manager<sup>32</sup> who took the company with the sole purpose of restoring it into a state of profitability and optimum performance.<sup>33</sup> This basically meant that a judicial management order vested the management of an unsuccessful company in a judicial manager under the supervision of a court where the court was satisfied that the company had the potential of becoming a successful concern.<sup>34</sup>

In essence, judicial management was not to be instituted or continued as an alternative method of liquidation<sup>35</sup> and it should not be initiated or continued merely on the basis that while it subsisted the company’s assets might be sold more advantageously.<sup>36</sup> The 1973 Act gave the power to apply for a judicial management order to the same persons that are entitled to apply in terms of section 346 for the winding up of a company.<sup>37</sup> Therefore, the application may be made by a company itself through a resolution by board of directors or it may be made by creditors (including contingent or prospective creditors), one or more of its members<sup>38</sup> or jointly by any of them.<sup>39</sup>

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<sup>31</sup> Henning, JJ. ‘Judicial management and corporate rescues in South Africa’. 1992. *Tydskrif vir Regswetenskap*, Volume 17(1).

<sup>32</sup> Section 1 of the Companies Act of 1973 defines a judicial manager as the final judicial manager referred to in section 432.

<sup>33</sup> *Supra* note 2.

<sup>34</sup> See section 427 and 432 of the Companies Act of 1973.

<sup>35</sup> *Millman NO v Swartland Huis Meubileerders (Edms) Bpk* 1972 (1) SA 741 9 (C).

<sup>36</sup> *Supra* note 8.

<sup>37</sup> Section 427(2) of the 1973 Act.

<sup>38</sup> Such creditors must have been registered as a member for at least six months immediately before the application. Section 346 (2).

<sup>39</sup> Section 346 (1) of the 1973 Act.



Cilliers and Benade<sup>40</sup> describes briefly the sequence of events in the judicial management process as follows:

“An interested party applies to a local or provincial division of the supreme court to have a company placed under judicial management. The application may be by the company itself, a creditor, a member, or one or more of these jointly.”

### **2.3 Grounds for application of judicial management**

In terms of section 427(1),<sup>41</sup> the first requirement for the granting of a judicial management order was that the company must be unable to pay its debts or unable to meet its obligations. Since there is no provision in terms of which a company will be deemed to be unable to pay its debts for the purposes of a judicial management application,<sup>42</sup> the inability to pay debts, also referred to as commercial insolvency, must be proved. The Act further provides for inability to meet obligations as an alternative to inability to pay debts.

The second requirement was that the company has not been prevented from becoming a successful concern.<sup>43</sup> The Act does not indicate at what point or under what circumstances a company would be regarded as not being a successful concern and this therefore, makes it rather difficult to prove.<sup>44</sup> The third requirement was that there must be a reasonable probability that the company will be in the position to pay its debts or meet its obligations and become a successful concern within a reasonable time.<sup>45</sup> A heavy burden was

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<sup>40</sup> Cilliers, HS., and Benade, ML. ‘Corporate law’. 1987. Durban: Butterworths.

<sup>41</sup> Companies Act 61 of 1973.

<sup>42</sup> Section 345 of the 1973 Act, which describes these circumstances for the purposes of an application for winding up of a company, has not been made applicable to judicial management.

<sup>43</sup> Section 427(1)(a) and (b) of the 1973 Act.

<sup>44</sup> Sher, LJ. ‘The Appropriateness of Business Rescue as opposed to Liquidation: A critical analysis of the requirements for a successful business rescue order as set out in section 131(4) of the Companies Act 71 of 2008’.

(LLM dissertation [unpublished]: University of Johannesburg, 2013). Retrieved from: <https://ujdigispace.uj.ac.za> (Accessed on: 10<sup>th</sup> June 2015).

<sup>45</sup> Section 427(1) of the Companies Act 61 of 1973.

placed on the applicant to prove this requirement,<sup>46</sup> and the success of the application was dependent upon the court's discretion. In the case of *Tenowitz v Tenny Investments*<sup>47</sup>, the court refused to grant a final order of judicial management due to the fact that the applicant had not discharged the onus of proving that the company would become a successful concern in a reasonable period of time.

The last but not least requirement was that the application for an order of judicial management must be just and equitable, meaning that judicial management must be the most appropriate measure to the situation at hand. This requirement was taken over from the requirements for judicial management contained in the Companies Act of 1926<sup>48</sup> where it was set in a completely different situation, namely where a court was authorized to issue an order for judicial management even though the application before it was for the winding up of the company.<sup>49</sup>

## **2.4 The provisional judicial management order**

Where the applicant has satisfied the court by meeting all the requirements, the court had the discretion to grant a provisional judicial management order, dismiss the application or make any other order it may deem fit.<sup>50</sup> The introduction of a provisional order was recommended in the Van Wyk de Vries Report<sup>51</sup> to provide a chance for creditors in particular to voice their opinion and oppose the making of a final order if they wished to do so.<sup>52</sup> A provisional judicial management order had to state a return date on which the court the court will

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<sup>46</sup> *Supra* note 41.

<sup>47</sup> 1979 (2) SA 680 (E).

<sup>48</sup> Section 195.

<sup>49</sup> See Loubser "Judicial Management" at 147-150 for a discussion of the origins and history of this requirement and the resulting incorrect interpretation attached to it.

<sup>50</sup> Section 428(1) of Companies Act 1973.

<sup>51</sup> Paragraph 51.05 at 55.

<sup>52</sup> *Supra* note 1.

decide whether to grant the final order.<sup>53</sup> The return day may not be more than sixty days after the date of the provisional order.<sup>54</sup>

Upon the granting of a judicial management order, the Master of the High court has the duty to appoint a provisional judicial manager.<sup>55</sup> The effect of the provisional judicial management order is the vesting of all the property of the company in the custody of the Master until the appointment of the provisional judicial manager.<sup>56</sup> One of the duties of a provisional manager as set out in section 430 of the 1973 Act is to prepare a report containing a description of the general state of affairs of the company, a list of the company's assets and liabilities with details of each creditor and his claim, an explanation of the reasons for the company's problems and how the capital required to continue the business will be raised.<sup>57</sup> The provisional judicial manager is also required to view out his opinion on the prospects of the company becoming a successful concern and the removal of the facts or circumstances that are preventing the company from becoming a successful concern.<sup>58</sup>

After a provisional judicial management order has been made, it is the duty of the Master to convene separate meetings of creditors, members and debenture holders of the company<sup>59</sup> in order to consider the above-mentioned report of the provisional manager and decide whether judicial management is desirable; nominate a person for appointment as final judicial manager if the order is made final; give creditors the opportunity to prove their claims against the company; and to decide whether the creditors should pass a resolution to accord preference

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<sup>53</sup> Section 428(1).

<sup>54</sup> Section 432(1). This date may, however, be extended by the court on good cause shown.

<sup>55</sup> Section 429(b) (1).

<sup>56</sup> Section 429(a).

<sup>57</sup> Section 430(c) (i)-(v).

<sup>58</sup> Section 430(c) (vi).

<sup>59</sup> Section 429(b) (ii).

over unsecured pre-judicial management claims to post-commencement liabilities incurred in the company's business during judicial management.<sup>60</sup>

## 2.5 The judicial management order

Section 432(2) of the 1973 Companies Act stipulates that the court must consider the opinions and wishes of creditors and members of the company as reported by the chairperson as well as the reports of the provisional judicial manager, the Master and the Registrar of Companies on the return day stated in the provisional management order. The court may, therefore, grant a final judicial management order if it appears that the order will enable the company to become a successful concern and that it is just and equitable.<sup>61</sup>

The final judicial order must direct that the management of the company will vest in the final judicial manager, subject to the supervision of the court, and order the provisional judicial manager to hand over all matters to the final judicial manager if he is not the same person.<sup>62</sup> However, it must be borne in mind that the court may alternatively discharge the provisional order<sup>63</sup> and make any other order it may deem just.<sup>64</sup>

Although a judicial manager takes over the control and management of the company, he has no authority to dispose of the company's assets except in the ordinary course of the company's business or with the approval of the court.<sup>65</sup>

The terms of the final judicial management order may be varied by the court that granted it, on application by the Master, the final judicial manager or a

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<sup>60</sup>Section 431(2).

<sup>61</sup>Section 427(1).

<sup>62</sup>Section 432(3) (a).

<sup>63</sup>Section 346(1) (f) specifically authorizes a provisional judicial manager to apply for the winding up of the company if the provisional judicial management order is discharged.

<sup>64</sup>Section 432(2).

<sup>65</sup>Section 434(1). A judicial manager was given leave by the court to sell all the assets of the company as a going concern in *Ex Parte Vermaak* 1964 (3) SA 175 (o) and in *Ex Parte Joubert* 1970 (3) SA 511 (T), but in *Ex Parte Paterson NO: In re Goodearth Estates (Pty) Ltd* 1974 (4) SA 281 (E) it was refused.

representative acting on behalf of the general body of creditors by virtue of a resolution passed by a majority in value and number of them at a creditors' meeting.<sup>66</sup>

## 2.6 The Moratorium

The moratorium may be defined simply as the temporary suspension of all activities against the company through some form of agreement.<sup>67</sup> Upon the issuing out of a provisional judicial management order, it may be ordered that all actions, proceedings, execution of all writs, summonses and other processes against the company be stayed during judicial management and proceed only with the leave of court.<sup>68</sup> Section 432(3) does not provide for a moratorium in the case of a final judicial management order, but it is assumed that it will be automatically be included if a provisional order containing a moratorium is made final.

