An appraisal of the new South African business rescue procedure

by

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SUMMARY

Introduced into our law in 2011, Chapter 6 of the Companies Act 71 of 2008 allows for the restructuring of companies that are reasonably unlikely to be able to pay all of its debts as they become due and payable or where it appears to be reasonably likely that the company will become insolvent, within the immediately ensuing six month period.

The legislation contemplates the appointment of a business rescue practitioner who is obligated to supervise the ongoing business of the company, together with its board of directors, by way of the implementation of a business rescue plan, where the practitioner can "rescue" the company and achieve a position where the company can continue to trade on a solvent basis into the future. If this is not possible, the practitioner must deliver to creditors and shareholders a better dividend than would result from the immediate liquidation of the company.

Some four years after implementation, this study analyses the history of the development of insolvency law in South Africa with a focus on the shift from a pro-creditor to a pro-debtor rescue culture, the failure of judicial management and the urgent need for the establishment of a viable and effective restructuring mechanism for financially distressed companies in South Africa. A brief overview of international standards of best practice in insolvency and corporate rescue models applicable in jurisdictions such as the US, the UK, Canada and Australia serves to set the bench mark for the establishment of a workable business rescue regime for corporate South Africa.

An appraisal of the South African business rescue legislation with an eye on international corporate rescue themes and international best practice is undertaken to establish if the South African business rescue model "stacks up" with those applicable in international jurisdictions.

Several shortfalls and weaknesses in the new rescue procedures are identified and certain recommendations for improvements are made.

The study concludes with views on the efficiency and effectiveness of the South African business rescue model and what the future holds for South African restructuring practice in the years ahead.

ACKNOWLEDGEMENTS

"Sometimes a scream is better than a thesis."

– *Manfred Eigen*

When I started this journey in January 2011, I really did not have a full appreciation of the time, effort and dedication that would be required to complete a study of this nature. Balancing heavy work commitments in my practice with writing a thesis has not been easy.

Of course, practising in the field of insolvency and business rescue makes the topic part and parcel of my everyday working life. Keeping up to date with the latest case law precedent, developments in the law and legal opinion is par for the course. But putting it all down on paper, compiling one's thoughts, doing the research, has been daunting, challenging and stimulating.

Professor André Boraine, my supervisor at the University of Pretoria, has been my guiding light, mentor and friend. We go back a long way and have presented together in many insolvency forums and seminars over the years, both locally and internationally. Together with Professor Harry Rajak, whose enthusiasm and energy has kept me on track for the last four years, I thank both of them for their interest, dedication and detailed contributions in getting me through this exercise.

My colleagues, librarians and secretarial staff at my firm Werksmans, have been supportive, dedicated and most helpful in assisting me along the way.

Last but not least, to my long-suffering wife, Mireille – my best friend and partner in life and in thesis. The long weekends and nights spent slaving away, while she sat up waiting for me will never be forgotten, and her immense support has been incredible. To my two sons Michael and Daniel, who had to cope with a "student father" for four years, I thank them for their patience and for putting up with their father's grumpiness.

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PREFACE

Since the financial crisis of September 2008, the need to restructure companies in financial distress has increased. The aversion to killing companies off by way of the liquidation process had been recognised for decades and this process has been seen as a poor outcome – for the company, its stakeholders and for the economy of each particular jurisdiction.

Business rescue in South Africa is the "new kid on the block". It has replaced judicial management and has kick-started a whole new industry for lawyers and business rescue practitioners.

Having practised as an insolvency lawyer for some two decades, business rescue has come as a "breath of fresh air". It provides a unique and vibrant option for saving companies that were teetering on the brink of insolvency. Placing companies into liquidation, with resultant job losses, general negativity and the stigma attached to liquidation, was a depressing and often frustrating area of law.

Business rescue now provides a fresh option, that of the fresh start, and one which needs to be taken on board by all those involved with the failing entity. There is a fascination with the knock-on effect of the business rescue process and with how many persons are potentially affected by the commencement of this restructuring regime. Like in foreign jurisdictions, there is a need for corporates, suppliers, accountants, auditors, politicians, bankers, entrepreneurs and business as a whole, to sit up and take cognisance of these rescue provisions and particularly to understand how the process affects them. All of these individuals and entities will at some stage have to deal with the business rescue procedure and will need to be empowered to be in a position to maximise value from the process.

The new puppet masters are the business rescue practitioners. They pull the strings in the rescue process and have the power to manipulate the supervision of the distressed entity to its most favourable outcome. These practitioners are a fascinating group of individuals. Coming from different backgrounds and professions, and all with different personality traits and skill sets, they are the key to the ongoing success of the process.

Business rescue practice and the opportunity to compile the research in this study, has provided me with the opportunity to appreciate how exciting and rewarding the concept of rescue has become in South Africa. The fact that our new legislation incorporates most of the common themes of rescue found around the world can make South Africans proud. We can safely say that restructuring practice in South Africa has finally been brought into line with international jurisdictions.

Rescue theory is littered with fascinating and interesting terminology, all linked to the medical profession. Terms such as "corporate death", "intensive care units", "corporate doctors", "post-mortems" and "bringing life back to the corpse", appear to all be favourably linked to my "doctoral thesis"! But it is true. Rescue and the need for the breathing space offered by the moratorium (stay), all contribute to breathing life back into the critically ill patient.

There are challenges in the implementation of business rescue. Interfacing with the banking fraternity, with those directors who have caused the demise of the company through bad management, and the constant search and need for the provision of post commencement finance, all contribute to the challenges imposed by the resuscitation exercise.

Challenges aside, rescue practice is dynamic and is constantly developing and improving. It is hoped that this study will stimulate continued thought and interaction amongst all those involved in the rescue process – lawyers, practitioners, laymen and creditors alike. The study should also be of interest to economists who are interested in the impact that failed rescue and liquidations will have to the economy as a whole.

The study should also be of interest to directors of companies who might, at some point in the future, be exposed to a rapidly deteriorating state of financial affairs in a company and who will need to understand and unpack the obligations imposed on directors when deciding whether or not to place the company into a business rescue process, as opposed to carrying on the trade of such company regardless. Coupled with the further decision whether or not to place the company into liquidation, taking appointment as a director is no longer for the fainthearted. There is no doubt that these decisions can be daunting and will result in many sleepless nights for directors.

Rescue is a universal concept and one which has fascinated lawyers for decades. As a legal professional advising directors, creditors, practitioners and other stakeholders, the rescue process has captured my interest. My fascination with the subject has only just begun. It is of course far easier being the innocent professional bystander dispensing legal advice to the role players faced with the pressures of financial distress. However, my interest in the prospect of being able to assist companies (and the economy) by way of the rescue process has not waned, and probably will not do so in the near future.

It is hoped that this study will encourage others to take up the cudgels of corporate rescue and to stimulate their interest in a manner which will contribute to the ongoing development and enhancement of this area of law, well into the distant future. Rescue is and remains a truly stimulating and fascinating subject.

This study was completed on 30 November 2015.

Eric Levenstein
Sandton, Gauteng
South Africa

KEY TERMS

Administration; Affected person; Bankruptcy; Business rescue; Business rescue plan; Business rescue practitioner; Corporate restructuring; Corporate rescue; Compromise; Contingent claim; Financial distress; Guarantee; Insolvency; Insolvent; Independent creditor; Judicial management; Moratorium; Post commencement finance; Rehabilitation; Restructuring; Subordination; Supervision; Suretyship; Voting interest.

PART 1 – GENERAL INTRODUCTION

CHAPTER 1 : INTRODUCTION

1.1 BACKGROUND AND OVERVIEW

Corporate rescue culture has finally found a home in South Africa with the introduction of Chapter 6 of the new Companies Act 71 of 2008 (the "2008 Companies Act") on 1 May 2011.

Chapter 6 replaced the outdated judicial management provisions of the old Companies Act 61 of 1973 (the "1973 Companies Act") and introduced the concept of business rescue proceedings for companies that are trading in a position of financial distress.

This study revisits the reasons for the failure of judicial management in South Africa and the development of South African insolvency law and its impact on, and the need for reform in, business rescue practice, prior to the final incorporation of Chapter 6 into the 2008 Companies Act. The development of rescue regimes applicable in foreign jurisdictions set the tone for the development of rescue practice in South Africa. By adopting many of the international core rescue principles applicable in foreign jurisdictions, South Africa has created a modern business rescue regime, which mirrors similar systems applicable abroad, and which is aimed at saving financially distressed companies, preserving employment and restructuring the discharge of debt.

This study will examine the practical challenges of business rescue implementation in South Africa and particularly the development of legal precedent, thinking, and interpretation of the provisions of Chapter 6 of the 2008 Companies Act. Weaknesses of the current legislation and the future of the business rescue process in South Africa will also be considered, together with recommendations for change.

1.2 RESEARCH QUESTIONS

Leading research questions in this study are limited to the following:

1.2.1 How did the historical development of insolvency law in South Africa act as a precursor to the development of a business rescue culture?

1.2.2 How has the concept of "advantage to creditors" impacted on the establishment of a pro-debtor rescue culture in South Africa?

1.2.3 What was the extent of the shift in rescue culture from a liquidation (pro-creditor) to a rescue (pro-debtor) culture in South Africa?

1.2.4 What are the international standards of best practice of corporate rescue and the common rescue themes applicable worldwide and how do they apply in modern rescue regimes?

1.2.5 What is a "corporate rescue culture" and how does it assist in the restructuring of financially distressed companies?

1.2.6 How has the concept of "discharge of debt" affected the willingness of creditors to agree to a compromise of claims?

1.2.7 What is the extent of jurisprudential development of business rescue law in South Africa since the introduction of Chapter 6 of the 2008 Companies Act?

1.2.8 How have core common rescue themes applicable in international regimes of corporate rescue impacted on the implementation of Chapter 6 of the 2008 Companies Act?

1.2.9 What are the shortcomings of business rescue legislation in South Africa and what recommendations can be made for further legal reform?

1.3 RESEARCH OBJECTIVES

The objectives of the study, having regard to the above research questions, are to ascertain –

1.3.1 Whether there has been a shift in rescue culture from a liquidation (pro-creditor) to a rescue (pro-debtor) culture in South Africa.

1.3.2 Whether or not international rescue and restructuring best practice standards that are being applied in modern business rescue regimes worldwide are in fact being applied successfully in South Africa and as a result of the introduction of Chapter 6 of the 2008 Companies Act.

1.3.3 Whether or not business rescue is in fact a viable alternative to liquidation and whether creditors will support the opportunity to have their debt restructured (by way of a "debt haircut") over a period of time, as opposed to placing the debtor company into liquidation and being forced to accept the necessary (negligible) liquidation dividend.

1.3.4 Whether or not the provisions of Chapter 6, despite their shortcomings, are being practically and effectively implemented in everyday restructuring practice in South Africa?

1.4 RESEARCH METHODOLOGY

The research methodology adopted includes a comparative and limited historical approach to the development of the South African law of insolvency, the liquidation of companies, the appraisal of international rescue themes and how they have been incorporated into Chapter 6 of the 2008 Companies Act.

The real focus is on the qualitative appraisal and analysis of the business rescue system now in place in South Africa. The thesis covers the core issues relating to existing restructuring and rescue systems in place worldwide and analyses rescue culture and its development in modern corporate South Africa.

The study focuses on international themes of rescue and highlights the comparative benchmarking of crucial elements of rescue and which includes an historical and literature study of the topic.

With reference to the literature used in this study, the author has used available international sources including journal articles, textbooks and relevant reports prepared on rescue methodology. Given the case-driven nature of the development of this area of the law in South Africa, reference is made to the many judgments that have been handed down in business rescue cases as well as commentary on those cases by South African academics and lawyers. Reference is also made to certain media reports, counsel opinions and South African textbooks on insolvency. This area of the law is fairly new and there are very few dedicated textbooks on the topic, albeit in certain textbooks, there are chapters dealing with business recue as a topic on its own.

Pre-2007/2008, the existing insolvency systems in South Africa favoured the creditor (mainly financial institutions). Post-2007/2008, with the shift in focus to consumer debtors and the establishment of their rights and ability to access credit, set the scene for the introduction of a new rescue dispensation in South Africa, namely business rescue.

The various parts and chapters in the thesis deal with the initial evolution of a pro-creditor focus (where in the main secured creditors received maximum dividend payouts), and where a marked shift resulted in the focus moving to that of the financially distressed debtor. Throughout the thesis, this consistent theme will be critically considered, which ultimately leads up to a detailed appraisal of the mechanics of the South African business rescue system, as well as conclusions and recommendations for improvements.