## 2.7 Termination of judicial management

There is no stipulated time period for the duration of judicial management in the Companies Act of 1973 and as a rule the order is granted for an indefinite period.<sup>69</sup> Judicial management may, therefore, be terminated by an order of the court that granted the judicial management order.<sup>70</sup> An order for cancellation of a judicial management order may be done by the judicial manager or any person having an interest in the company.<sup>71</sup> Section 433(1) of the 1973 Act compels the

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<sup>66</sup>Section 432(4).

<sup>67</sup> Hornby *Oxford Advanced Learners' Dictionary*, 1995.

<sup>68</sup> Section 428(2).

<sup>69</sup> In *Keens Electrical (Jhb) (Edms) Bpk en 'n Ander v Lightman Wholesalers (Edms) Bpk* 1979 (4) SA 186 (T) at 189, De Villiers AJ stated that the court had a discretion to determine a fixed period for judicial management but it was usually undesirable to do so.

<sup>70</sup>Section 440(1).

<sup>71</sup> Section 440(1).

judicial manager to apply for the cancellation of the judicial management order and for an order for the winding up of the company if he comes to the conclusion during the process that judicial management will not succeed.

## **2.8 Conclusion**

Needless to say, the South African law has always preferred liquidation in spite of the fact that a statutory procedure of judicial management for the rescue of insolvent companies has been available for almost a century. There has always been a debate on the fact that the old judicial management needed fine-tuning rather than an outright replacement, however, the complete overhaul of the 1973 Act invited an opportunity to throw the old regime overboard and by the time the 2008 Act was enacted in 2009, reform in this area was long overdue.<sup>72</sup>

Judicial management was a stepping stone for the business rescue regime in South Africa, and it also served as an alternative measure to liquidation for companies in financial distress. Although it became a failure in the long run, judicial management helped in shaping the South African business rescue regime into what it is today because the legislature took note of why judicial management failed and sought to address that in Chapter 6.

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<sup>72</sup> *Supra* note 8.

## Chapter 3

### BUSINESS RESCUE PROCEEDINGS

#### 3.1 Introduction

The failure of a company affects not only its shareholders and creditors, but also employees, suppliers, distributors and customers: whole communities could experience serious socio-economic problems when a large company in their area collapses.<sup>73</sup> It is therefore important to attempt to rescue a company a company that is suffering from a temporary setback but has the potential to survive if it is given some breathing space to overcome its financial woes.<sup>74</sup>

South African's new regime of business rescue contained in Chapter 6 of the Companies Act 71 of 2008 has been welcomed as a long-overdue replacement for judicial management.<sup>75</sup> The regime is designed to resolve a company's future direction quickly by appointing an independent and suitably qualified person, referred to as a business rescue practitioner<sup>76</sup> to take full control of the company and try to work out a way to save the business.<sup>77</sup> The new procedure was also aimed at aligning South Africa's new rescue procedure with those international jurisdictions such as the United States of America, the United Kingdom and Australia.<sup>78</sup>

In what has been described as a "shift away" from the traditional creditor-oriented approach that prevailed in South Africa under the previous 1973 Act, the involvement of the debtor company itself in the rescue is the most noteworthy

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<sup>73</sup>Davis *et al.* 'Companies and other business structures'. 2009. 1<sup>st</sup> edition.

<sup>74</sup> *Supra* note 74.

<sup>75</sup> Klopper, H., and Bradstreet, R. 'Averting liquidations with Business rescue: Does a section 155 compromise place the bar too high?' 2014. *Stellenbosch Law Review*, volume 25 at page 549.

<sup>76</sup> Section 128(1)(d) defines a business rescue practitioner as one or more persons appointed to oversee the affairs of a financially distressed company during the business rescue procedure.

<sup>77</sup> Pretorius, M., and Rosslyn-Smith, W. 'Expectations of a business rescue plan: international directives for Chapter 6 implementation.' 2014. *Southern African Business Review*, Volume 18(6) at page 113.

<sup>78</sup> Joubert, EP. 'Reasonable possibility versus reasonable prospect: Did business rescue succeed in creating a better test than judicial management?' 2013. *THRHR*, Volume 76.

feature of a “debtor-friendly” system incorporated in the new rescue legislation.<sup>79</sup> Bradstreet<sup>80</sup> states that this shift in emphasis from a primarily creditor-friendly dispensation is, however, likely to affect the interests of various parties (more especially creditors) in different ways, giving rise to new issues for courts to confront.

### **3.2 Definition and purpose of business rescue in the new Companies Act 71 of 2008**

Business rescue, as defined by the Act, refers to the proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for the temporary supervision of the company and the management of its affairs, business and property, as well as a temporary moratorium on the rights of the claimants against the company or in respect of property in its possession.<sup>81</sup> The new business rescue regime has been developed from similar concepts in other jurisdictions, in particular in the United States of America and Great Britain and is intended to provide a reasonable balance between the interests of the debtor company, which is given the opportunity to prepare a rescue plan with some protection from action by creditors, and the creditors themselves who have a right to vote on the plan.<sup>82</sup>

The new procedure for business rescue, therefore, is intended to give effect to one of the purposes of the Act contained in section 7k.<sup>83</sup> This purpose is to “provide for the efficient rescue and recovery of financially distressed companies

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<sup>79</sup> *Supra* note 74.

<sup>80</sup> Bradstreet, R. ‘The leak in the Chapter 6 Lifeboat: Inadequate regulation of business rescue practitioners may adversely affect lender’s willingness and the growth of the economy’. 2010. *South African Mercantile Law Journal*, Volume 22. Emphasis also added.

<sup>81</sup> Section 128 (1)(b) of the Companies Act 71 of 2008. See also Pretorius, M. and Rosslyn-Smith, W. ‘Expectations of a business rescue plan: international directives for Chapter 6 implementation.’ 2014. *Southern African Business Review*, Volume 18(6) at page 112.

<sup>82</sup> Rushworth, J. ‘A critical analysis of the Business rescue regime in the Companies Act 71 of 2008.’ *Acta Juridica: Modern company law for a competitive South African Economy*.

<sup>83</sup> *Supra* note 45.



in a manner that balances the rights and interests of all relevant stakeholders.” Needless to say, the new business rescue mechanism is broadly accessible and strikes a better balance between the interests of stakeholders generally than was previously the case under judicial management.<sup>84</sup>

### **3.3 Initiation and commencement of business rescue proceedings**

Business rescue proceedings (hereinafter referred to as “the proceedings”) are commenced by way of a resolution passed by directors of the company or by a shareholder, creditor, trade union or employee applying to the court for an order to place the company under supervision.<sup>85</sup> The Act provides that the Judge President of the High Court may designate a judge of the court as a specialist to determine issues relating to commercial matters, commercial insolvencies and business rescue.<sup>86</sup> If the proceedings are commenced by the directors, section 130 sets out the grounds of objections by certain interested parties.

#### **3.3.1 Commencement of business rescue by voluntary board resolution**

The board of directors may pass a resolution by majority vote (or by the majority of the board giving written consent) that the rescue proceedings should begin and that the company be placed under the supervision of a business rescue practitioner.<sup>87</sup> The board must have reasonable grounds to believe that the company is financially distressed and there appears to be a reasonable prospect of rescuing it.<sup>88</sup> A company is deemed to be ‘financially distressed’ at any particular time if:

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<sup>84</sup> *Supra* note 79.

<sup>85</sup> Section 129 and 131 of Act 71 of 2008.

<sup>86</sup> Section 128(3).

<sup>87</sup> Section 129(1).

<sup>88</sup> *Supra* note 83.

- i. It is unable to pay its debts as they fall due and payable within the immediately following six months;
- ii. It appears to be reasonably likely that the company will become insolvent within the ensuing six months.<sup>89</sup>

There are a number of restrictions to the passing of a resolution commencing business rescue proceedings and, in addition, publicity requirements.<sup>90</sup> The proceedings may not commence if liquidation proceedings have been initiated by or against the company and the resolution to commence the proceedings will have no force until it has been filed at the Companies and Intellectual Property Commission (CIPC) in the manner and form prescribed.<sup>91</sup> Within five business days of adopting and filing a resolution<sup>92</sup>, the company must publish a notice of the resolution to every affected person, with a sworn statement of the facts relevant to the grounds in respect of which the board resolution was founded.<sup>93</sup>

A qualified business rescue practitioner must also be appointed within this period to oversee the company during the proceedings and he must express his consent to the appointment in writing.<sup>94</sup>

At any time after the adoption of a board resolution commencing the proceedings until a business plan is adopted, an affected person may apply to a court for an order to set aside the resolution or to set aside the appointment of the business rescue practitioner.<sup>95</sup> However, the directors who voted in favor of a resolution commencing the proceedings may not apply to the court to set aside the resolution or the appointment of the practitioner, unless the court consents on certain specified grounds.<sup>96</sup> A copy of an application to set aside either the resolution or the appointment of the practitioner must be served by the applicant

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<sup>89</sup> Section 128(1) (f).

<sup>90</sup> *Supra* note 79.

<sup>91</sup> Section 129(2).

<sup>92</sup> With the possibility of an extension of this period by the Commission.

<sup>93</sup> Section 129(3) (a).

<sup>94</sup> Section 129(3) (b).

<sup>95</sup> Section 130(1).

<sup>96</sup> Section 130(2).

on the company and the Commission.<sup>97</sup> It remains the discretion of the court to decide on the application and it may, for instance, set aside the resolution on the grounds set out in the Act or if it considers it is just and equitable to do so.

When setting aside the resolution to commence the proceedings, the court may make additional orders, for instance, it may order that the company be placed under liquidation or an order for costs against any directors who voted in favor of the resolution to commence the proceedings if there were no reasonable grounds for believing that the company would be unlikely to pay its debts as they became due and payable.<sup>98</sup> Moreover, in appropriate circumstances, if the court sets aside the appointment of the practitioner, it must appoint an alternate practitioner recommended by, or acceptable to, the holders of a majority of the voting interests of independent creditors who were represented at the hearing before the court.<sup>99</sup>

### **3.3.2 Commencement by court order**

In terms of section 131(1)<sup>100</sup>, any ‘affected person’<sup>101</sup> may apply to court at any time for an order placing the company under supervision and commencing business rescue proceedings.<sup>102</sup> There are various requirements that must be met before the court could consider granting an order in favor of an applicant; firstly, the applicant must notify each affected person in the prescribed manner and serve a copy of the application on the company as well as the commission.<sup>103</sup> Secondly, the court may only make an order provided it is satisfied in terms of section 131(4)(1)(a)(i)-(iii) that;

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<sup>97</sup> Section 130(3) (a).

<sup>98</sup> Section 130(5) (c).

<sup>99</sup> Section 130(6).

<sup>100</sup> Companies Act 71 of 2008.

<sup>101</sup> Defined in section 128(1) (a) of the 2008 Act and in the first chapter of this dissertation.

<sup>102</sup> Wassman, B. ‘Business Rescue – Getting it right.’ 2014. *De Rebus*.

<sup>103</sup> Section 131(2) (a) and (b).

- i. The company is financially distressed;
- ii. The company has failed to pay over any amount in terms of an obligation under or in terms of a public regulation, or contract, with respect to employment-related matters; or
- iii. It is otherwise just and equitable to do so for financial reasons and there is a reasonable prospect for rescuing the company.

Should the court not be satisfied, it may dismiss the application and give any appropriate order including a liquidation order.<sup>104</sup>

### **3.4 Duration of Business rescue proceedings**

Business rescue proceedings do not have an automatic termination through effluxion of an allocated time period.<sup>105</sup> However, the underpinning approach to the duration of business rescue proceedings is that the business rescue practitioner is expected to perform his or her functions swiftly, efficiently and cost-effectively.<sup>106</sup> Underlying the strict time limits imposed by the Act is a degree of urgency and therefore, the quicker the process, the less the prejudice to creditors, employees and other parties.<sup>107</sup> Instead of an automatic termination provision, the Act implicitly contemplates that the business rescue process should end within 90 days, subject to an extension of time granted by the court.<sup>108</sup> Failing which, a business rescue practitioner must

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<sup>104</sup> Section 131(4)(1)(b).

<sup>105</sup> *Supra* note 98.

<sup>106</sup> Cassim, FH. et al. 'The law of business structures'. 2012. Juta publications. [www.jutalaw.co.za](http://www.jutalaw.co.za).

<sup>107</sup> *Supra* note 103.

<sup>108</sup> Section 132(3).

prepare a progress report, update it at the end of every subsequent month until the end of the proceedings, deliver the report and each update in the prescribed manner to each affected person and to the court (if the proceedings have been the subject of a court order) or to the Commission in any other case.<sup>109</sup>

According to Loubser<sup>110</sup> the period of three months is fairly unrealistic and would be quite insufficient in most cases, which will result in either a substantial administrative burden for the practitioner, with added costs for the company as a result of this duty, or the costs of applying to court for an extension in order to avoid having to prepare and deliver the monthly updates. Loubser suggests that a period of 12 to 18 months would have been far more realistic to allow sufficient time for the rescue plan that may be necessary, as well as for proper implementation of the plan.

Moreover, in terms of section 132(2), business rescue proceedings may be terminated in one of the three ways:

- i. By an order of court that either sets aside the resolution or order commencing the proceedings, or converts the proceedings to liquidation proceedings;

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<sup>109</sup>Section 132(3) (a) and (b).

<sup>110</sup> Loubser, A. 'The business rescue proceedings in the Companies Act of 2008: concerns and questions (Part2)'. 2010. *TSAR*, Volume 4.

- ii. By the filing of a notice by the business rescue practitioner; or
- iii. By the rejection or substantial implementation of a business rescue plan.

### **3.5 THE LEGAL CONSEQUENCES OF A BUSINESS RESCUE ORDER**

#### **3.5.1 The Moratorium (Automatic Stay of proceedings)**

The Act provides for significant restrictions against any action by third parties against the company, its property or property in its possession during the course of the business rescue proceedings, subject to certain exceptions.<sup>111</sup>

The moratorium is of cardinal importance to business rescue, since it provides the crucial breathing space or a period of respite during which the company is given the opportunity to reorganize and reschedule its debts and liabilities.<sup>112</sup>

Cassim *et al*<sup>113</sup> stipulate that during this period, the business rescue practitioner has the opportunity to formulate a business rescue plan designed to achieve the purpose of the rescue process.

##### **3.5.1.1 Moratorium on legal proceedings against the company**

During business rescue proceedings, no legal proceeding (including enforcement action) against the company, or in relation to any property belonging to or in the lawful possession of the company, may be commenced or proceeded with in any forum, except with the written consent of the practitioner or with the leave of the court and in accordance with such terms the court considers suitable.<sup>114</sup> If any right to commence proceedings or otherwise assert a claim against the company

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<sup>111</sup>Section 133.

<sup>112</sup> *Supra* note 103.

<sup>113</sup> The law of business structures. 2012.

<sup>114</sup>Section 133(1)(a)-(b). See also Sharrock *et al.* Hockly's Insolvency Law. 2012. 9<sup>th</sup> edition.

is subject to a time limit, the measurement of that time must be suspended during the company's business rescue proceedings.<sup>115</sup>

However, the moratorium on legal proceedings does not apply to certain proceedings such as:

- i. Criminal proceedings against the company or any of its directors or officers;<sup>116</sup>
- ii. Proceedings against the company by a regulatory authority in the execution of its duties – the authority may continue with the proceedings after written notification to the business rescue practitioner;<sup>117</sup>
- iii. Proceedings concerning any property or right over which the company exercises the powers of a trustee;<sup>118</sup>
- iv. Proceedings instituted as a set-off against any claim made by the company itself in any legal proceedings.<sup>119</sup>

### **3.5.1.2 Moratorium on property interests**

According to Sharrock<sup>120</sup>, while a company is subject to rescue proceedings, it may dispose, or agree to dispose, of its property only:

- i. In the ordinary course of business;
- ii. In a *bona fide* transaction concluded at arm's length for fair value approved in advance and in writing by the practitioner; or
- iii. In a transaction contemplated by, and undertaken as part of, the implementation of an approved business rescue plan.<sup>121</sup>

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<sup>115</sup>Section 133(3).

<sup>116</sup>Section 133(1)(d).

<sup>117</sup>Section 133(1)(f).

<sup>118</sup>Section 133(1)(e).

<sup>119</sup>Section 133(1)(c).

<sup>120</sup>Hockly's Insolvency law. 2012. 9<sup>th</sup> edition.

<sup>121</sup>Section 134(1)(a).

However, the company may validly dispose of property subject to a security or title interest provided prior consent of the holder of the interest was obtained, unless the proceeds of the disposal would be sufficient to fully discharge the secured or protected debt.<sup>122</sup> Section 134(1)(c) prohibits others persons from exercising any rights in respect of property lawfully in the possession of the company , except to the extent that the practitioner consents in writing.

### **3.6 EFFECT OF THE PROCEEDINGS ON VARIOUS STAKEHOLDERS**

#### **3.6.1 Shareholders and directors**

Shareholders are included in the definition of ‘affected persons’, and as such, are entitled to receive notices of court proceedings, meetings and other relevant events concerning the business rescue proceedings.<sup>123</sup> So far as directors are concerned, they must continue to exercise their functions as directors during the proceedings, subject to the practitioner’s authority.<sup>124</sup> They also have a duty to the company to exercise management functions in the company as expressly instructed or directed by the practitioner, to the extent that it is reasonable to do so.<sup>125</sup>

Each director must attend to the requests of the practitioner at all times during the business rescue proceedings.<sup>126</sup> In addition to that, they must provide the practitioner with information about the company’s affairs as may be reasonably required.<sup>127</sup> The practitioner has the power to apply to court for an order removing a director from office.<sup>128</sup> Such an application may only be made on the grounds that the director has failed to comply with a requirement for the

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<sup>122</sup> Section 134(3)(a).