1.5 OVERVIEW OF CHAPTERS

The thesis is divided into four main parts:

- Part 1: General introduction
- Part 2: International best practice, rescue instruments, the development of corporate rescue culture and common rescue themes
- Part 3: South Africa's business rescue regime
- Part 4: Appraisal, recommendations and conclusion

Each part consists of chapters relevant to the part topic, followed by a synopsis of each part.

Part 1 will commence with a general introduction to the thesis and will go on to deal with the development of insolvency law in South Africa. Consideration of the history and background to the thinking and methodology applicable to the insolvency of individuals and liquidations of companies in the decades prior to the introduction of the new business rescue process in Chapter 6 of the 2008 Companies Act will be dealt with in this part. Issues such as advantage to creditors, the pro-creditor versus pro-debtor mind-set, the socio-political implications of debt and the manner in which these methodologies influenced the development of South Africa's insolvency law, pre-2011, will be considered.

In addition, the reasons for the failure of judicial management as a rescue mechanism will be discussed, as well as the need for the introduction of a corporate rescue model for South

Africa. The value of informal creditor workouts and its contribution to the development of business rescue will also be considered.

Part 2 will focus on international standards of best practice and the development of international rescue instruments (tools), such as those developed by the United Nations Commission on International Trade Law ("UNCITRAL"), the World Bank, the International Association of Restructuring, Insolvency and Bankruptcy Professionals ("INSOL International"), the European Union (EU), the International Monetary Fund ("IMF") and the European Bank for Reconstruction and Development.

Modern rescue regimes and the development of an international corporate rescue culture will also be discussed. In particular, there will be a focus on international core principles relating to the discharge and compromise of debt.

Certain common international rescue themes relevant to rescue procedures operating in foreign jurisdictions will be considered.

Part 3 will focus on South Africa and the new business rescue regime introduced by Chapter 6 of the 2008 Companies Act. It will deal with the recognition of the need for law reform in corporate rescue, in the lead-up to the introduction of the 2008 Companies Act. It will further consider the manner and extent to which the South African legislature has embraced and incorporated international best practice and business rescue themes into the provisions of Chapter 6. The jurisprudential development of the Chapter 6 rescue regime will be dealt with, together with case law relevant to the business rescue process. This part will include an analysis of the practical implementation of the provisions of Chapter 6 of the 2008 Companies Act in modern-day South African restructuring practice.

Part 4 consists of an appraisal of the new South African business rescue regime, as it is applied in practice, and how it "stacks up" when compared to international trends of practice. Current weaknesses in the business rescue system will be identified and recommendations will be made for specific legislative amendments to be effected, largely in view of certain practical and political constraints resulting from confusing interpretations of the provisions of the 2008 Companies Act. This part will also consider the level of success of business rescue in South Africa to date. Finally, conclusions will be drawn and a view expressed on the way forward for South Africa in respect of the ongoing development of the business rescue process.

1.6 SIGNIFICANCE OF STUDY

The development of rescue culture in South Africa is a significant feature of this study. The historical development of liquidation and insolvency legislation, coupled with the political pressures of the need for restructuring and rescue legislation in South Africa, and the shift from a pro-creditor to a pro-debtor culture, have all contributed to the development of the new South African rescue regime.

The study serves to draw on the core themes and principles of corporate rescue regimes currently in place in foreign jurisdictions and to reflect on how these themes and principles have found their way into the new provisions of Chapter 6 of the 2008 Companies Act. The study further critiques and analyses the various sections of Chapter 6. Since its implementation on 1 May 2011, significant legal precedent has been established which serves as a guideline for the practical implementation of the new business rescue regime. This study examines the manner in which the South African courts, and all stakeholders, have interpreted such provisions. This is done with a view to supporting the contention that South Africa now has a workable and effective corporate rescue regime.

The success of business rescue implementation and its pitfalls should be considered critically by the Department of Trade and Industry with a view to establishing whether or not business rescue is working in South Africa, adding value to the economy, saving jobs and providing creditors with a positive alternative to losses which would be suffered in the liquidation process. Shortfalls should be addressed by possible amendments to the legislation.

1.7 LIMITATIONS OF STUDY

In the research undertaken, the fundamental core themes and principles of corporate rescue are identified. The themes and principles which are applied in various foreign jurisdictions are compared with those now being applied in South Africa, since the introduction of Chapter 6 of the 2008 Companies Act. The study will briefly highlight certain rescue themes applicable in other jurisdictions, such as the US, the UK, Australia and Canada. A detailed comparative analysis of rescue provisions in these jurisdictions has not been undertaken.

The study does not include an in-depth analysis of section 155 of the 2008 Companies Act. Section 155 replaced the old section 311 (compromise) procedure found in the 1973 Companies Act and deals with a restructuring process without the imposition of a moratorium (stay on claims).

It has not been possible to examine or identify each and every shortcoming of the new South African legislation. Only certain sections of the 2008 Companies Act, and problems associated with both their implementation and interpretation, have been highlighted.

It should be noted that the thesis has taken legal development and case law precedent (to the best of my knowledge) into account up to **30 November 2015** and not beyond that date. Developments in the law of business rescue are ongoing and will continue to develop over time.

1.8 DEFINITIONS AND REFERENCES

The definitions relevant to the section applicable to South Africa and Chapter 6 will be dealt with in that section of the study.

- "Business rescue practitioner" is the person (one or more) appointed to oversee a company during business rescue proceedings and "practitioner" has a corresponding meaning;
- "Corporate rescue" refers to a procedure designed to either rescue a company as a going concern or to introduce mechanisms to ensure that creditors receive a better dividend than they would have received had the company gone into liquidation. The term "business rescue", introduced by the 2008 Companies Act, will refer generically to "corporate rescue". Thus the terms "corporate rescue" and "business rescue" will be used interchangeably;
- "Creditor" is any party that reflects, in its books, monies owed to it by a company with which it has traded or which it intends to continue to trade into the future;
- "Debtor" will refer to an individual debtor (person) or to a debtor company that owes monies to creditors;
- "Insolvency" will denote an inability by a company to pay its debts as and when they fall due (commercial insolvency) as well as the to a situation where its balance sheet reflects that its liabilities exceed its assets (factual insolvency);
- "Post commencement finance" is the funding that is required to be made available to a business rescue practitioner whilst he or she is in the process of supervising a business rescue;

- "Restructuring" or "reorganisation" will refer to the opportunity for turnaround specialists to restructure/reorganise the affairs of a company, its business, property, debt, liabilities and equity in a manner which enables such company to trade its way out of its financial distress or insolvent position to continue in existence and going forward;

- "Supervision" relates to the manner in which corporate recovery officers and restructuring specialists have the opportunity to impose some form of supervision on a company during its restructuring processes.

CHAPTER 2 : THE DEVELOPMENT OF INSOLVENCY LAW IN SOUTH AFRICA… A SHIFT FROM A PRO-CREDITOR TO A PRO-DEBTOR CULTURE?

2.1 INTRODUCTION

Insolvency law is the foundation of both commercial and financial law because it obliges the law to choose. There is not enough money to go around and so the law must choose whom to pay.[1] Thus insolvency law focuses on both individuals and companies that have become financially distressed. It is a collective procedure for the recovery of debts by creditors and is designed to protect the individuals and corporations that have become overburdened by their debts. Corporate insolvencies are, in terms of size and impact upon people's lives and countries' economies, of much greater significance now than individual insolvencies.[2]

It is submitted that the development of the law applicable to South African individual insolvency has had a profound influence on the development of our corporate rescue procedures and the introduction of Chapter 6 of the 2008 Companies Act. The forerunner to our new restructuring processes introduced by Chapter 6 was a sound and robust insolvency regime introduced by various pieces of legislation going back to the first South African colonies in the 1800s. The different philosophy and approach used in the conceptual mechanisms of an insolvency system is markedly different from that of corporate rescue. However, in order to understand the marked shift away from creditor-focused insolvency thinking to that of a corporate rescue culture where the needs of the debtor are considered, it is necessary to understand the history, philosophy and approach in South Africa to insolvency law prior to the business rescue provisions introduced in the 2008 Companies Act.

Further it is submitted that there is an astonishing degree of similarity between the law applicable to corporate insolvency and rescue applicable in modern times, to that which existed in the ancient law of insolvency. A brief historical survey of the manner in which individual insolvency law developed in South Africa will enable us to understand and

1. Wood *Principles of International Insolvency* (2007) 3.
2. Ibid 3.

appreciate the fundamental themes of debt compromise and rescue that are applicable to companies and which are dealt with in Chapter 6 of the 2008 Companies Act.

Thus to appreciate the shift from "old world" insolvency thinking to that of the "new world" of corporate rescue thinking, one needs to consider individual insolvency principles. Rescue culture took root in the principles of individual insolvency and South African law had little option (with the support of the South African business community), but to develop the laws applicable to corporate rescue, having an eye on what had come before.

2.2 HISTORY AND BACKGROUND

The Insolvency Ordinance of Amsterdam of 1777 is cited as the foundation of South Africa's insolvency law.[3]

South Africa's first insolvency legislation was introduced in 1829 in the former Cape Colony and was based on English bankruptcy law.[4] Ordinance 6 of 1843 (in the Cape) abolished the concept of *cessio bonorum* and replaced the 1829 ordinance.[5] It also formed the statutory basis for Insolvency Ordinances of the former pre-Union Republics such as Transvaal, Orange Free State and Natal. In 1916, after the establishment of the South African Union in 1910, the Insolvency Act of 1916 was adopted as the first uniform insolvency law for the whole of South Africa. Currently insolvency law dealing with insolvent persons is regulated by the Insolvency Act 24 of 1936 (the Insolvency Act) which came into force on 1 July 1936.[6]

The Insolvency Act only regulates the insolvency of individuals. Corporate insolvency (bankruptcy, liquidation, winding-up) was dealt with by the 1973 Companies Act and the insolvency of close corporations was dealt with by the Close Corporations Act 69 of 1984 (the Close Corporations Act).[7] These acts had chapters dealing with the liquidation or

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3. Den Tex, Van Hall, Van Jutphaas, and Faure *Nederlandsche Jaarboeken Voor Regtsgeleerdheid en Wetgeving* (1855) 291. Also see Smith *The Law of Insolvency* (1988) 6. See also Bertelsmann et al. *Mars*: *The law of Insolvency in South Africa* (2008) 10.

4. Wessels *History of the Roman-Dutch Law* (1908) 670.

5. Ibid. The Cape Ordinance 6 of 1843 was the foundation of the law of insolvency in the whole of South Africa – Acts 15 of 1859, 38 of 1884, 17 of 1886, sections 11 and 23 of 1905. See Bertelsman et al. *Mars*: *The law of Insolvency in South Africa* (2008) 11–12. The *cessio bonorum* is the concept of the debtor surrendering his estate to his creditors. Also see Wiggins "The Sixth Annual Ernst C. Stiefel Symposium: Rethinking the Structure of Insolvency Law in South Africa" (1997) 17(2/3) *New York Law School Journal of International and Comparative Law* 509–510 (noting South African insolvency law is based on both Dutch and English law).

6. See Bertelsmann et al. *Mars*: *The law of Insolvency in South Africa* (2008) 6–12 for a detailed history of the South African Law of Insolvency. See also Smith and Boraine "Crossing Borders into South African Insolvency Law: From the Roman-Dutch Jurists to the UNCITRAL Model Law" (2002) 10 *ABI Law Review* 140–143.

7. Ibid 143–151.

winding up of companies and close corporations. However, the liquidation of corporate entities required reference back to certain provisions of the Insolvency Act as well as South African common law provisions applicable to the liquidation or winding up of companies and close corporations that were unable to pay their debts.[8]

The 1973 Companies Act was replaced by the 2008 Companies Act which has been in force since 1 May 2011.[9] The Act has brought about certain amendments regarding the winding-up and liquidation of companies and close corporations;[10] it has introduced the new business rescue procedure which has replaced the old judicial management procedure found in the 1973 Companies Act.[11]

The review of South African insolvency legislation has been ongoing for several years.[12] The continued development of South Africa's insolvency law remains work in progress. The first version of the Draft Insolvency Bill of 1996 was published by the South African Law Reform Commission in 2000. In 2003, the South African cabinet approved the idea of a unified Insolvency Act that would possibly apply to various types of debtors, including natural persons, debtors (individuals) and corporate entities.[13] Apart from the Working Document published in 2013, no formal Reform Bill has yet been published.[14]

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8. Ibid.