<sup>123</sup> Section 135(1).

<sup>124</sup> Section 137(2)(a).

<sup>125</sup> Section 137(2)(b).

<sup>126</sup> Section 137(3).

<sup>127</sup> Section 137(3).

<sup>128</sup> Section 137(5).



provisions of the Act,<sup>129</sup> or by act or omission, has impeded or is impeding the practitioner in the performance of his powers and functions, his management of the company or the development or implementation of a business rescue plan.<sup>130</sup>

### 3.6.2 Employees and contracts

The rights of employees during the business rescue proceedings are specifically set out in the 2008 Act<sup>131</sup>. Employees of the company who are employed immediately before the proceedings will continue to be employed on the same terms and conditions, save to the extent that there are changes in the ordinary course of attrition or the employees and the company agree on different terms and conditions, in accordance with applicable labor law.<sup>132</sup> It is, therefore, evident from the provisions of the Act that employees hold a significant position in the company and this is also seen in their inclusion in the definition of ‘affected persons’.

While the protection of employees is undeniably an important objective, doubts have been expressed about the appropriateness of the inclusion of employees in the definition of ‘affected persons’.<sup>133</sup> Loubser<sup>134</sup> submits that the benefits that business rescue process holds for employees may open the business rescue process to abuse by employees. A further argument can be made that an imbalance exists in the protection of the interests of employees when compared to the protection of creditors’ interests during business rescue proceedings.<sup>135</sup> This imbalance is evident in the preference given to employees’ claims for

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<sup>129</sup> Section 137(5)(a).

<sup>130</sup> Section 137(5)(b).

<sup>131</sup> Section 144.

<sup>132</sup> Section 136(1)(a).

<sup>133</sup> *Supra* note 22.

<sup>134</sup> ‘The business rescue proceedings in the Companies Act of 2008: Concerns and questions (Part 1)’. 2010. TSAR Volume 3.

<sup>135</sup> Joubert, T. *et al.* ‘Impact of labour law on South Africa’s new corporate rescue mechanism.’ 2011. *The International Journal of Comparative Labor law and Industrial Relations*, Volume 27(1).

remuneration that become due and payable during business rescue process.<sup>136</sup> Joubert *et al*<sup>137</sup> conclude that the legislature may have gone too far in the protection of employees and that this protection erodes the interests of creditors and especially those creditors who provided post-commencement finance.

### 3.6.3 Creditors

Adequate creditor protection is cardinal in ensuring the success of a business rescue as creditors feel that their interests are protected and would then allow the company to undergo a business rescue.<sup>138</sup> A good business rescue regime must therefore provide for this. In South Africa, creditors of the company are entitled to similar rights in a number of respects to those afforded to employees and employee representatives in respect of participation in business rescue proceedings.<sup>139</sup> Where creditors feel that a business rescue would best promote their interests, Chapter 6 provides protection by including them in the definition of ‘affected persons’<sup>140</sup> and also allowing any such person to apply to court for commencement of rescue proceedings.<sup>141</sup> The advantage of business rescue is that not only does it aim at maximizing the likelihood of the company’s existence on a solvent basis, but also aims at achieving a result that is more favorable for creditors than immediate liquidation.<sup>142</sup>

When the company is unable to exist on a solvent basis, the aim of business rescue is to return the company to a solvent position or alternatively pursue better returns for the creditors and shareholders.<sup>143</sup> The argument in favor of a

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<sup>136</sup> Section 135(1) read with section 135(3)(a).

<sup>137</sup> *Supra* note 136.

<sup>138</sup> Kaulungombe, KG. ‘Business rescue for Zambia: Suggestions for Legislative Reform’. (LLM dissertation, University of Cape Town, 2012).

<sup>139</sup> *Supra* note 74.

<sup>140</sup> *Supra* note 8.

<sup>141</sup> Section 131(1).

<sup>142</sup> *Supra* note 136.

<sup>143</sup> Section 7(k).

better return for creditors is based on the fact that the new dispensation, with its primary goal of preserving the business, seems to offer creditors a greater prospect of recovering in full and is perhaps therefore better aligned with creditors' primary interest in obtaining full recovery.<sup>144</sup>

The new business rescue legislation does, however, raise some concerns.<sup>145</sup> Amongst the recent spate of emerging case law on the business rescue provisions in chapter 6 of the Companies Act 71 of 2008, comes the decision of *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others*<sup>146</sup> which is of particular relevance to creditors who may have been concerned about a loss of protection under the new dispensation.<sup>147</sup> This case is of significance in that it has confirmed an interpretation of the meaning of 'business rescue' that embraces the protection of creditors.<sup>148</sup>

In the light of the new business rescue regime being viewed as a shift away from a more traditional creditor-oriented insolvency procedures that may be traced back to South Africa's English law roots, this case gives reassurance to creditors that their interests, although no longer of paramount importance, are afforded protection by the very definition of what business rescue seeks to achieve.<sup>149</sup> In delivering the unanimous decision of the full bench, Brand JA held<sup>150</sup> that 'business rescue' in terms of section 131(4) of the new Companies Act of 2008 means 'rehabilitation', which in turn means the achievement of either one of the two goals, namely to –

- i. Return the company to solvency; or

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<sup>144</sup> *Supra* note 136. See also Sher, L.J. 'The Appropriateness of Business Rescue as opposed to Liquidation: A critical analysis of the requirements for a successful business rescue order as set out in section 131(4) of the Companies Act 71 of 2008. (LLM dissertation [unpublished]: University of Johannesburg, 2013). Retrieved from: <https://ujdigispace.uj.ac.za> (Accessed on: 10<sup>th</sup> June 2015).

<sup>145</sup> *Supra* note 9.

<sup>146</sup> 2012 (3) SA 273 (GSJ).

<sup>147</sup> Bradstreet, R. 'Business rescue proves to be creditor-friendly: CJ Claassen J's analysis of the new business rescue procedure in *Oakdene Square Properties*.' 2013. *South African Law Journal*.

<sup>148</sup> Bradstreet, R. 'Lending a helping hand: the role of creditors in business rescue?'

<sup>149</sup> *Supra* note 148.

<sup>150</sup> Paragraph 26.

- ii. Provide a better deal for creditors and shareholders than what they would receive through liquidation.

Although the circumstances of *Oakdene Square Properties* will certainly not be typical to any business rescue application, the case is useful in that it provides an illustration of how creditors' interests will be weighed *vis-à-vis* the interests of the financially distressed company.<sup>151</sup> A creditor should, therefore, where appropriate, be entitled to liquidation of the debtor company as a means of obtaining repayment of debts owed when the company finds itself in financial distress.<sup>152</sup>

In South Africa, the level of protection afforded to secured and unsecured creditors differs. The debate on the balance in the protection of secured creditors and unsecured creditors is an old-age debate and one that often arises in general company law.<sup>153</sup> McCormack<sup>154</sup> advances several reasons for which secured creditors should enjoy a priority over unsecured creditors. One reason is that the secured creditor seeks to maximize the debtor's insolvency and take control of the assets in order to oblige the debtor to pay.<sup>155</sup> Another reason is that the secured creditor will be able to sell off or take possession of the debtor's assets without having to seek judicial or other official intervention.

### **3.7 Post-commencement finance**

Post-commencement finance refers to the funding made available to a company to enable it to continue trading after the commencement of business rescue

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<sup>151</sup> *Supra* note 103.

<sup>152</sup> *Supra* note 139

<sup>153</sup> *Supra* note 139.

<sup>154</sup> McCormack, G. 'The Priority of secured Credit: An Anglo American Perspective'. 2003. *Journal of Business Law* at page 391.

<sup>155</sup> *Supra* note 155.

proceedings.<sup>156</sup> It is critical for the company in distress to have access to funds to be able to pay for crucial day to day costs.<sup>157</sup> However, according to Davis *et al*<sup>158</sup> it can be very difficult for a company for a company to obtain capital when it is subject t business rescue proceedings, as creditors will be concerned that they may not be paid. Section 135(2) provides a solution to this problem by allowing the company to use its assets as security for such loans and states that these creditors, irrespective of whether they were given security for their claims, must be repaid before any other unsecured creditors.

According to the World Bank’s publication on “Principles for effective Creditor rights and insolvency systems”, one of the principles for successful post-commencement financing is found in Principle C9 which provides as follows:

*“Subject to appropriate safeguards, the business should have access to commercially sound forms of financing, including on terms that afford a repayment priority under exceptional circumstances, to enable the debtor to meet its on-going business needs.”*<sup>159</sup>

Post-commencement finance is undoubtedly, therefore, one of the most important aspects of business rescue as new financing after a company commences business rescue proceedings is ‘critical to the survival and turnaround of the company’s business’.<sup>160</sup> Unless new finance is available, the assets of the company may have to be sold on a piecemeal basis and the company forced into liquidation.<sup>161</sup>

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<sup>156</sup>Habi, MH. ‘A comparative study of some issues relating to corporate insolvency law in Nigeria and South Africa’. (LLM dissertation, University of Pretoria, 2013).

<sup>157</sup>Du Preez, W. ‘The status of post-commencement finance for business rescue in South Africa’. (MBA dissertation, Gordon Institute of Business Science, University of Pretoria, 2012).

<sup>158</sup>Companies and other business structures. 2009.

<sup>159</sup> World Bank. ‘Insolvency and Creditor rights’. 2005. Retrieved on 8<sup>th</sup> September 2015, from the World Bank Group: Reports on the Observances of Standards and Codes: [http://www.worrlbank.org/ifa/rosc\\_icr.html](http://www.worrlbank.org/ifa/rosc_icr.html).

<sup>160</sup>*Supra* note 107.

<sup>161</sup> McCormack, G. ‘Super priority new financing and corporate rescue’. 2007. *Journal of Business Law* at page 1.

Section 135 of the Companies Act tries to persuade possible financiers to provide finance to companies in distress in exchange for preferential repayment of that finance. This finance may be secured to the lender by the use of the company's unencumbered assets and will be paid after the practitioner's remuneration, expenses and the employee post commencement financiers are paid.<sup>162</sup>

Hutchison<sup>163</sup> stipulates that the post commencement finance as provided for in the Companies Act shows no sign of being favorable to secured creditors because the interests of the secured creditors are taken into consideration. This is evident from the balance that section 135<sup>164</sup> strikes in favor of secured creditors. Moreover, although the favorable treatment of secured creditors over unsecured creditors can be justified, the fact remains that the super priority accorded to post commencement financiers infringes on the rights of pre commencement unsecured.<sup>165</sup>

## **3.8 THE BUSINESS RESCUE PRACTITIONER**

### **3.8.1 Appointment and Removal**

The definition of a business rescue practitioner includes the possibility of two or more persons appointed jointly to oversee a company during business rescue proceedings.<sup>166</sup> Section 129(3)(b) states that if business rescue proceedings result from a resolution by the board of directors, the board also appoints the business rescue practitioner and must do so within five business days. The business rescue practitioner must meet the stipulated requirements<sup>167</sup> and provided his or her written consent to the appointment.<sup>168</sup> Thereafter, a notice of the business rescue

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<sup>162</sup> Section 135(3) of the Companies Act.

<sup>163</sup> Hutchison, A. 'Business rescue – How secure is the secured creditor?' 2011. Unpublished Article 1 at page 24.

<sup>164</sup> Section 135 of the Companies Act provides that post commencement financiers will rank below the secured pre commencement creditors.

<sup>165</sup> *Supra* note 139.

<sup>166</sup> Section 128(1)(d).

<sup>167</sup> Section 138.

<sup>168</sup> Section 129(3)(b).

practitioner's appointment must be filed with the Commission within two business days and must also be published to every 'affected person' within five business days after filing the notice in terms of section 129(4).

In the case where the court makes an order for business rescue proceedings to commence,<sup>169</sup> it may appoint an interim business rescue practitioner nominated by the applicant in terms of section 131(5). This appointment will, however, be subject to approval by the majority in value of the independent creditors at the first meeting of creditors.<sup>170</sup>

On the other hand, vacation or removal of the business rescue practitioner from office is subject to section 139(3) which provides that if a practitioner dies, resigns or is removed from office, the directors or the creditors who nominated him or her must appoint a new one. Although the Act does not contain a provision specifically allowing a practitioner to resign, it must be assumed that, since provision is made for the appointment of a practitioner to replace the one who has resigned, a practitioner has the right to resign from office, apparently also at any time and for any reason.<sup>171</sup>

Moreover, a business rescue practitioner can be removed from office only by an order of court, in terms of either section 130(1)(b) or section 139 on application by an affected person or on its own initiative, on any of the following six grounds:

- i. Incompetence or failure to perform his duties;<sup>172</sup>
- ii. Failure to perform his functions with the proper degree of care;<sup>173</sup>
- iii. Engaging in illegal acts or conduct;<sup>174</sup>
- iv. No longer meeting the requirements contained in section 138(1);<sup>175</sup>

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<sup>169</sup>In terms of section 131(4).

<sup>170</sup>Section 147(1) states that this meeting must be convened by the business rescue practitioner within ten business days after his appointment.

<sup>171</sup>*Supra* note 1.

<sup>172</sup>Section 139(2)(a).

<sup>173</sup>Section 139(2)(b).

<sup>174</sup>Section 139(2)(c).

<sup>175</sup>Section 139(2)(d).

- v. Conflict of interest or lack of independence;<sup>176</sup>
- vi. Incapacity and inability to perform his duties.

### **3.8.2 Qualifications**

In terms of section 138(1)(a)-(f), a business practitioner has to meet certain stipulated requirements in order to qualify for appointment. According to that section, a person may be appointed as the business rescue practitioner of a company only if the person –

- i. Is a member in good standing of a legal, accounting or business management profession accredited by the Commission;
- ii. Has been licensed as such by the Commission in terms of subsection (2);
- iii. Is not subject to an order of probation in terms of section 162(7);
- iv. Would not be disqualified from acting as a director of the company in terms of section 69(8);
- v. Does not have any other relationship with the company such as would lead a reasonable and informed third party to conclude that the integrity, impartiality or objectivity of that person is compromised by that relationship; and
- vi. Is not related to a person who has a relationship contemplated in (d).

### **3.9 Business Rescue Plan**

One of the responsibilities of a business rescue practitioner is to develop and implement a business rescue plan.<sup>177</sup> The business rescue practitioner is required by the Act to consult with the creditors of the company, its management

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<sup>176</sup>Section 139(2)(e).

<sup>177</sup> Section 140(1)(d).



and other affected persons in order to develop the business rescue plan.<sup>178</sup> The company must publish the plan, after which the practitioner must hold a meeting of creditors and other company members who have a voting interest to consider and possibly adopt the plan.<sup>179</sup> A notice of the meeting must be given to all ‘affected persons’ at least five business days before the meeting and must contain information on the time, date and place of the meeting, the agenda of the meeting and the voting and participation rights of ‘affected persons’.<sup>180</sup>

The practitioner is expected to introduce the proposed business rescue plan at the meeting, state whether he or she believes that there is a reasonable prospect of rescuing the company, give the employees’ representatives an opportunity to address the meeting and accommodate a discussion and voting on motions to amend or to adjourn the meeting to revise the plan.<sup>181</sup> The proposal will be adopted on a preliminary basis if the holders of more than seventy five per cent of the creditors’ voting interests vote in favor of the plan, which must include at least fifty per cent of the independent creditors’ voting interests.<sup>182</sup> Failing which, the plan will be rejected.<sup>183</sup>

### **3.10 Conclusion**

One of the clear objectives of the 2008 Act is to provide for the efficient rescue and recovery of financially distressed companies in a manner that balances the rights and interests of all relevant stakeholders as envisaged in section 7(k). The legislature was clearly careful to avoid a regime that would allow defaulting debtor companies to use business rescue proceedings in an underhanded

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<sup>178</sup>Section 150(1). See also Martin, KJ. ‘Employee protection during business rescue proceedings in South Africa: A comparative perspective.’ (LLM dissertation, University of Cape Town, 2013).

<sup>179</sup>Section 150(1).

<sup>180</sup> Section 150(2).

<sup>181</sup> Section 152(1)(a)-(d).

<sup>182</sup>Section 152(2).

<sup>183</sup> Section 152(3)(a).

manner in order to defraud or frustrate their creditors.<sup>184</sup> This is evident if one considers, amongst other things, the fact that affected persons may oppose a company resolution to initiate business rescue<sup>185</sup> and the extensive degree of oversight that creditors are given during the course of the proceedings.

When considering the past legislation, the success rates and bad stigma connected to judicial management, South Africa was in dire need of change towards a workable system to enable the tools to maximize the possibility of successful recovery of companies trading in financial difficulty or financially stressed.<sup>186</sup> However, according to Braadvedt<sup>187</sup>, Rajak<sup>188</sup> and Henning<sup>189</sup>, the new business rescue procedure is open to abuse as some companies may use it as a delaying tactic to defraud creditors.

Although it may be argued that the new business rescue regime provides a better turnaround for financially distressed companies than judicial management, recent research into business rescue has revealed numerous challenges facing the industry. Le Roux and Duncan<sup>190</sup>, for instance, identified the fact that the majority of creditors involved in business rescue proceedings had little to no knowledge of what the regime is and what it involved. Their research indicates that a poor expectation of the plan stems from a lack of understanding and experience within the industry.<sup>191</sup> Furthermore, research conducted by Pretorius<sup>192</sup> into the competencies required by a business rescue practitioner

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<sup>184</sup>Stoop, H. 'When does an application for business rescue proceedings suspend liquidation proceedings?' 2014.

*De Jure*.

<sup>185</sup>Section 130

<sup>186</sup>Bezuidenhout, PJT. 'A review of business rescue in South Africa since implementation of the Companies Act 71 of 2008'. (MBA dissertation, North-West University, Potchefstroom Campus, 2012).

<sup>187</sup>Braadvedt. 'South African courts – Establishing a trend in business rescue judgments'. (2012)

<http://www.legalcity.net/Index.cfm?fuseaction=Magazine.article&ArticleID=4294532>. [Accessed on the 14<sup>th</sup> September 2015].