9. For a summary of the lead-up in the drafting of the 2008 Companies Act, see Mongalo "An Overview of Company Law Reform in South Africa: From the Guidelines to the Companies Act, 2008" in *Modern Company Law for a Competitive South African Economy* (2010) xiii–xxv.

10. The Act has retained Chapter 14 of the 1973 Companies Act and remains applicable to insolvent companies being wound up. See item 9 of Schedule 5 of the 2008 Companies Act. This will remain the position until new insolvency legislation is enacted. Reference is made to the Working Document in respect of the Insolvency Bill B-2013 (approved by the cabinet in 2003 as a section 75-Bill) published by the Department of Justice in 2013. No formal Bill has yet been published. The various changes to the Bill have been prompted by the NEDLAC Report, Reports published by the World Bank, the Report on Observance of Standards and Codes (ROSC report) and by the South African Law Commission. The Department of Trade and Industry (DTI) has assumed responsibility for the business rescue aspects of the new legislation. See Cronjé "SA Insolvency Law Reform Project": presentation at Pretoria University (12 July 2013). Note that a process has commenced to phase out close corporations as a business entity in South Africa.

11. South Africa enacted its first insolvency statute in 1936, the Insolvency Act 24 of 1936, and its first Companies Act in 1926. The Companies Act of 1926 was significantly reviewed in 1963 and culminated in the 1973 Companies Act. After 1994, further reviews of company law took place which culminated in the enactment of the current Companies Act of 2008. Judicial management found in the 1973 Companies Act was replaced with Chapter 6, containing the new business rescue legislation. The 1936 Insolvency Act has not been replaced and remains part of South African law, applicable to the sequestration of individuals, trusts, partnerships and sole proprietorships.

12. See Chapter 3 below for an analysis of the development of business rescue concepts and legislation prior to the introduction of the 2008 Companies Act. South Africa has constantly reviewed its insolvency legislation. The legislature followed international developments which have been ongoing for the last 20 years and which have taken place in most common-law countries. Developments in the US with the introduction of the 1987 US Bankruptcy Reform Act (amended substantially in 1994) followed a comprehensive report by the Commission on Bankruptcy Laws of the US. In addition, following the delivery of the Report of the Insolvency Law Review Committee, Insolvency Law and Practice (known as the "Cork Report"), the UK enacted the Insolvency Act of 1985, followed by the Insolvency Act of 1986. In Australia, the Australian Law Commission in its report in relation to its General Insolvency Inquiry (the Harmer Report) recommended the enactment of various statutes, and Canada enacted the Bankruptcy and Insolvency Act of 1992. See Keay "To Unify or not to Unify Insolvency Legislation: International Experience and the Latest South African Proposals" (1999) *De Jure* 62.

13. See Centre for Advanced Corporate and Insolvency Law *Final Report containing Proposals on a Unified Insolvency Act* Part 1 and 2 (1999).

14. The Working Document (2013) published by the Department of Justice was last updated in 2015 (now referred to as the Unofficial Draft Unified Insolvency Bill) (the "UIB"). The Working Document deals with both companies and close corporations and contemplates dealing with the insolvency of other forms of business entities as well, including trusts, partnerships and other legal entities, with or without legal

Various initiatives were brought about in an attempt to modernise South African insolvency law and to bring it into line with the fresh-start principles being applied in jurisdictions like the US.[15] However, despite attempts to modernise South African insolvency law and to bring it into line with international principles of insolvency, South Africa remained frozen in time with a 1936 Insolvency Act which, to a large extent, was out of touch with modern day insolvency thinking.[16]

It is submitted that concepts such as "advantage to creditors" were and remain outdated. The need for the debtor to escape financial distress by showing that a distribution of assets must result in an advantage to such debtor's creditors remains archaic and places an unnecessary burden on a debtor attempting to escape the paralysis of being insolvent. As a result South African attempts at introducing rescue or restructuring mechanisms were stunted and resulted in financially distressed companies labouring under an ineffective regime of judicial management for many years.

2.3 ADVANTAGE TO CREDITORS AND ITS INFLUENCE ON THE DEVELOPMENT OF A PRO-CREDITOR CULTURE

Principles of insolvency in any system have always had to balance the twin competing policies of insolvency law; namely the protection of creditors and the protection of debtors. Insolvency law has always been preoccupied with the collision of these interests.[17]

These competing interests represent fundamental and ancient attitudes towards the manner in which business should be conducted:

> … on the one hand, stern values of discipline, prudence, responsibility and diligent care of other people's money, expressed in an intense moral disapproval of defaulting

personality. The latest version is available from Marthinus Cronje on mcronje@justic.gov.za. Should the Working Document become law, it appears that the concept of business rescue will apply to individual debtors who carry on business and where such individual employs 10 or more employees (see section 121 of the Working Document). Further, it is submitted that legal precedent already set by our courts will become applicable to all entities and individuals who are placed into a business rescue process by the envisaged new Insolvency Bill. For views on the South African unification proposals see Keay "To Unify or not to Unify Insolvency Legislation: International Experience and the Latest South African Proposals" (1999) *De Jure* 44–61. On 12 October 2015, the Deputy Minister of Justice and Constitutional Development announced at the INSOL Africa Round Table in Cape Town that the UIB will imminently become part of our law. See Deputy Minister of Justice and Constitutional Development, the Hon. Jon Jefferey, MP "Legislation: Insolvency Bill about to be finalised" *Legal Brief Today Issue 3856* (13 October 2015) available at http://legalbrief.co.za/diary/legal-brief-today/policy-watch/legislation-insolvency-bill-about-to-be-finalised-deputy-minister accessed 15 October 2015. Also see comments by Levenstein in "Old Insolvency Laws Out of Favour" (19 October 2015) available at http://www.werksmans.com/virt-e-bulletins/old-insolvency-law-out-of-favour.

15. Boraine and Van der Linde "The Draft Insolvency Bill: An Exploration" (1998) 4 *TSAR* 621.

16. To date, no attempt has been made to replace the outdated provisions of the Insolvency Act, although certain reforms have been suggested in the form of the proposed Draft Insolvency Bill (or Unified Insolvency Bill) – see latest draft on file with Mr Marthinus Cronjé: martinuscronje@gmail.com (Project of the Department of Justice) or contact Thanda Skhosana at ThSkhosana@justice.gov.za.

17. Wood *Principles of International Insolvency* (2007) 4. It is submitted that corporate insolvency has the added dimension of destruction of employment, which has a far greater impact on the economy when compared to the fall-out in a personal insolvency context.

> debtors, and, on the other hand, sympathy for the weak, expressed in antipathy to creditors and a wish to redistribute. The fact that these emotions are so bitterly entwined in bankruptcy law is the despair of economists, but they are a fact of life and help explain why practically every facet of bankruptcy law, big or small, is contentious.[18]

In South Africa, the debate over pro-creditor versus pro-debtor insolvency regimes continues unabated to this very day.[19]

South African insolvency law historically has favoured the interests of the creditor due to its strong ties with the UK. Much of our statute finds itself based, *inter alia*, on English law principles, although our law finds its roots in Roman-Dutch law. As a result, concepts such as favouring the creditor are founded in English law.[20]

The old English common law, stretching back to medieval times, was stark and uncompromising, making the position of the debtor extremely unenviable. In medieval England, creditors could either seize the body of the debtor or they could seize the effects of the debtor. The result of the system was to give the race for assets to the swift, the rule being "first come first served".[21]

An important and far-reaching distinction was commonly made between the position of traders, i.e. persons employed in the manufacturing of and the buying or selling of goods, and non-traders such as those in employment or engaged in a profession, such as land owners and farmers. Non-traders were not expected to obtain, nor to have the occasion to give extensive credit. Assets of non-traders were viewed as being "stationary", "known", "visible" and "permanent". If a non-trader were to take steps to put himself beyond the

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18. Ibid.

19. Creditors in South Africa have become far more supportive of rescue regimes in the context of corporate insolvency. Allowing a company to end up in liquidation destroys the potential of future business and the reduction in the ability to trade with an entity which often, for a long period of time, generated profits for the supplier of goods and services (creditors). Often the maintenance and solvency of the trading partner (financially distressed company) far outweighs the importance of the immediate recovery of current debt. It is submitted that what is meant by "pro-creditor" versus "pro-debtor" requires some clarification. It is submitted that the term "pro-creditor" describes a restructuring regime which favours the interests of the creditor and the party/entity that seeks full recovery of its indebtedness. "Pro-debtor" on the other hand describes a regime which favours the interests of the debtor and the ability of such debtor (whether ultimately an individual or a corporate) to continue to trade, preserve its business, jobs for employees and a general dispensation to allow such individual or entity to continue to contribute to the particular jurisdiction's economy into the future. The pro-debtor regime leans in favour of the "fresh start" principles which allows individuals and corporates to survive and not end up being sequestrated or placed into liquidation.

20. Hunter "The Nature and Functions of a Rescue Culture" (1999) *Journal of Business Law* 491. In describing the regulatory environment in Britain prior to the introduction of modern business rescue provisions, Hunter states at p. 493: "The rights of the unpaid judgment creditor were regarded as paramount; but, as is so often the case with oppressive laws, the draconian nature of the jurisdiction sometimes worked against its own objective."

21. Christiaan *The Origin, Progress and Present Practice of the Bankrupt Law* (1814) XIII. Also see Wood *Principles of International Insolvency* – Historical developments in the UK 17–18.

reach of his creditors, it was not expected that he would be able to "make away with his assets".[22]

However, the position of the trader was quite different. The nature of the trader's activities required him to give and receive credit. Much of the trader's assets were movable property of the type "generally unknown, always uncertain and perpetually fluctuating".[23]

English bankruptcy legislation developed in the 15th century allowed, at the suit of the creditor, the ability to order the seizure of the assets of an absconding trader and to provide for the distribution of the sale amongst his creditors. It was only in 1705 that legislation allowed for the discharge from bankruptcy for traders. The defaulting trader (and one who did not meet his contractual obligation to repay debt)[24] was expected to forfeit the privileges of, and incidental to, earning their livelihood in commercial society and whose structure and fabric was put at risk by any trader who failed to fulfil his commitments.[25]

Leading up to the Bankruptcy Act, 1883 ("the 1883 Act") in the UK, bankruptcy legislation was clearly focused on the creditor. The provisions of this new Act were designed to ensure impartial and independent examination as to the cause of bankruptcy and the conduct of each bankrupt. The 1883 Act was designed to severely punish misconduct in the interests of redressing losses caused to creditors. The machinery for dealing with bankruptcy matters created by the 1883 Act is essentially in force today.[26]

It is submitted that the historical pro-creditor slant (and the parallel methodology of punishment being meted out to the defaulting trader), dating back to medieval times in England, certainly had its impact on the development of insolvency laws in South Africa.

Why this is so needs to be considered within the historical backdrop and understanding of the philosophy, social and political needs of South African society and with reference to certain principles of Roman-Dutch law. The starting point is to have a broad understanding of the historical expectation of the rights of debtors and creditors in South African insolvency law.

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22. Cullen Principles of the Bankrupt Law (1800) 4–5.
23. Ibid 5.
24. See discussion on the principle of "pacta sunt servanda" – sanctity of contract in Chapter 5, para 5.4.
25. Holdsworth A History of English Law 1871–1944 Volume XIII (1909–1952) 265.
26. See Cork *Insolvency law and practice: report of the review committee (the Cork committee)* Cmnd 8558 (1982) 14–21.

Considering the history of insolvency practice in South Africa, one needs to go back to the Twelve Tables (part of the ancient Roman statutes). [27] Table III deals with the execution of judgments. If a debtor failed to discharge his debt, the creditor was entitled to take the debtor and bind him with a "thong or fetters":

> Meanwhile they shall have the right to compromise, and unless they make a compromise the debtors shall be held in bonds for thirty days. During these days they shall be brought to the praetor into the meeting place on three successive market days, and the amount for which they have been judged liable shall be declared publicly. Moreover, on the third market day they shall suffer capital punishment or shall be delivered for sale abroad across the Tiber River.
>
> On the third market day the creditors shall cut shares. If they have cut more or less than their shares it shall be without prejudice.[28]

Clearly, the treatment of debtors was unbelievably crude and harsh and some modification of the law became necessary. Provision was made for the attachment of the debtor's property and to appoint a *praetor* to manage the sale of such property.[29] A sale of the debtor's property was arranged and his property sold *en masse* to the highest bidder. The proceeds of the sale were divided amongst creditors according to a fixed order of preference. Later, a law of voluntary surrender of goods (*cessio bonorum*) was introduced, allowing debtors to discharge their debts by transfer of their property to their creditors. This infinitely more humane procedure had as its consequence exemption from arrest and imprisonment as well as exemption of subsequently acquired property from attachment of debts incurred prior to surrender.[30]

As referred to above, the 1777 ordinance, passed in Amsterdam,[31] was the foundation of our insolvency law culminating in various pieces of legislation and ordinances being repealed

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27. See Twelve Tables 3 and 4, Maine *Ancient Law* (1861) Chapter 9 61.

28. Johnson, Coleman-Norton, Bourne and Pharr *Ancient Roman Statutes* (1961) 10. Also see Scott *The Civil* Law (2001) 62-64. Also see Smith *The Law of Insolvency* (1988) 5. Also see Duncan "From Dismemberment to Discharge: The Origins of Modern American Bankruptcy Law" (1995) 100 *Commercial Law Journal* 191.

29. Smith *The Law of Insolvency* (1988) 5. Also see Calitz *A reformatory approach to State Regulation of insolvency law in South Africa* (LLD Thesis 2009) Part II, Historical Overview, Chapter 1 15–23. Also see Burdette *A Framework for Corporate Insolvency Law Reform in South Africa* (LLD thesis, University of Pretoria, June 2002) 22 – 31. Also see Calitz *A reformatory approach to State Regulation of insolvency law in South Africa* (LLD Thesis 2009) Part II, Historical Overview, Chapter 1 27–33. For the current insolvency statutes applicable in the UK today, see Chapter 5, para 5.2.1.

30. Smith *The Law of Insolvency* (1988) 5.

31. Den Tex et al *Nederlandsche Jaarboeken Voor Regtsgeleerdheid en Wetgeving* (1855) 291.

by the Insolvency Act 32 of 1916. As set out above, our present law of insolvency of individuals is found in the 1936 Insolvency Act.[32]

It is submitted that the background to the practice of a creditor-orientated approach is found in the manner that debtors were treated historically.[33]

In commercial transactions, the incurring of debt is inevitable. Debt can culminate in financial difficulty with the result that debtors end up being unable to pay their debts. Discharge of such debt can only occur through a formal sequestration process, with the possibility of rehabilitation. Thus, some relief to the financially distressed debtor is a possibility, which reflects a shift from a harsh creditor-orientated approach to a debtor-friendly approach.[34]

It is clear that the "fresh start" principle (prevalent in international jurisdictions) had a very difficult history to contend with in South Africa especially in the lead-up to the new business rescue (restructuring) principles introduced in Chapter 6 of the 2008 Companies Act. Prior to the introduction of the 2008 Companies Act, it was accepted that South African debtors (with specific reference to individuals) may become insolvent through no fault of their own. As a result there was a recognition that debtors should be provided with an opportunity to make a fresh start.[35] Often creditors contributed towards insolvencies by granting credit to debtors who could not afford to repay it.[36]

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32. Smith *The Law of Insolvency* (1988) 6–7. Also see developments in the Cape, Pre-Union Legislation, discussion on the Insolvency Act 32 of 1916 and amendments to present in Bertelsmann et al. *Mars*: *The law of Insolvency in South Africa* (2008) 9–16. Also see Calitz *A reformatory approach to State Regulation of insolvency law in South Africa* (LLD Thesis 2009) Part II, Historical Overview, Chapter 1 15–23.

33. For a history of the manner in which traders incurred debt in Roman law, see Visser "Romeinsregtelike aanknopingspunte van die sekwestrasie proses in die Suid-Afrikaanse insolvensie reg" (1980) *De Jure* 42; Wenger *Institute of Roman Law of Civil Procedure* (1940) 230; Stander "Die eienaar van die bates van die insolvente boedel" (1996) 59 *THRHR* 388; Burdette *A Framework for Corporate Insolvency Law Reform in South Africa* (LLD thesis, University of Pretoria, June 2002) 22 – 26. The harsh treatment meted out to debtors in fact allowed creditors to cut the debtor into pieces, each creditor taking his rightful share, at 24. Also see Bertelsmann et al. *Mars*: *The law of Insolvency in South Africa* (2008) 6–7. For developments under Roman Law, see Hunter *Introduction to Roman Law (1844–1898)* (1994) 1036; Kunkel *An Introduction to Roman Legal and Constitutional History* (1966) 271; Roestoff *'n Kritiese Evaluasie van Skuldverligtingsmaatreëls vir Individue in die Suid-Afrikaanse Insolvensiereg* (LLD University of Pretoria, 2002). For developments under Roman-Dutch law, see Bertelsmann et al. *Mars*: *The law of Insolvency in South Africa* (2008) 8–9. Also see Wessels *History of the Roman–Dutch Law (1862–1936)* (1908) 108.

34. Rochelle "Lowering the Penalties for Failure: Using the Insolvency Law as a Tool for Spurring Economic Growth: The American Experience, and Possible Uses for South Africa" (1996) *TSAR* 315. Clearly then, gone are the days when insolvency law was used as a form of punishment against the debtor. As Rochelle aptly puts it, "[t]hose who fail would not become modern lepers but instead would receive another chance to be productive for themselves and society". Also see Asheela *The Advantage Requirement in Sequestration Applications: A Call for Relaxation* (LLM University of Pretoria, 2012) 1.

35. For an analysis of the fresh-start policy in Bankruptcy Law for individuals, see Jackson *The Logic and Limits of Bankruptcy Law* (1986) 225–252.

36. As early as 2000, the South African Law Commission recognised the need to strike a balance between the rights of creditors and giving an opportunity to the debtor to make a fresh start. There was however an expectation from debtors to act honestly and to assist in the winding-up of their insolvent estates. See South African Law Commission *Review of the Law of Insolvency* Volume 1 (2000) 20. Also see Roestoff "'n Kritiese Evaluasie van Skuldverligtingsmaatreëls vir Individue in die Suid-Afrikaanse Insolvensiereg" (LLD Dissertation University of Pretoria) (2002) 445.

It is submitted that in South African insolvency law, the fresh-start principle (prior to the introduction of Chapter 6 of the 2008 Companies Act) found its high-water mark in the ability of a debtor (individual) being able to be sequestrated (declared insolvent/bankrupt) with the opportunity of rehabilitation. Unfortunately, the "advantage to creditors" approach to sequestration orders left many over-indebted individuals with little opportunity to take advantage of the process.[37]

In South Africa, when an individual debtor cannot meet his or her debt obligations, it is necessary to consider the compulsory sequestration of the insolvent debtor's estate.[38] This has the effect of implementing the collective debt-collecting procedure of the South African law of insolvency.[39] The aim of such procedure is to provide for a collective debt collecting process that will ensure an orderly and fair distribution of the debtor's assets in circumstances where these assets are insufficient to satisfy all creditors' claims. The *concursus creditorum* comes into place once a sequestration order is made. The *concursus creditorum* is a fundamental principle of South African insolvency law and entails that the rights of creditors as a group are preferred to the rights of individual creditors. As a result, no single creditor can execute against the debtor's estate in order to obtain full payment of such creditor's claim at the expense of other creditors.[40]

The concept of a *concursus creditorum* is a common dominant thread in the Insolvency Act and is a concept linked to the "advantage of creditors"; not one creditor or some creditors, but the general body of creditors.[41]

37. See Asheela *The Advantage Requirement in Sequestration Applications: A Call for Relaxation* (LLM University of Pretoria, 2012) (ii)–(iii). Note that the South African Law Reform Commission in the 2000 Insolvency Bill has recommended that the advantage for creditors' requirement be retained in the new Insolvency Act. South African natural person insolvency law has remained largely creditor-orientated despite the international trend to assist over-indebted debtors. Entry levels into debt relief procedures in South Africa are of such a nature that most debtors are effectively excluded from any form of relief and are therefore bound to their desperate situations. The majority of these excluded debtors fall within the "no income no asset" debtor category (NINA debtors). Thus, in the South African insolvency system, and because of the concept of advantage to creditors, a person can be "too poor to go bankrupt". See Coetzee and Roestoff *Consumer Debt Relief in South Africa – Should the Insolvency System Provide for NINA Debtors? Lessons from New Zealand* (24 July 2013) 1.

38. Section 9(1) of the Insolvency Act. For the law on the insolvency of individuals, see Smith and Boraine "Crossing Borders into South African Insolvency Law: From the Roman-Dutch Jurists to the UNCITRAL Model Law" (2002) 10 *ABI Law Review* 143–152. For the different forms of debt relief, see Coetzee and Roestoff *Consumer Debt Relief in South Africa – Should the Insolvency System Provide for NINA Debtors? Lessons from New Zealand* (24 July 2013) 2–3.

39. Bertelsmann et al. *Mars*: *The law of Insolvency in South Africa* (2008) 1. Also see Coetzee and Roestoff *Consumer Debt Relief in South Africa – Should the Insolvency System Provide for NINA Debtors? Lessons from New Zealand* (24 July 2013) 9–13.

40. Bertelsmann et al. *Mars*: *The law of Insolvency in South Africa* (2008) 2. See section 20(1)(c) of the Insolvency Act. On insolvency, the concept of a *concursus creditorum* is explained as a "gathering of creditors". The insolvent estate is frozen and it is no longer possible for any one creditor to do anything which would have the effect of altering or prejudicing the rights of other creditors. Nothing can be done to disturb the insolvent's assets or disturb the preferent claims of creditors. See Smith "The Recurrent Motif of the Insolvency Act: Advantage to Creditors" (1985) 7 *Modern Business Law* 27.

41. Ibid 24–27. The concept of a *concursus creditorum* is fundamental to South African insolvency law and the various acts relating to insolvency are merely declaratory for the realisation and distribution of insolvent estates and to regulate proceedings to that end rather than to alter that fundamental concept. See *Richter NO v Riverside Estates (Pty) Ltd* 1946 OPD 209 at 223.

The *locus classicus* with regard to the concept of *concursus creditorum* is *Walker v Syfret*,[42] where the court explained the legal position as follows:

> The object of the [Insolvency Act] is to ensure a due distribution of assets among creditors in the order of their preference … The sequestration order crystallises the insolvent's position; the hand of the law is laid upon the estate, and at once the rights of the general body of creditors have to be taken into consideration. No transaction can thereafter be entered into with regard to estate matters by a single creditor to the prejudice of the general body. The claim of each creditor must be dealt with as it existed at the issue of the order.

As far as the procedures available to the debtor for addressing a debt problem are concerned, it is important to note that it is not a primary object of the Insolvency Act to grant debt relief to debtors.[43]

Once a trustee is appointed to administer the insolvent's estate, the creditor's sole redress to collect outstanding debt is to prove a claim by means of a formal process for the ultimate purpose of sharing, with all other proved creditors, in the proceeds of the estate.[44] Once assets are realised by the trustee, the trustee must distribute the proceeds amongst creditors in the order of preference set out in the Insolvency Act. In brief, the trustee's duty is to liquidate and distribute the assets of the estate amongst the creditors. This is the core of the principal objectives of the Insolvency Act.[45]

Rehabilitation of the insolvent might occur thereafter. The ability to apply to court for rehabilitation will depend on the extent and severity of the individual's insolvency. In any event, an individual will be deemed to be rehabilitated after the expiry of a period of ten years.[46]

Again, the ability to successfully achieve the "fresh start" offered by the provisions of the Insolvency Act (either through sequestration or by rehabilitation) is premised on the

42. *Walker v Syfret NO* 1911 AD 141 at 166. The *concursus creditorum* equated to a "levelling of the playing fields" for all creditors, thus ensuring an equitable distribution of assets. As far as the procedures available to a debtor were concerned, it was not a primary object of the Insolvency Act to grant debt relief to debtors – see Bertelsmann et al. *Mars*: *The law of Insolvency in South Africa* (2008) 3.

43. For alternative debt relief mechanisms such as administration, see Coetzee and Roestoff *Consumer Debt Relief in South Africa – Should the Insolvency System Provide for NINA Debtors? Lessons from New Zealand* (24 July 2013) 13–16. Also see *R v Meer and Others* 1957 (3) SA 614 (N) at 619, where the court remarked:"The Insolvency Act was passed for the benefit of creditors and not for the relief of harassed debtors."