<sup>188</sup>Rajak, H., and Henning, J. 'Business rescue in South Africa'. 1999. *South African Law Journal*, Volume 116(2).

<sup>189</sup>*Supra* note 188.

<sup>190</sup>*Supra* note 139.

<sup>191</sup>Rosslyn-Smith, W. 'Stakeholder expectations of the business rescue plan from a South African perspective'. 2015. *SAJESBM*, Volume 7.

<sup>192</sup>Pretorius, M. 'A competency framework for the business rescue practitioner profession'. 2013a. *Acta Commercii*.

revealed that most entailed critical elements of the business plan. This reiterated that a direct correlation between the practitioner's ability to draft the plan and the effectiveness of the rescue.

## Chapter 4

### Comparing the South African Business Rescue regime to rescue regimes in other jurisdictions

#### INTRODUCTION

Many countries have embarked on establishing business rescue regimes in order to rescue companies on the verge of collapse.<sup>193</sup> According to Harvey<sup>194</sup>, the South African business rescue model is in line with the rescue regimes of foreign jurisdictions such as the United Kingdom (UK), Australia and the United States of America (USA). This chapter seeks to make a comparative analysis of the South African business rescue regime to the above-mentioned jurisdictions. However, the procedure of business rescue in each of these jurisdictions is too wide to be covered in this dissertation. As a result, the chapter will only focus on the major aspects of business rescue in those three jurisdictions compared to the regime in South Africa.

#### 4.1 AUSTRALIA

Significantly, Australia has never had a separate insolvency statute, with its corporate insolvency legislation incorporated within Chapter 5 of its general company legislation, now known as the Corporations Act 2001(Cth)<sup>195</sup> (hereinafter referred to as “the Act”). The Act provides for a company that is insolvent or nearing insolvency to operate under a deed of company arrangement (DCA) approved by the creditors.<sup>196</sup> The DCA is a plan comprising decisions that consider the present condition of the company and the ultimate goal of restoring

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<sup>193</sup>Keay, A. ‘A comparative analysis of administration regimes in Australia and the United Kingdom’ in Paul J. Omar’. 2008. *International Insolvency Law – Themes and Perspectives* at page 105.

<sup>194</sup>Harvey, N. ‘Turnaround management and corporate renewal: A South African perspective’. 2011. Johannesburg: Wits University Press.

<sup>195</sup> Blazic, MJ. ‘In search of a corporate rescue culture: A review of the Australian Part 5.3A Legislation’. 2010. *SBS HDR Student Conference*. Paper 8. <http://ro.uow.edu.au/sbshdr/2010/papers/8>.

<sup>196</sup>Austin, RP., and Ramsay, IM. ‘Ford’s Principles of Corporations law’. 2013. 15<sup>th</sup> edition.

the company to a sustainable going concern.<sup>197</sup> Commonly such a DCA will provide for a composition of existing debts or for payments to be postponed while the company continues to trade and recovers or, in another case, while there is an orderly sale of its assets.<sup>198</sup>

In terms of section 435A of the Act, the business property and affairs of the company that is financially distressed are administered in such a way that maximizes the chances of the company or as much of it as possible surviving. However, if that is not possible the secondary object is that the return to creditors and members is better than would have resulted from an immediate winding up.<sup>199</sup> Austin<sup>200</sup> states that if the business can be saved, not only might creditors get a better return but also a disruption to the company's employees and customers might be avoided.

The voluntary administration process in Australia commences when an administrator is appointed. The appointment of the administrator is simple in that it is an out of court process whereby only the board of directors<sup>201</sup>, the liquidator, the provisional liquidator<sup>202</sup> and a secured creditor who holds a charge over the whole or substantially the whole of the company's property (fully secured creditor)<sup>203</sup> may make the appointment. In terms of the Act, the board of directors and the liquidator are required to show that the company is insolvent or likely to be insolvent while the fully secured creditor is only required to show an entitlement to enforce a charge.<sup>204</sup>

As with all other business rescue procedures, the company is placed under a temporary moratorium which is designed to give the company a breathing space

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<sup>197</sup> *Supra* note 191.

<sup>198</sup> *Supra* note 196.

<sup>199</sup> Anderson, C. 'Viewing the proposed South African business rescue provisions from an Australian perspective'.

2008. *PER/PELJ*, Volume 11, Issue 1.

<sup>200</sup> 'Ford's Principles of Corporations law'. 2013. 15<sup>th</sup> edition.

<sup>201</sup> Section 436A (1) of the Corporations Act.

<sup>202</sup> Section 436B (1) of the corporations Act.

<sup>203</sup> Section 436C (1) of the Corporations Act.

<sup>204</sup> Corporations Act 50 of 2001.

binding even owners or lessors of property to its conditions.<sup>205</sup> The Harmer report recommended the moratorium on the basis of promoting an orderly dealing with the company's affairs.<sup>206</sup>

The Corporations Act<sup>207</sup> sets out the purpose of Voluntary administration which is 'to provide for the business, property and affairs of the insolvent company to be administered in a way that maximizes the chances of the company or as much as possible of its business, continuing in existence or, if this is not possible, results in a better return than would be the case if there was an immediate winding up of the company.'

The administrator is expected to investigate the company's affairs as soon as the company enters into Voluntary administration, and to form an opinion on whether it would be in the best interests of the creditors of the company to execute a deed to facilitate company rescue, for the administration to end or for the company to be wound up.<sup>208</sup> The administrator is, with the assistance of the company directors in the investigations, thereafter required to report the findings to the company's creditors in terms of section 439A (4) of the Act so that the creditors may decide on the company's future.

The administration process will come to an end, if the events in either section 435C (2) or 435C (3) occur after the administration process has begun.<sup>209</sup> Section 435C (2) outlines the normal outcome of the administration of a company where a deed of a company arrangement is executed by both the company and the deed's administrator or alternatively the company's creditors resolve under paragraph 439C (b) that the administration should end. Section 435C (3), on the

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<sup>205</sup> *Supra* note 2.

<sup>206</sup> ALRC Harmer Report. [www.alrc.gov.au/inquiries/title/alrc6&36&45/index.htm](http://www.alrc.gov.au/inquiries/title/alrc6&36&45/index.htm). Accessed on: 13th September 2015.

<sup>207</sup> Section 435A of the Act.

<sup>208</sup> Section 438(A)(4) of the Act.

<sup>209</sup> Corporations Act 50 of 2001, Volume 2, section 435C.

other hand, provides that the administration of a company may end due to the court orders under section 447A, or the convening period coming to an end.<sup>210</sup>

As seen from above, the fundamental objective of Voluntary Administration is to rescue viable companies from being wound up, where the threat of insolvency would otherwise likely result in steps being taken by creditors to place the company into liquidation.<sup>211</sup> The Voluntary Administration regime is effectively a formal moratorium type administration, which seeks to facilitate a unique stay on creditor actions.<sup>212</sup> According to Blazic<sup>213</sup>, this provides an opportunity for a company to restructure, thereby increasing the likelihood of saving it from insolvency and producing a situation ultimately beneficial to creditors and other stakeholders when compared with liquidation.

## 4.2 THE UNITED KINGDOM

The principles of corporate rescue in the United Kingdom (UK) were explored and consolidated for the first time in the Cork report.<sup>214</sup> The report<sup>215</sup> considered the merit of a corporate rescue regime and how it would be beneficial to give distressed companies an alternative to being wound up. It recognized that there were many factors that could contribute to a company suffering hardship and it was not necessarily improper actions carried out by the actors in charge of the company that contributed to its position, but rather wide issues that were beyond its control.<sup>216</sup> However, it is imperative to note that the concept of rescue has been known in the UK for some time but has rarely been used because of

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<sup>210</sup>Section 439A (5)(a).

<sup>211</sup> *Supra* note 193.

<sup>212</sup> *Supra* note 193.

<sup>213</sup> 'In search of a corporate rescue culture: A review of the Australian Part 5.3A Legislation'. 2010. *SBS HDR Student Conference*. Paper 8. <http://ro.uow.edu.au/sbshdr/2010/papers/8>.

<sup>214</sup>Wood, JM. 'Corporate Rescue: A critical analysis of its Fundamentals and Existence'. (PhD thesis, University of Leeds, 2013).

<sup>215</sup>The Cork Report (report of the Review Committee on Insolvency Law and Practice). Cmnd 8558, 1982.

<sup>216</sup> *Supra* note 215.

the preference for receivership. It therefore should not be surprising that the Cork Report took some time to be compiled and subsequently not all of its recommendations were enacted in the Insolvency Acts of 1985 and 1986.<sup>217</sup>

Prior to the Insolvency Act 1986, the only formal procedures were the company scheme of arrangement and the receivership.<sup>218</sup> The Insolvency Act 1986 introduced the company voluntary arrangement (CVA) as a method of imposing on a dissenting minority of ordinary unsecured creditors a rescheduling with which most creditors were in agreement.<sup>219</sup> A CVA made by a company with its creditors and members under Part I of the Insolvency Act 1986 is a composition of the company's debts<sup>220</sup> or a scheme of arrangement of its affairs<sup>221</sup>, the composition or scheme resulting from acceptance of a proposal by the directors to the company and its creditors.<sup>222</sup>

A CVA under the Insolvency Act offers the administrator an out-of-court route to compile a plan, thus reducing costs and time.<sup>223</sup> The alternative is a scheme of arrangement, which is more complex and may take more time to implement, but it binds all creditors without exception, making it more powerful than a CVA.<sup>224</sup> Administration was however seen and criticized for being cumbersome, expensive and unsuitable for small to medium sized companies.<sup>225</sup> A white paper was, therefore, published in July 2001 setting out the need for reform and the Enterprise Act 2002 substantially replaced a number of provisions within the Insolvency Act of 1986.<sup>226</sup>

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<sup>217</sup> *Supra* note 196.