44. Smith *The Law of Insolvency* (1988) 3.

45. Ibid 3.

46. Ibid. See section 129(b) of the Insolvency Act. Also see Smith "The Recurrent Motif of the Insolvency Act: Advantage to Creditors" (1985) 7 *Modern Business Law* 31.

provision of the *concursus creditorum*. Without this, it would be possible for a vigilant creditor to exhaust the debtor's assets leaving nothing behind for the more tardy creditors.[47]

Clearly, the purpose of the concept of an advantage to creditors is to ensure that the general body of creditors is able to share in the winding up of the insolvent estate as economically and as expeditiously as possible. The purpose is to ensure that the debtor surrenders his estate for the benefit of creditors and to ensure that the debtor is released from continued execution against his new estate (post sequestration).[48]

One of the fundamental allegations in an application for the sequestration of an individual is establishing an advantage to creditors.[49] It is not essential that the application show a monetary advantage as there are other advantages to a sequestration. These advantages would include the avoidance of an unfair distribution of the respondent debtor's assets amongst some of his creditors to the exclusion of others, the interrogation of the respondent, the investigation of his affairs by a trustee and in general the superior legal machinery of the Insolvency Act. However, these latter issues do not in themselves constitute an "advantage to creditors", but when these issues are coupled with allegations that there is a reasonable prospect that assets may be revealed or recovered as a result of investigations, the right to share in the distribution of potential hidden assets will constitute an advantage to creditors.[50]

In an estate where there are a number of creditors with competing claims it has been held that there is a definite advantage to creditors where, after the estate has been administered, there will be no danger that the assets will be dissipated in the cost of the sequestration.[51]

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47. Smith *The Law of Insolvency* (1988) 3–4.
48. Ibid 4.
49. While an "advantage to creditors" need not be established in an application for the compulsory liquidation of a company (or a close corporation) it is essential to understand this as an "insolvency" concept: when analysing the South African attitude to creditors generally and how they have been generally "preferred" in historical insolvency proceedings in South Africa. The pro-creditor stance adopted by corporate South Africa resulted in judicial management being hardly used, which led to the need to introduce a business rescue process into South African law. See Meskin *Insolvency Law and its Operation in Winding Up* (1990+).
50. Smith *The Law of Insolvency* (1988) 56. In practice the term advantage to creditor has tended to lean towards a "monetary advantage". Although the grant of a sequestration order is left to the court's discretion, whether there will be some monetary benefit to creditors is a factor weighing on the court in its determination. Also see p. 64: the "advantage to creditors" requirement serves the purpose of a filter, in other words, it is the decisive factor regarding whose estate will be sequestrated and whose not. The most important factor to determine compliance is whether the creditors will receive a pecuniary benefit. In practice this relates to the question as to whether the unsecured concurrent creditors will receive at least a dividend based on the *pari passu* principle. Also see Smith and Boraine "Crossing Borders into South African Insolvency Law: From the Roman-Dutch Jurists to the UNCITRAL Model Law" (2002) 10 *ABI Law Review* 143–152. See *Consolidated Practice Directive Manual: Practice Manual of the North Gauteng High Court* (2009) 90–92 on advantage to creditors.
51. Boraine and Roestoff "The Treatment of Insolvency of Natural Persons in South African Law: An Appeal for a Balanced and Integrated Approach" (2013) 5 *The World Bank Legal Review* 91–100. Also see on dividends realised in a sequestration p. 96: "There should be a dividend of at least 20 cents in the Rand. In recent times, however, a dividend of 20 cents in the Rand is generally regarded as the minimum benefit that would have to be established before a sequestration application will be granted." See *Ex parte Ogunlaja & Others*, 2011 JOL 27027 (GNBP) para 9. Also see Bertelsmann et al. *Mars*: *The law of Insolvency in South Africa* (2008) 139 for a detailed history of the

The term "advantage to creditors" often appears to be nonsensical. How can the insolvency of an individual (or a corporation) ever be to the benefit of a creditor? The term itself is anomalous and confusing. There certainly can be no advantage to a creditor if insufficient assets available for distribution result in a shortfall and a contribution is levied on creditors. This can only result in further losses for the unfortunate creditor.[52]

It was clear that the need for financially distressed debtors to have to show that their personal sequestration would result in some inherent "advantage to creditors", left South Africa focused on the needs of creditors when it came to the practice of insolvency law.

It is submitted that by the early 2000s, South Africa began to make a marked shift in focus from the continued protection of creditors and their recovery of debt. The old regime of "advantage to creditors", at least in the context of corporate insolvency began to wither, in that the South African legislature saw the "debtor" as the primary focus when it came to issues of financial distress. The political landscape in South Africa of indigent consumers being driven into long periods of debt at the hands of "unscrupulous" corporates changed society's view on the protection of the creditor at all costs. Creditors too began to see that the protection of the debtor provided that creditor with the opportunity to sustain ongoing business and profit making into the future.

Despite the practice of South African insolvency law being rooted in a pro-creditor culture, South Africa took a giant leap of faith in protecting consumer debtors with the introduction of the National Credit Act 34 of 2005 (the "NCA"). The aim of the NCA is to, *inter alia*, promote a fair and non-discriminatory marketplace for access to consumer credit. In addition, provisions protect the consumer from unfair credit and credit marketing practices, promotes responsible credit granting and prohibits the granting of reckless credit.[53] One of

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South African Insolvency Law. See *Selwell Shops Interiors v Van Der Merwe*, Case No. 27527/1990 (16 November 1990) (WLD). Also see Loubser "Ensuring Advantage to Everyone in a Modern South African Insolvency Law" (1997) *SA Merc LJ* 327–329.

52. Smith *Modern Business Law* (1987) 27; *Consolidated Practice Directive Manual: Practice Manual of the North Gauteng High Court* (2009) 90–92 on advantage to creditors as well as Roestoff and Coetzee "Consumer Debt Relief in South Africa: Lessons from America and England and Suggestions for the Way Forward" (2012) *SA Merc LJ* 55–59; Asheela *The Advantage Requirement in Sequestration Applications: A Call for Relaxation* (LLM University of Pretoria, 2012) 23–47. The true meaning of the term "advantage to creditors" remains open to debate. Pecuniary advantage to creditors remains at the forefront of the meaning of the term. In *Stainer v Estate Beukes* 1993 OPD 86, at 90, De Villiers JP said: "There are, of course, other advantages and factors which the Court will take into consideration, besides the direct financial advantages; such as the superior legal machinery which the creditors acquire by sequestration, their rights of control and investigation, etc." This was followed in *Awerbuch, Brown & Co (Pty) Ltd v Le Grange* 1939 OPD 20 at 33. Also see Smith *Modern Business Law* (1987) 7 31–32.

53. See the full memorandum on the objects of the National Credit Bill, 2005 (Bill 18D of 2005). Also see the provisions of administration orders in terms of the Magistrates' Court Act 32 of 1944.

the purposes of the NCA is to protect consumers by providing mechanisms for resolving over-indebtedness.[54]

The "harassed debtor" was considered in *Ex Parte Ford and Two Similar Cases*.[55] The court confirmed that the primary object of the Insolvency Act is to benefit creditors and not to grant relief to harassed debtors. The court pointed out that there is a consonance between the objects of the relevant provisions of the NCA and the Insolvency Act, namely "not to deprive creditors of their claims but merely to regulate the manner and extent of their payment".[56]

South Africa has thus seen a further shift in favour of consumer rights with the introduction of the Consumer Protection Act 68 of 2008 (the "CPA") which protects the rights of consumers.[57] The CPA's objective is to promote a fair, accessible and sustainable marketplace for consumer products and its provisions focused on an array of consumer protection mechanisms.[58]

The preference and focus on the rights of creditors, while remaining a fundamental prerequisite for applications for the insolvency of individuals, also finds itself, it is submitted, reflected in the manner and process affecting the liquidation or winding up of companies.[59] While there is no requirement in an application for the compulsory liquidation of a company to show an advantage to creditors, the legacy of the concept has filtered its way into the manner in which South African companies have been wound up historically. It is submitted that this attitude and approach has resulted in stakeholders expecting that in the

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54. Refer to section 3(g) of the NCA. For an analysis of debt review in terms of the NCA, see Coetzee and Roestoff *Consumer Debt Relief in South Africa – Should the Insolvency System Provide for NINA Debtors? Lessons from New Zealand* (24 July 2013) 16–19.

55. *Ex Parte Ford and Two Similar Cases* 2009 (3) SA 376 (WCC) at 383. Also see *R v Meer* 1957 (3) SA 614 (N) at 619 and *Ex Parte Pillay* 1995 (2) SA 309.

56. Roestoff and Coetzee "Consumer Debt Relief in South Africa: Lessons from America and England and Suggestions for the Way Forward" (2012) *SA Merc LJ* 53. On the issue of consumer insolvency: there are various options for discharge, including rehabilitation in terms of the Insolvency Act; administration orders, debt review in terms of the NCA and informal creditor workouts. Also see Boraine and Roestoff "The Treatment of Insolvency of Natural Persons in South African Law: An Appeal for a Balanced and Integrated Approach" (2013) 5 *The World Bank Legal Review* 91–100.

57. The Consumer Protection Act 68 of 2008 (CPA) was introduced into South African law to further protect the rights of consumers when purchasing goods and services in the South African marketplace. Reference should be made to the preamble to the CPA where the objectives of the CPA are clearly set out. The promotion and protection of the economic interests of the consumer is a primary feature of the legislation – see Government Gazette No. 32186 Notice 467 *Determination of threshold in terms of the Consumer Protection Act, 2008 (Act No. 68 of 2008)* (29 April 2009).

58. See Memorandum of the Objects of the Consumer Protection Bill, 2008. The CPA came into law on 29 April 2009.

59. The overlap between individual insolvency and the insolvency of consumers involved in business is recognised by authors and academics. A regime for natural person insolvency must also coordinate with that for business insolvency. Many of the same issues of law, policy and practice that arise in business insolvency might also arise in the context of addressing the insolvency of natural persons. This is especially true when the insolvent natural person is or has also been engaged in business, whether or not the insolvency arises as a direct consequence of business activity. See The World Bank *Insolvency and Creditor/Debtor Regimes* (Report 77170) 13–14 and pp. 17−18 on the distinction between business insolvency and the insolvency of natural persons. On the concept of an "advantage to creditors" in a winding up, see *In Re Palmer Marine Surveys Ltd* [1986] 1 WLR 573 at 578.

liquidation process there will always be a pro-creditor bias, which acts to the detriment and prejudice of the debtor company (and its stakeholders). The statutory preferences created by the relevant provisions of the Insolvency Act[60] sets out clearly that secured creditors (often the banks) and preferent creditors (usually the Receiver of Revenue) generally end up receiving the bulk of liquidation dividends to the substantial prejudice of concurrent creditors. It is submitted that the liquidation process as a whole is geared towards realising the assets of the company to the benefit of creditors, leaving the debtor company "wound up" with zero prospects of recovery.

The legal fraternity and scholars have long recognised the fact that South African insolvency law has traditionally been classified as a pro-creditor system. This is due to the fact that South African insolvency law is aimed at protecting creditors and not at assisting the struggling debtor.[61]

The fresh-start pro-debtor principles began to take root in South Africa in the late 1970s, when sequestrated debtors founded a support organisation to assist sequestrated debtors to put an end to what they perceived to be unfair discrimination.[62]

Coupled with the fact that modern international insolvency law was moving further and further away from the principles of burdening debtors unable to pay their debts with severe or permanent disabilities, let alone severe punishment, insolvent debtors began to be treated differently. The reasoning behind the modern viewpoint is that in a capitalist society, people should be encouraged to take business risks which, if successful, will result in economic growth and the creation of new job opportunities.[63] However, taking risks implies the possibility of failure, and should positive results not be achieved, the failed entrepreneur should be assisted and encouraged to become economically productive again as soon as possible, or, as it is generally termed, to make a "fresh start".[64]

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60. See sections 98A–103 of the Insolvency Act for ranking of creditors in insolvency.

61. According to Wood *Principles of International Insolvency* (1995) 8–9. South Africa is a pro-creditor country, leaning towards a pro-debtor system. For a criticism of this classification, see Burdette *A Framework for Corporate Insolvency Law Reform in South Africa* (LLD thesis, University of Pretoria, June 2002) 8.

62. See Snyman "Gesekwestreerdes snoer hul kragte saam" *Beeld* (17 June 1996) 7.

63. Rochelle "Lowering the Penalties for Failure: Using the Insolvency Law as a Tool for Spurring Economic Growth: The American Experience, and Possible Uses for South Africa" (1996) 2 *TSAR* 315. Also see Loubser "Ensuring Advantage to Everyone in a Modern South African Insolvency Law" (1997) *SA Merc LJ* 325–326. On the scope of discharge for individuals, see Jackson *The Logic and Limits of Bankruptcy Law* (1986) 253–279.

64. Rochelle "Lowering the Penalties for Failure: Using the Insolvency Law as a Tool for Spurring Economic Growth: The American Experience, and Possible Uses for South Africa" (1996) 2 *TSAR* 315.

The worldwide trend began to catch on in South Africa and resulted in a totally new attitude regarding the processes which followed when debtors found themselves to be insolvent and unable to pay their debts.[65]

The balancing act between the rights of creditors and that of debtors began to take on new meaning as South Africa began to look at developments in Europe and the US.[66]

Various approaches to bankruptcy in international jurisdictions began to filter through to South Africa, particularly where it involved the attitude of creditors of insolvent companies and the manner in which recoveries could be made from an insolvent entity. Modern bankruptcy systems would tend to consider a system whereby creditors as a group would prefer to coordinate their collective actions so that the debtor company is liquidated piecemeal, but only where such action would result in raising greater returns for creditors than would be the case in continuing to operate the company by way of a reorganisation or rescue process. The balancing act between liquidations versus reorganisation became a value-maximising election.[67]

Various alternatives could be considered. Either regulation of insolvency recoveries could occur by way of informal procedures, court recovery procedures (either by way of liquidation or reorganisation) or by way of contractually determined procedures, such as arbitration. Other suggestions included a contractual basis authorising creditors to collect promptly and in full upon default. The criticism of such an approach was that such a mechanism could result in piecemeal liquidations which would benefit (prefer) certain creditors above others. Further, "traditionalists" argued that bankruptcy law serves an important purpose in the rehabilitation of companies in that without sound bankruptcy/insolvency/reorganisation laws, such companies would fail. Jobs would be lost and communities damaged – economically and otherwise – if the protection offered by reorganisation law were unavailable.[68] By contrast, "proceduralists" deny that bankruptcy laws are able to work any special magic and that some companies must live or die in the

65. Loubser "Ensuring Advantage to Everyone in a Modern South African Insolvency Law" (1997) *SA Merc LJ* 326. Also see Boraine and Roestoff "Vriendskaplike Sekwestrasies – 'n Produk van Verouderde Beginsels?" (1994) 27 *De Jure* 31. On principles of friendly sequestrations see Asheela *The Advantage Requirement in Sequestration Applications: A Call for Relaxation* (LLM dissertation, University of Pretoria, 2012) 33–37; Boraine and Roestoff "The Treatment of Insolvency of Natural Persons in South African Law: An Appeal for a Balanced and Integrated Approach" (2013) 5 *The World Bank Legal Review* 6–8.

66. Duncan "From Dismemberment to Discharge: The Origins of Modern American Bankruptcy Law" (1995) 100 *Commercial Law Journal*. 191–199.

67. See Schwartz "A Contract Theory Approach to Business Bankruptcy" (1998) *The Yale Law Journal* 1807–1851.

68. See Baird "Bankruptcy's Uncontested Axioms" (1998) *Yale Law Journal* 577.

market. All that bankruptcy law can offer is to ensure that confrontation between creditors and investors of capital do not accelerate a company's liquidation. The forces of the market should prevail and determine the future viability of a company.[69]

Ultimately, a bankruptcy system must have the goal of maximising the value of insolvent estates. It is submitted that in South Africa, the goal of maximum recovery for creditors had always been the focus of insolvency law where the principle of "advantage to creditors" had indeed left a legacy of "asset stripping" through a creditor founded liquidation process. Historically, the balancing act referred to above had been heavily slanted in favour of the creditor, at the expense of the debtor company.

What follows on insolvency must of necessity entail a delicate balancing act between the interests of the various stakeholders, the unpaid creditors, the insolvent debtor and the general public; the latter group being on the one hand, the consumers who eventually have to pay higher prices to compensate creditors for losses suffered through unpaid debts; but on the other hand, those who have a right to be protected against dishonest or reckless traders.[70]

A move towards a consideration of the plight of the insolvent debtor and the opportunity to be given a fresh start was echoed in the judgment of Slomowitz AJ in *Kruger v The Master and Another NO; Ex Parte Kruger*.[71] The learned Judge stated that in a capitalist society, insolvency was not a crime, and by implication, that sequestration should not be a punishment.

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69. Ibid 577–578. For the different and contrasting views of "traditionalist" versus "proceduralist" theories of bankruptcy law, see ibid 573–580. The value of preserving firms, the role of the judge as arbiter and the manner in which financially distressed firms can be rehabilitated are discussed. Also see views of Lee "How is "efficiency" determined in the insolvency context? Clarifying the meaning of efficiency with the conjunction of insolvency jurisprudence and economic methodology" (PhD, University of Queensland 2015). Lee specifically highlights theories of contractarianism in insolvency law and efficiencies surrounding wealth maximisation 13–24 and 25–32. Also see Goode *Principles of Corporate Insolvency Law* (2011) – Dealing with the theories of corporate insolvency law, Chapter 2, paras 2.01–2.14, 68–70. For a full discussion on the effect of a bankruptcy system whereby insolvency and bankruptcy mechanisms could be regulated contractually, see Schwartz "A Contract Theory Approach to Business Bankruptcy" (1998) *The Yale Law Journal* 1807–1851. Issues such as bankruptcy systems which are state dependent, mandatory (statute) based rules dealing with bankruptcy and systems which support and assist creditors' recoveries directly by way of a coordinated approach are discussed. Also see discussion in Mooney "A Normative Theory of Bankruptcy Law: Bankruptcy as (is) Civil Procedure" University of Pennsylvania Law School (2004) *Faculty Scholarship* Paper 18 available at http://scholarship.law.upenn.edu/faculty_scholarship/18 accessed 4 October 2015. This article deals specifically with the core procedure which supports bankruptcy law and which proposes that this is the normative for measuring recoveries for the holders of legal entitlements in respect of a financially distressed debtor. The "proceduralist theory" argues that it is generally wrong to redistribute a debtor's wealth away from its rights holders to benefit third party interests (creditors, employees and the general community). The question is posed, should bankruptcy law exist, essentially, in order to serve the interests of creditors and their wealth maximisation or whether its goals are more expansive, such as the company's stakeholders, shareholders and investors. See 931–932. For a further discussion on the modern themes of bankruptcy law (including "proceduralist" versus "traditionalist" approaches), see Ferriell and Janger *Understanding Bankruptcy* (2013) 7–10. The authors state that both the "proceduralist" and "traditionalist" views have influenced US Bankruptcy Courts' decisions and various congressional enactments – see ibid, 7–8.
70. Loubser "Ensuring Advantage to Everyone in a Modern South African Insolvency Law" (1997) *SA Merc LJ* 326.
71. *Kruger v The Master and Another NO; Ex Parte Kruger* 1982 (1) SA 754 (W).

These sentiments had already been recognised by the South African Insolvency Bill and Explanatory Memorandum (1996) in which it was stated that "a balance must be struck between the rights of creditors and giving a debtor an opportunity to make a fresh start."[72]

The softening of attitude towards debtors was also seen in the judiciary's stance to "friendly sequestrations". This was where a creditor would apply for the compulsory sequestration of a debtor's estate with the intention of obtaining the discharge of debts for such debtor, rather than with the advantage to creditors in mind.[73] Over time, and while initially many of these applications were received with suspicion, the courts allowed them, provided that such applications were dealt with with care and proper scrutiny. As long as there was no collusion, there was no objection to a friendly sequestration.[74]

Whether or not the current sequestration process continues to hold much of an advantage to creditors is open to debate. As far back as 1925, Curlewis JP remarked that the words "benefit of creditors" have in many cases come to be entirely meaningless.[75]

In summary, the principle of an advantage to creditors had been at the forefront of sequestration law in South Africa for decades. Presently, not much has changed in respect of the courts' attitudes towards the establishment of an advantage to creditors when considering an application for the sequestration of an insolvent debtor's estate. It should be the case that some pecuniary benefit results from the grant of a sequestration order. Courts should attempt to ensure that creditors of an insolvent estate in fact do obtain some advantage, but without depriving the insolvent debtor of the possibility of a fresh start.[76]

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72. South African Insolvency Bill and Explanatory Memorandum, 1996 (para 5.4 at 8).

73. Loubser "Ensuring Advantage to Everyone in a Modern South African Insolvency Law" (1997) *SA Merc LJ* 327. Also see Smith "Friendly and not so Friendly Sequestrations" (1981) *Modern Business Law* 58; Loubser "Making Friends with Friendly Sequestrations" (1991) 2 *Codicillus* 23. Also see *Ex Parte Steenkamp and Related Cases* 1996 (3) A 822 (W) *Finance Factors CC v Jayesem (Pty) Ltd and Others* (5304/2013) [2013] ZAKZDHC 45 (22 August 2013); *Craggs v Dedekind; Baartman v Baartman & Another, Van Jaarsveld v Roebuck, Van Aardt v Barett* 1996 (1) SA 935 (C).

74. Loubser "Ensuring Advantage to Everyone in a Modern South African Insolvency Law" (1997) *SA Merc LJ* 327.

75. See Kanamugire "The Requirement of Advantage to Creditors in South African Insolvency Law: A Critical Appraisal" (2013) 4(13) *Mediterranean Journal of Social Sciences* 23–25; Boraine and Roestoff "Revisiting the State of Consumer Insolvency in South Africa After Twenty Years: The Court's Approach, International Guidelines and an Appeal for Urgent Law Reform" (2014) 77 *THRHR* Part 1 351–374, Part 2 1–20. In 1989, the South African Law Commission referred to an investigation conducted at the Master's Office and found that only in 28,6 per cent of sequestrations did creditors receive a dividend while in 40,6 per cent of cases examined, creditors had to pay a contribution. As a result, very few concurrent creditors proved their claims against an insolvent estate. South African Law Commission Report *Project 63 – Review of the Law of Insolvency: Pre-requisites for and Alternatives to Sequestration* (Working Paper 29 Schedule 3) (1989).

76. Loubser "Ensuring Advantage to Everyone in a Modern South African Insolvency Law" (1997) *SA Merc LJ* 329. For an interesting analysis of personal bankruptcies in Israel, see Efrat *The Evolution of Bankruptcy Stigma* (2006) 365–393 and Efrat "Legal Culture and Bankruptcy: A Comparative Perspective" (2001) 20 *Emory Bankruptcy Developments Journal* 352–400.

There is a strong movement for the abandonment of the necessity for over-indebted individuals to be made to show that there is an advantage to creditors in their sequestration process. This reflects the worldwide trend to accommodate overburdened debtors seeking debt relief. The South African insolvency system has always remained largely creditor-orientated. The NCA does not go much further in assisting in the discharge of debt. Despite these limitations, there is a strong underswell of support to assist the debtor and to provide effective and meaningful opportunity for debt relief/restructuring.[77]

Debt relief for consumers through a sequestration remains an expensive procedure and disables indebted consumers to obtain the benefits of sequestration if they are unable to show an advantage to creditors. The alternative remedy of debt relief in terms of the NCA does not result in the court providing a discharge of consumer's debt obligations if there is insufficient income available to consumers to repay their debt.[78] A consumer might end up "being too poor" to go under debt review. Applications for debt review can be cumbersome, costly and time consuming. The administration procedure in terms of the Magistrates Court Act[79] is of limited scope and is only available to debtors whose claims do not exceed R50 000. The procedure is not able to provide for a discharge of debts as the administration order only lapses once the cost of administration and the listed creditors have been paid in full.[80]

Section 9(1) of the South African Constitution, 1996[81] states that "[e]veryone is equal before the law and has the right to equal protection and benefit of the law". It is clear that the disparity of treatment between overburdened debtors looking for a fresh start through the South African statutory process of sequestration and the rights of creditors to "an advantage" in the process does not do justice to the aforementioned provision of the Constitution. Certainly a discharge of debt and a fresh-start policy would assist debtors and the economy as a whole, as stated by Boraine and Roestoff:

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77. Roestoff and Coetzee "Consumer Debt Relief in South Africa: Lessons from America and England and Suggestions for the Way Forward" (2012) *SA Merc LJ* 75.
78. Section 8A of the Insolvency Act provides that a submission by an individual to debt review in terms of the NCA does not constitute an act of insolvency as contemplated by section 8 of the Insolvency Act.
79. Section 74 of the Magistrates' Court Act 32 of 1944.
80. Roestoff and Coetzee "Consumer Debt Relief in South Africa: Lessons from America and England and Suggestions for the Way Forward" (2012) *SA Merc LJ* 75. Also see Kanamugire "The Requirement of Advantage to Creditors in South African Insolvency Law: A Critical Appraisal" (2013) 4 13 *Mediterranean Journal of Social Sciences* 19–36 and specifically see para 6 dealing with the advantage to creditors in the NCA, pp. 27–28. Note that the current Magistrate's Court jurisdiction for claims has been increased to R200 000. See Magistrate's Court Act 32 of 1944, Government Gazette No. 37477 Notice 217 *Determination of monetary jurisdiction for cause of action in respect of courts for districts* (27 March 2014).
81. The Constitution of the Republic of South Africa, 1996 was approved by the Constitutional Court on 4 December 1997.