<sup>218</sup> Tolmie, F. 'Corporate and personal insolvency law'. 2003. 2<sup>nd</sup> edition. [www.cavendishpublishing.com](http://www.cavendishpublishing.com)

<sup>219</sup> *Supra* note 214.

<sup>220</sup> That is, an agreement by creditors to accept less than the amount due to them in discharge of their claims.

<sup>221</sup> Section 1 of the Insolvency Act 1986.

<sup>222</sup> Goode, R. 'Principles of corporate insolvency law'. 2007. Student edition.

<sup>223</sup> *Supra* note 191.

<sup>224</sup> Daley PP, and Shuster GW. Jr. 'Basic provisions of United Kingdom insolvency law'. 2013. Available Online at: <http://www.abiworld.org/committees/newsletters/international/vol1num3/ReorgEuroUnion2.pdf>. Accessed on 14th September 2015.

<sup>225</sup> Parry, R. 'Administrative Receivership and Administration: An overview of recent development from selected countries'. 2004. At page 146.

<sup>226</sup> *Supra* note 2.



A company in the UK may be classified as insolvent if it is unable to pay its debts<sup>227</sup>, this will mean that the distressed company has satisfied either the cash flow or balance sheet test.<sup>228</sup> It was held in *BNY Corporate Trustee Services Ltd v Eurosail-UK*<sup>229</sup> that section 123(2) of the Insolvency Act 1986 was satisfied when a company whose assets and liabilities, including contingent and future liabilities, were such that it had reached the 'point of no return'. The significance of this case is realized in the clarity that it has brought in helping define 'when a company is unable to pay its debts' for the purposes of the Insolvency Act 1986.

One of the basic tenets of insolvency within the United Kingdom is to offer companies facing insolvency which have good future prospects, the opportunity to be rescued.<sup>230</sup> This is done through restructuring and reorganization where the business is mainly healthy and has a good forecast of the financial tides turning in its favor.<sup>231</sup> The Enterprise Act 2002 can be seen as a milestone in the UK rescue legislation. Its significance was reflected in many aspects, especially in the aspect of terminating floating charge holder's power to appoint an administrative receiver, providing the way to administration out of court and abolishing Crown's preferential rights.<sup>232</sup>

The process of administration in the UK is initiated by either the company or the directors.<sup>233</sup> The actual appointment of an administrator signifies the official commencement of administration process. When an application is made by the company or by the directors, the affidavit must be drafted by one of the directors or the secretary of the company.<sup>234</sup> However, if the application is made by the

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<sup>227</sup> Keay, A., and Walton, P. 'Insolvency Law: Corporate and Personal'. 2008. 2<sup>nd</sup> edition.

<sup>228</sup> Alternatively, they have been also referred to as commercial insolvency and absolute insolvency respectively, see Goode, RM. 'The Principles of corporate Insolvency law'. 2011. 4<sup>th</sup> edition at page 114.

<sup>229</sup> 2007-BL Plc Court of Appeal (Civil Division) [2011] EWCA Civ 227.

<sup>230</sup> Aruoriwo, A. 'Financing corporate rescues, where does the UK stand?' 2014. *IALS Student Law Review*, Volume 1, Issue 2.

<sup>231</sup> *Supra* note 222.

<sup>232</sup> Yang, M. and Li, X. 'The History of corporate rescue in the UK'. 2012. *Asian Social Science*, Volume 8, Issue 13. [www.ccsenet.org/ass](http://www.ccsenet.org/ass). [Accessed on 13 September 2015].

<sup>233</sup> *Supra* note 218.

<sup>234</sup> Rule 2.2(2) of the Insolvency Rules.

creditors, they must authorize one of the above persons to make the affidavit on their behalf.<sup>235</sup>

According to Bailey and Groves<sup>236</sup>, the courts rely heavily on the evidence supplied by the prospective administrator and his or her statements should contain enough information to show why other options such as liquidation are not appropriate and how the administrative process is to be dealt with. In terms of the notification procedure, there is a detailed and very specific list of persons to whom the notice must be given; this however does not include the general body of creditors or the employees of the company, but is limited to the company and the applicant or prospective administrator.<sup>237</sup>

The moratorium commences only once the company is in administration and although the definition of the word connotes an allowance or breathing space for the company, it does not like the South African system postpone the payment of debt, but only protects the company from the creditors and other parties alike from enforcing several legal rights.<sup>238</sup>

Termination of the administrator's term of service and consequently the administration process are automatically terminated one year after the appointment of the administrator became effective.<sup>239</sup> The rationale behind the lapsing of the procedure automatically after one year is that it is seen as a temporary course of action that should grant the company support, while the essentials for the actual rescue strategies are laid out, rather than being the rescue measure itself.<sup>240</sup> The administration process may also come to an end through an order of the court or through the filing of a notice.

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<sup>235</sup> Rule 2.2(3) of the Insolvency Rules.

<sup>236</sup> Bailey, E., and Groves, H. 'Corporate Insolvency'. 2008. 3<sup>rd</sup> edition. Oxford University Press.

<sup>237</sup> Paragraph 12(2) of Schedule B1 to the Insolvency Act 1986 and Rule 2.6 of the Insolvency Rules.

<sup>238</sup> Lightman, G. *et al.* 'The Law of Administrators and Receivers of Companies'. 2007. 4<sup>th</sup> edition. Sweet and Maxwell, London.

<sup>239</sup> Paragraph 76(1) of Schedule B1 to the Insolvency Act 1986.

<sup>240</sup> *Supra* note 227.

The UK system has basically been regarded as creditor based and this stance is exemplified by three features<sup>241</sup>. The first being the entitlement of a creditor to take steps to retrieve his due amount by way of winding up or a bankruptcy order, the second feature is the entitlement of the secured creditor to enforce his security irrespective of the consequences to others, considering nothing but his own interests and finally, the principle which permits the equal distribution of the debtor's wealth amongst the unsecured creditors. However, the UK regime has been criticized for being too biased towards creditor interests when compared to other jurisdictions and not offering enough protection and opportunity for troubled companies to rehabilitate.<sup>242</sup>

### **4.3 UNITED STATES OF AMERICA**

The US Constitution grants the US Congress the exclusive power to establish uniform laws on bankruptcies.<sup>243</sup> Currently, the Bankruptcy Reform Act of 1978, as amended and supplemented, provides the nation's bankruptcy law, covering liquidations and reorganizations for individuals, businesses and municipalities.

“Congress envisioned the objectives of Chapter 11 reorganization to allow a debtor, usually a business, ‘to restructure a business’ finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders’... Creditors, employees and equity holders all benefit by allowing the business to operate and reorganize. The end result sought in reorganization is a confirmed plan and a profitable business.”<sup>244</sup>

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<sup>241</sup> *Supra* note 238.

<sup>242</sup> *Supra* note 195.

<sup>243</sup> Weil, Gotshal and Manges LLP. *The America's Restructuring and Insolvency Guide 2008/2009*.

<sup>244</sup> Kerkman, JR. ‘The Debtor in full control: A case for the Trustee system’. 1987. *Marq. Law Review*, Volume 70 at page 161.

Chapter 11 of the Bankruptcy Code permits firms to attempt to ‘reorganize’ their financial affairs under court supervision.<sup>245</sup> According to the 1977 House Report, the purpose of a business reorganization case, unlike a liquidation case, is to restructure a business’s finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders. The premise of business reorganization is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap.<sup>246</sup>

A business or person may file for voluntary relief under Chapter 11 of the Bankruptcy Code, provided that the debtor has a place of business, residence or property in the United States of America.<sup>247</sup> Neither balance-sheet insolvency nor inability to pay debts as they mature is a requirement. According to Weil, Gotshal and Manges LLP<sup>248</sup>, the efficacy of a bankruptcy in the United States of America is determined by whether the US courts have the power to enforce the debtor’s discharge against creditors. That, in turn, depends on whether the creditors have minimum contracts with the United States or whether foreign jurisdiction will grant comity to US bankruptcy law.

Chapter 11 of the Bankruptcy Code allows a business to propose a reorganization plan which will be binding on dissenting creditors as long as at least one class of impaired creditors votes to accept the plan by a majority of the votes and two-thirds of the value of the claims voted in that class.<sup>249</sup> As prescribed in Chapter 11 of the Bankruptcy Code 1978, filing for the reorganization of a company brings about a moratorium on enforcement proceedings against the debtor company and its property while a plan of reorganization is worked out with its creditors.<sup>250</sup> The provisions of the code

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<sup>245</sup> Tabb, CJ. ‘Bankruptcy Anthropology’. 2002. 1<sup>st</sup> edition.

<sup>246</sup> Tabb, CJ. ‘The Future of Chapter 11’. (1993) 44 *S.C.L Rev.* 791.

<sup>247</sup> *Supra* note 229.

<sup>248</sup> The America’s Restructuring and Insolvency Guide 2008/2009.

<sup>249</sup> *Supra* note 248.

<sup>250</sup> Franks *et al.* ‘A comparison of US, UK, and German insolvency codes’. 1996. *Financial Management* (European Corporate Finance): at page 86-101.

allow a firm to remain in operation while management reassesses its business plan and negotiates the restructuring of its capital structure, binding all existing creditors and shareholders to the plan's acceptance.<sup>251</sup> Notably unlike the case in business rescue, management remains in control of the company in the majority of filings.<sup>252</sup>

The expectations of the Chapter 11 reorganization plan are set by the parties responsible for its approval, being the creditors and the court and the plan should clearly communicate its intention and impact on the rights of creditors.

The creditors' vote is required for any plan to progress; however, in the event of a 'cram down', they are less of an authority than one might at first think.<sup>253</sup>

The court must in all fairness approve a plan that is feasible, is in the best interest of creditors, fair and equitable and completed in good faith.<sup>254</sup>

Needless to say, the underlying rationale behind the reorganization plan is the notion that creditors will gain more from the continued existence of the company than from its liquidation.<sup>255</sup>

Moreover, the goal of the debtor's plan focuses on restoring the company to financial health, not simply through debt restructuring, but also through managerial decisions aimed at producing a more efficient business entity.<sup>256</sup>

On the other hand, the expectations of shareholders are somewhat less pertinent, as they have no real bargaining power other than the ability to delay the proceedings.<sup>257</sup>

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<sup>251</sup> Bracewell, and Giuliani LLP. 'Chapter 11 of the United States Bankruptcy Code: Background and Summary'. 2012. Houston, TX.

<sup>252</sup> *Supra* note 191.

<sup>253</sup> Kunkel *et al.* 'Bankruptcy: Chapter 11 Reorganizations'. (University of Minnesota, 2009).

<sup>254</sup> *Supra* note 191.

<sup>255</sup> *Supra* note 238.

<sup>256</sup> Elson *et al.* 'Corporate governance reform and reemergence from bankruptcy: putting the structure back in restructuring'. 2002. *Vanderbilt Law Review*, Volume 55.

<sup>257</sup> Hubbard J., and Stephenson, K. 'Bankrupt stocks, reorganization plans and market efficiency: Are bankrupt stocks overpriced?' 1997. *Quarterly Review of Economics and finance*, Volume 37(2) at page 547-562.

According to Weil et al, the following are the advantages of filing for Chapter 11 relief:

The automatic stay against collection actions;

The ability to reject burdensome leases and executory contracts; and

The ability to impose a reorganization plan accepted by a majority of creditors (by contrast, in an out-of-court restructuring the consent of all creditors is required).

#### **4.4 CONCLUSION**

In conclusion it is safe to say, looking at the overview of the corporate rescue regime in South Africa, Australia and the United Kingdom, that each regime is similar to the others but different in some aspects in order to suit the unique needs of each country, especially when it comes to creditor protection (which is the main focus in the study). However, each of these regimes could learn a thing or two from the United States of America, mainly because the concept of corporate rescue originated from there.

Voluntary administration in Australia and Administration in the United Kingdom are both perceived to provide stronger protection for the fully secured creditors at the expense of other secured creditors and unsecured creditors.<sup>258</sup> The South African business rescue, on the other hand, strives to strike a balance in protecting the interests of both secured and unsecured creditors.<sup>259</sup>

Although Voluntary administration and Administration accord priority protection to fully secured creditors over and above other secured creditors and

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<sup>258</sup>*Supra* note 1.

<sup>259</sup>Kaulungombe, K. 'Business rescue for Zambia: Suggestions for legislative reform'. (LLM dissertation, University of Cape Town, 2012). This is evident from the uniform application of the moratorium on both secured and unsecured creditors. It is further evidenced by the fact that all creditors are bound by the business rescue plan regardless of whether they attended the meeting at which the plan was voted on or whether they voted in favor of the plan.

unsecured creditors, the two regimes try to ensure that the secured and unsecured creditors also enjoy a considerable level of protection in several ways.<sup>260</sup>

In the case of business rescue, however, the question of creditor protection does not seem to have really come up as a point of discussion perhaps because business rescue is a new phenomenon and creditor protection issues have not been encountered thus far and perhaps because it seems that the South African courts will protect the interests of all creditors even above those of the company.<sup>261</sup>

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<sup>260</sup> *Supra* note 145.

<sup>261</sup> This inference is drawn from the Gauteng High Court's decision in the case of *Swart v Beagles Run Investments 25 and Others* 2011 (5) SA 422 (GNP), where an application brought by the sole director and shareholder of the company was refused, because the company was hopelessly insolvent and business rescue proceedings would not in any way increase the prospects of the creditors receiving more money.

## Chapter 5

### CONCLUSION

As a replacement for judicial management, there is no doubt that the business rescue model contained in Chapter 6 of the 2008 Act addresses the need for reform, and embraces international trends in corporate reorganization.<sup>262</sup> The fact that the primary emphasis of a reorganization or rescue was placed on the interests of creditors has been identified as a cause of the failure of judicial management,<sup>263</sup> and Chapter 6 business rescue has addressed this problem without unduly prejudicing creditors. As Rajak and Henning<sup>264</sup> stated ‘it is frequently the case that a creditor will benefit far more from having the debtor in the market place than from suing the debtor in extinction’.

Business rescue attempts to secure and balance the opposing interests of creditors, shareholders and employees.<sup>265</sup> It encapsulates a shift from creditors’ interests to a broader range of interests.<sup>266</sup> The rationale behind this is that to preserve the business coupled with the experience and skills of its employees may, in the end, prove to be a better option for creditors in securing full recovery from the debtor.<sup>267</sup> In addition to this, business rescue brings the country in line with international trends, maximizes returns for creditors, saves jobs and ultimately gives financially distressed companies a chance to trade their way out of financial difficulties.<sup>268</sup>

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<sup>262</sup> *Supra* note 8.

<sup>263</sup> *Supra* note 3.

<sup>264</sup> Rajak, H. and Henning, J. ‘Business rescue for South Africa’. 1999. *South African Law Journal*, Volume 116.

<sup>265</sup> *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others*, 2012 (3) SA 273 (GSJ) at paragraph 12.

<sup>266</sup> *Supra* note 265. See also Sher, LJ. ‘The Appropriateness of Business Rescue as opposed to Liquidation: A critical analysis of the requirements for a successful business rescue order as set out in section 131(4) of the Companies Act 71 of 2008. (LLM dissertation [unpublished]: University of Johannesburg, 2013). Retrieved from: <https://ujdigispace.uj.ac.za> (Accessed on: 10<sup>th</sup> June 2015).

<sup>267</sup> *Supra* note 265.

<sup>268</sup> *Supra* note 8.



Apart from that, Smits<sup>269</sup> reckons:

‘modern corporate rescue and reorganization seeks to take advantage of the reality that in many cases an enterprise not only has substantial value as a going concern, but its going concern value exceeds its liquidation value.’

However, despite all the good things being said about the new business rescue provisions in the Companies Act 71 of 2008, there are also concerns and challenges that are faced by the rescue regime in South Africa. For one, I believe lack of precedents on the concept of business rescue poses a great problem to our courts when dealing with business rescue applications. This, however, will soon be the thing of the past as more troubled companies bring applications to be rescued.

Pretorius<sup>270</sup> submitted the following sentiments as the challenges that are mostly encountered since the introduction of the new South African business rescue regime:

The absence of sufficient awareness, knowledge and understanding of business rescue has resulted in many players being reticent about participating in the industry because of the many loopholes and inefficiencies that still exist in the law, and the uncertain interpretation thereof.

Business rescue is an expensive process for the different players to pursue and test.

Companies usually file too late in their distress timeline, when all possible turnaround and rescue options or efforts would have already been exhausted.

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<sup>269</sup>Smits, A. ‘Corporate Administration’. 1999. *De Jure*, Volume 80.

<sup>270</sup> Pretorius, M. ‘Constraints on decision making regarding post-commencement finance in business rescue’. 2013. *Southern African Journal of Entrepreneurship and Small Business Management*, Volume 6.

Financiers are generally interested only in companies which still have a viable business model in place, with potential and realistic future prospects.

Consequently, although business rescue is seen as a major improvement from judicial management, it is still doubtful whether it has achieved the results anticipated by the legislature so far. This is evident in the fact that liquidation is still preferred by the courts as far as protecting the interests of creditors is concerned. Apart from that, although it has been stressed that Chapter 6 seeks to maintain a balance between different stakeholders, somehow I believe that that balance is blurred when it comes to the rights of employees and this may impose fear in those creditors who keep the company afloat during business rescue proceedings as to how far the Act will go in protecting their own interests. Therefore, the previously creditor-friendly culture in South Africa, solely protecting the interests of creditors, will take a long time to change into a debtor-friendly culture focused on corporate renewal.

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