> The South African personal insolvency system must abandon its continued creditor-orientated approach. The system should provide adequate debt relief and equal treatment to all insolvent or over-indebted individuals. It may well be argued that since many creditors do not receive any significant benefit from the sequestration of the estate of their debtors, in spite of the advantage of creditors' principle, that this principle is in fact causing an unequal treatment of debtors in that many are left without proper relief in the form of a statutory discharge. Such exclusion furthermore infringes the basic constitutional right of equality in terms of the South African Constitution and upholds the dualism in the South African economy.
>
> Were the penalties for failure lowered from their current levels in South Africa, citizens and companies would take more economic risks to succeed. More businesses would start, more jobs would be created, and society as a whole would benefit. Those who fail would not become modern lepers, but instead would receive another chance to be productive for themselves and society.[82]

South Africa's adherence to the "pro-creditor" approach for consumer insolvency stems back to the fact that we have a 1936 Insolvency Act, which has not stayed in touch with commercial realities of worldwide trends in insolvency. Thus the shift towards debtor-focused advantage has largely passed us by.[83]

In a recent decision of the Constitutional Court of South Africa, the issue of "advantage to creditors" was dealt with in the context of a sequestration application. The principle of "advantage to creditors" has been maintained as a ground for obtaining a sequestration order. In *Stratford and Others v Investec Bank Limited and Others*[84] the Constitutional Court held that to grant a sequestration order (either provisionally or finally), there must be a reason to believe that it will be to the advantage of creditors of the debtor if his estate is sequestrated. Reference was made to the dicta in *Meskin & Co v Friedman*, where the court held:

> [T]he facts before the Court must satisfy it that there is a reasonable prospect – not necessarily a likelihood, but a prospect which is not too remote – that some pecuniary benefit will result to creditors. It is not necessary to prove that the insolvent has any assets. Even if there are none at all, but there are reasons for thinking that as a result of

82. Boraine and Roestoff "The Treatment of Insolvency of Natural Persons in South African Law: An Appeal for a Balanced and Integrated Approach" (2013) 5 *The World Bank Legal Review* 25–26. Clearly, the continued reliance on the advantage to creditors principle was inhibiting the promotion of entrepreneurship and as a result opportunities for success diminished. Also see Rochelle "Lowering the Penalties for Failure: Using the Insolvency Law as a Tool for Spurring Economic Growth: The American Experience, and Possible Uses for South Africa" (1996) 2 *TSAR* 315.

83. Boraine and Roestoff "Revisiting the State of Consumer Insolvency in South Africa After Twenty Years: The Court's Approach, International Guidelines and an Appeal for Urgent Law Reform" (2014) 77 *THRHR* Part 1, 351–374, Part 2, 1–20.

84. *Stratford and Others v Investec Bank Limited and Others* 2015 (3) SA 1 (CC).

> enquiry under the [Insolvency Act] some may be revealed or recovered for the benefit of creditors, that is sufficient.[85]

The court held that the correct approach in evaluating advantage to creditors is for the court to exercise its discretion guided by the dicta authorised in *Friedman*. It is up to the court to assess whether the sequestration will result in some payment to the creditors as a body, that there is a substantial estate from which the creditors cannot get payment through sequestration or that some pecuniary benefit will result for creditors. Thus, it appears that the principle of establishing an "advantage to creditors" in order to declare an individual insolvent, remains entrenched in South Africa law.[86]

As stated above, the principle of establishing an advantage to creditors is not a formal requirement for the liquidation of a company or close corporation. There is a view, however, that this principle remains a useful tool in deciding which cases should be allowed to enter the bankruptcy forum and which should be dealt with by other procedures.[87]

Whether or not courts should indeed consider if a winding up of a company would be to the advantage of creditors has been dealt with. In *Securefin Ltd v KNA Insurance and Investment Brokers (Pty) Ltd*,[88] the applicant applied for the winding up of the respondent company. The court held that the applicant would not be required to show that it would be to the advantage of creditors of the respondent to grant a winding-up order. The court held that the fact that a dividend will, or will not, be paid to a creditor who brings an application for the winding up of his debtor *ex debito justitiae* is, at the most, a factor to be considered by the court together with numerous other factors, in deciding whether or not it will grant a winding up order. Thus advantage of creditors is not a requirement in winding up the company.[89]

Another reason that supports the contention that South Africa had a "pro-creditor" regime was the fact that any creditor could apply to court to wind up a company (*ex debito justitiae*) on the basis that such company was "unable to pay its debts".[90] As dealt with in *Securefin (supra)*, there was no real need to show that an "advantage to creditors" was a requirement

85. See *Meskin & Co v Friedman* 1948 (2) SA 555 at 559.
86. Ibid.
87. Boraine and Van der Linde "The Draft Insolvency Bill: An Exploration" (1998) 4 *TSAR* 632.
88. *Securefin Ltd v KNA Insurance and Investment Brokers (Pty) Ltd* [2001] 3 All SA 15 (T).
89. See Ibid 23.
90. See section 344(f) as read with section 345 of the 1973 Companies Act. The application for winding up would occur in terms of section 346(1)(b).

in a winding up of a company. This remained an issue however in the sequestration of individual debtors.

Attempts to remedy this approach is reflected in the South African Law Reform Commission's recommendations in the 2000 Insolvency Bill.[91] The recommendation is that the advantage for creditor's requirement be retained in the new Insolvency Act. To provide a remedy for debtors who cannot prove an advantage to creditors, it has been proposed that a pre-liquidation composition provision be inserted in the new Insolvency Act.[92] Unfortunately a discharge from debt is not inherent from the provision and the debtor can only obtain the required relief when the majority of creditors voting on the composition agree thereto.[93]

Creditors generally do not receive substantial dividends from the liquidation process.[94] Levels of frustration, fuelled by minimal and negligible liquidation dividends, spurned creditors and government to find a workable alternative to the liquidation of companies, since liquidation clearly did not (in the ordinary course) provide an advantage to creditors.[95]

Scholars recognised that there was a need for an alternative statutory procedure(s) in the South African legal system that could result in effective debt relief.[96] Procedures would have to include a moratorium on as well as a rescheduling and a discharge of debt.[97]

It is submitted that the need for the introduction of a fresh-start policy was recognised and has culminated, at least for companies and close corporations, in the rescue procedure

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91. South African Law Reform Commission Report *Review of the Law of Insolvency* (2000). On insolvency law initiatives for consumer insolvency, also see Boraine and Roestoff "The Treatment of Insolvency of Natural Persons in South African Law: An Appeal for a Balanced and Integrated Approach" (2013) 5 *The World Bank Legal Review* 22–26.

92. For an analysis of insolvency law reform initiatives, including the pre-liquidation composition amendment to the Magistrate's Court Act, see the latest version of the Unofficial Draft Unified Insolvency Bill 2015 (available from mcronje@justice.gov.za and on www.justice.gov.za). It should be noted that the 2015 Working Document maintains the advantage to creditors principle for liquidation and the term "sequestration" has been replaced by the term "liquidation". Also see comments in Coetzee and Roestoff *Consumer Debt Relief in South Africa – Should the Insolvency System Provide for NINA Debtors? Lessons from New Zealand* (24 July 2013) 19–20.

93. Asheela *The Advantage Requirement in Sequestration Applications: A Call for Relaxation* (LLM University of Pretoria 2012) 63–64. For a comparison with the NINA debtor issue in New Zealand and alternatives for debtors who cannot show an advantage to creditors, see Coetzee and Roestoff *Consumer Debt Relief in South Africa – Should the Insolvency System Provide for NINA Debtors? Lessons from New Zealand* (24 July 2013) 34–40.

94. Statistics on dividends paid from liquidated companies are not readily available. However, the South African Law Commission, in its report *Review of the Law of Insolvency* (2000) 19 stated clearly that one of the reasons why concurrent creditors seldom receive a dividend from the estate, is the preferences payable from the free residue to the state and other creditors and the special rights enjoyed by the state and other persons. The only preferences payable out of the free reside retained in the Bill are those in favour of employees; contributions to employee funds; and claims for arrear maintenance payable in terms of a court order (clause 80). In cases where the debtor failed to submit returns to SARS, substantial claims are often submitted against insolvent estates by SARS with the result that nothing remains for ordinary creditors.

95. Boraine and Van der Linde "The Draft Insolvency Bill: An Exploration" (1998) 4 *TSAR* 632.

96. Ibid 634.

97. Ibid. It is submitted that it appears unlikely that the principle of advantage to creditors will be discarded from the South African law of insolvency for individuals in the immediate term.

introduced by Chapter 6 of the 2008 Companies Act.[98] The new rescue dispensation does create an advantage to creditors as ultimately, if the company is indeed rescued, it will result in a better dividend to creditors than would have been achieved in a liquidation. At the same time, debtor companies are being given a fresh start through the business rescue process, with the opportunity of a restructuring process which results in such companies being able to trade out of their financially distressed positions to one of solvency. Although creditors control the business rescue outcome to a large degree (creditors ultimately vote in the business rescue plan), the focus in South Africa, it is submitted, has shifted dramatically in favour of the interests of the financially distressed debtor.

In South Africa, the methodology of dealing with individual insolvency when compared to that of the rescue or liquidation of corporates and companies was a natural result of applying the fundamental issue: should the creditor or the debtor be protected in periods of financial distress?[99]

These conflicts of interest were often decided on emotional grounds and on the basis that the debtor was always perceived to be delinquent; thus it was up to the creditors to protect themselves as best as possible. What was contemplated was creditors using rights of set-off, the establishment of security interests and the ability to cancel contracts.[100] Other conflicts were decided by whether society instinctively backed debtors, initially identified by the interests of individuals and later with the interests of corporates, as opposed to the rights of creditors. Often these contests were influenced by economic efficiency, regardless of ethical or moral consideration or notions of fairness. Others, like in South Africa, were heavily

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98. A business rescue regime has a far better chance of succeeding if the insolvency system in which it is applied is debtor-friendly, as opposed to a creditor-friendly system of insolvency where business rescue regimes are not applied as successfully. This is certainly true of South Africa. South Africa historically has had a creditor-friendly insolvency system, and it is submitted that the fact that the courts took a very conservative approach to insolvency and judicial management was a contributing factor in the failure of judicial management as a business rescue regime in South Africa. See Harmer "Comparison of Trends in National Law: The Pacific Rim" (1997) 23 *Brooklyn Journal of International Law* 147. Also see comments on the recognition for reform and a move away from a "creditor oriented" approach in Bertelsmann et al. *Mars*: *The law of Insolvency in South Africa* (2008) 4–5.

99. See Boraine, Evans, Roestoff and Steyn "The Pro-Creditor Approach in South African Insolvency Law and the Possible Impact of the Constitution" (2015) *Nottingham Insolvency and Business Law E-Journal 5* 59–92. The South African law of insolvency (enshrined in an antiquated Insolvency Act of 1936) aims at facilitating the equitable realisation and debt distribution of insolvent estates for the *benefit of creditors*, while in fact avoiding the often inhumane treatment that debtors have to endure in attempting to be sequestrated. The archaic provision of having to show an advantage to creditors diminishes the ability of overburdened debtors from obtaining debt relief and a statutory discharge of part of their debt. The authors argue that the exclusion of many overburdened consumer debtors from a discharge procedure infringes their basic constitutional rights of equality under the South African Constitution – see 90–91.

100. Wood *Principles of International Insolvency* (2007) 5.

influenced by the historical perceptions of the importance of the "creditor" as opposed to that of the "debtor".[101]

The impact of insolvency in corporations was always accepted as being far more profound than that of the insolvency of an individual:

> Bankruptcy has a profound effect on normal legal relationships. Bankrupts and their directors are disqualified from working. Property is seized and sequestrated. Assets are expropriated without compensation. Contracts are shattered and their terms interfered with or negated. Security interests are frozen or avoided or debased. The cost of credit is increased or credit – the lifeblood of modern economies – is withdrawn. People lose their jobs and their pensions. The collapse of banks and insurance companies destroys the savings of the citizen. The economy of the state itself may be sapped. Bankruptcy is a destroyer and spoliator.[102]

Thus, it is further submitted, the legacy of the concept of an advantage to creditors, ensuring that creditors received their "pound of flesh", often left the South African corporate debtor on the scrapheap with zero opportunity for rescue. Prior to the introduction of Chapter 6 of the 2008 Companies Act, the pro-creditor culture, existing in South Africa as a legacy of individual insolvency principles, had served to discard failed entities in favour of boardroom emotion and the protectionism of the creditor. The lead-up to the rescue regime found in Chapter 6 of the 2008 Companies Act should however be understood in the socio-political context of South Africa at the time.

2.4 THE SOCIO-POLITICAL IMPLICATIONS OF DEBT IN SOUTH AFRICA AND THE SHIFT FROM A LIQUIDATION (PRO-CREDITOR) TO A RESCUE (PRO-DEBTOR) CULTURE

The Oxford English Dictionary defines "debt" as "a sum of money owed"; "the state of owing money"; "a feeling of gratitude for a favour or service".[103]

In order to examine the history of debt, it is necessary to reconstruct the manner in which the marketplace has come to pervade every aspect of human life.[104] Debt, by its very nature, is an issue of give and take; of reciprocity:

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101. Boraine, Evans, Roestoff and Steyn "The Pro-Creditor Approach in South African Insolvency Law and the Possible Impact of the Constitution" (2015) *Nottingham Insolvency and Business Law E-Journal 5* 92.
102. Wood *Principles of International Insolvency* (2007) 3. The negative outcomes of a liquidation have a destabilising effect on the economy with a negative result for all stakeholders.
103. "Debt" as defined in the Oxford English Dictionary online: www.oxforddictionaries.com/definition/English/debt.
104. Graeber *Debt: The First 5,000 Years* (2011) 89.

> From early on, there were those who wished to create a theory of social interaction grounded in a more generous view of human nature – insisting that moral life comes down to something more than mutual advantage, that it is motivated above all by a sense of justice. The key term here became "reciprocity", the sense of equity, balance, fairness, and symmetry, embodied in our image of justice as a set of scales. Economic transactions were just one variant of the principle of balanced exchange – and one that had a notorious tendency to go awry. But if one examines matters closely, one finds that all human relations are based on some variation on reciprocity.[105]

Debt is a fundamental premise of trade and is founded in "money". The difference between a debt and a mere obligation is that a debt can be precisely quantified. Thus, an analysis of debt and the role that it has played in human society is simply to follow the forms of money and the methodology of barter over centuries of trade.[106]

Debt is a very specific thing arising from very specific situations. It first requires a relationship between two people, who do not consider each other fundamentally different, but who are potential equals. During the time that the debt remains unpaid, the logic of hierarchy takes hold.[107] There is no reciprocity. Effectively, unpaid debt is difficult and painful. Since creditor and debtor are ultimately equals, if debtors cannot do what it takes to restore themselves to equality, there is obviously something wrong and as a result the situation must be the fault of the debtor.[108]

It is submitted that in South Africa, the causal effect of losses incurred in the marketplace due to unpaid debt was always left at the door of the debtor. Thus the foundation of our "creditor focus" (mainly on the banks) supported the notion of an "advantage to creditors". South Africa had always been seen as a "creditor-oriented" society, discarding and blaming irrecoverability on the debtor. Fundamentally, insolvency law had always perceived that an intervention was required to establish fairness, a sense of equality and to prevent an unnecessary and unfair, unequal distribution of assets from the insolvent debtor.[109]

105. Ibid 91. For a general analysis of money and debt, see Ferguson *The Ascent of Money – A Financial History of the World* Allen Lane (ed) (2008).

106. Graeber *Debt: The First 5,000 Years* (2011) 21.

107. Ibid 120–121.

108. Ibid.

109. See Chapter 2, para 2.3. The twin competing policies of insolvency law are the protection of creditors and the protection of debtors. Insolvency law is generally preoccupied with the collision of these interests. See Wood *Principles of International Insolvency* (2007) 4. Also see Steyn *Statutory regulation of forced sale of the home in South Africa* (2012). In her thesis, Steyn deals with the constitutional rights of individuals where debt enforcement processes (execution) against a debtor's home, even where it has been mortgaged in favour of a creditor, may constitute an unjustifiable infringement of the right of that individual to have access to adequate housing – section 2 of the Constitution of South Africa. Thus the impact of debt and its recovery process in South Africa remains of fundamental relevance to the protection of the individual debtor in the context of foreclosure and insolvency processes.

In the last few years, the nature of debt has come under the spotlight, particularly since September 2008, the beginning of a financial crisis that almost brought the entire world economy screeching to a halt. In many ways, the world economy did exactly that: ships stopped moving across oceans, building cranes were dismantled, banks stopped granting loans and generally the world economy moved into crisis mode. In the wake of this, there was not only public rage and bewilderment, but the beginning of an actual public conversation about the nature of debt, of money, and of the financial institutions that have come to hold the fate of nations in their grip.[110]

South Africa's introduction of a new rescue dispensation in 2007/2008 could never have been more timely. Historically, South Africa had laboured under the apartheid regime, clearly dividing South Africa's economy between the "haves and have-nots". In 1948, the National Party had legislated in an effort to distinguish between races, effectively dividing the economy into a privileged white one, and an impoverished black one. The policy was widely criticised and led to crippling sanctions being implemented against the country in the 1980s.[111]

It is submitted that during this period, impoverished (mainly black) South Africans struggled to obtain credit and the banking sector controlled the housing mortgage loan sector of the economy. As a result, secured creditors (banking and financial institutions) controlled levels of credit and to a degree the level of consumer spending. The development of the microloan industry made the situation even more difficult for indigent consumers wishing to access credit.

During the apartheid years, the balance between dealing with a sophisticated first-world economy alongside a third-world economy resulted in many indigent consumers having to rely on the microloan sector of the economy (informal money lenders) who would grant small loans at very high interest rates, with little or no security being provided. Consumers from previously disadvantaged communities over time had little choice but to become part of the mainstream credit industry.[112]

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110. Wood *Principles of International Insolvency* (2007) 15. The knock-on effect of the financial crisis brought banks and other entities, such as Lehman Bros, to their demise. Countries such as Greece have come to the brink of financial collapse.

111. The World Bank *South Africa Economic Update* (2012) available at http://siteresources.worldbank.org/INTAFRICA/Resources/257994-1342195607215/SAEU-July_2012_Full_Report.pdf

112. Boraine and Roestoff "Fresh Start Procedures for Consumer Debtors in South African Bankruptcy Law" (2002) *International Insolvency Review* 1.

In the years of apartheid, it is submitted that concurrent creditors would receive negligible dividends, while secured creditors (mainly the banks) and the South African Revenue Service ("SARS"), would reap the spoils of any recoveries on a secured and preferent creditor basis respectively. Thus while secured creditors were receiving secured dividends, there was no real and urgent need for a business rescue regime to save companies and to alleviate the fallout in the job market caused by liquidations.

This all changed in 1994. South Africa held its first multiracial elections in 1994, leaving the newly elected African National Congress ("ANC") government the daunting task of trying to restore order to an economy already harmed by sanctions, while also integrating the previously disadvantaged segment of the population into it. The 1994 government inherited an economy wracked by long years of internal conflict and external sanctions.[113]

The new government refrained from resorting to economic populism. Inflation was brought down, public finances were stabilised and some foreign capital was attracted. Growth remained on lower than expected levels. President Thabo Mbeki committed himself to promote economic growth and foreign investment by relaxing labour laws, stepping up the pace of privatisation, raising governmental spending and cutting interest rates sharply from 1988 levels. His policies faced strong opposition from organised labour. From 2004 onwards economic growth picked up significantly; both employment and capital formation increased.[114]

After the regime changed in 1994, a black middle class began to emerge; an upwardly mobile and fast growing African middle class, which in 2009 was reported to have grown by 30 per cent in just over a year.[115] It soon became apparent that the supply of and the demand for credit required attention. For South Africans, learning to live within their means became a priority. The introduction of the NCA in 2007 was a fundamental piece of legislation aimed at addressing the advance of "reckless credit".[116] The concept of reckless lending came from the background of the perceived unscrupulous lending practices of large

113. The World Bank *South Africa Economic Update* (2012) available at http://siteresources.worldbank.org/INTAFRICA/Resources/257994-1342195607215/SAEU-July_2012_Full_Report.pdf

114. Ibid.

115. See James "Money-Go-Round: Personal Economics of Wealth, Aspiration and Indebtedness – Africa" (2012) 82 (1) *The Journal of the International African Institute* 20–40.

116. Ibid 21.

corporations (especially microlenders) where indigent, financially illiterate consumers had become powerless at the hands of these predatory institutions.[117]

In 2007, government came to the decision that the management of corporate debt in a rescue context was important enough to be considered in the thinking about a reconstituted new Companies Act. Thus, the business rescue provisions of the 2008 Companies Act were drafted into the initial bill.

It is submitted that the need for South Africa to become aligned with modern corporate rescue thinking was obvious. With worldwide enlightenment in the treatment of debt, with South Africa becoming part of the international community and with a marked increase in cross-border trade, there was a need to introduce a corporate rescue regime. The additional benefits of job saving and overall boost to the economy as a whole made a business rescue model necessary. The change in mind-set of allowing the debtor company to remain in control of its future through its existing management, albeit under the supervision of a practitioner, made the model acceptable to stakeholders, all looking to increase dividends flowing from the turnaround or rescue of a financially distressed company. The culture of debt forgiveness had changed in South Africa and the socio-political dispensation of the treatment of debt had changed with it.

After the 2008 financial crisis, amid fears that South Africa would join much of the rest of the world in the late 2000s recession, Reserve Bank governor Tito Mboweni and finance minister Trevor Manuel accepted that South Africa was on the verge of a recession and thus continued stimulus needed to be introduced into the South African economy.[118]

Despite a weak rand and other economic constraints, South African companies had fared well when compared to other emerging market economies. In a 2010 survey, South Africa was found to have the second most sophisticated financial market and the second lowest effective business tax rate out of fourteen surveyed countries.[119] However, on the availability of manual labour, South Africa was ranked last and was also the only country of the fourteen whose labour force shrunk in 2008. South Africa was, at the time, falling

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117. Ibid 28. For a full analysis of "debt" and the manner in which consumers were treated by lenders, see James "Money-Go-Round: Personal Economics of Wealth, Aspiration and Indebtedness – Africa" (2012) 82:1 *The Journal of the International African Institute* 20–38.

118. The World Bank *South Africa Economic Update* (2012) available at http://siteresources.worldbank.org/INTAFRICA/Resources/257994-1342195607215/SAEU-July_2012_Full_Report.pdf

119. See James "Money-Go-Round: Personal Economics of Wealth, Aspiration and Indebtedness – Africa" (2012) 82:1 *The Journal of the International African Institute* 26–27.

behind other emerging markets, such as India and China, owing to several factors: the country was relatively small, without the advantage of a huge domestic customer base; it had experienced an unusually low rate of saving and investment for decades, partly because of political constraints; it had inherited an inadequate education system which resulted in an acute shortage of skilled manpower; a strong and volatile currency which deterred investors and which made its exports less competitive; the infrastructure was good but suffered from severe bottlenecks, including power shortages, and its power grid urgently needed upgrading.[120]

In 2011, after a year of observer status, South Africa officially joined the BRICS[121] group of now five emerging market nations. This had the effect of boosting trade and investment for South Africa. However, within the context of where South Africa stood economically, debt and the management of debt remained of increased concern.[122]

With South Africa's high unemployment rate having increased to 25 per cent in the second quarter of 2014, the management of consumer debt through legislation like the NCA will have to be carefully considered.[123] Unsecured loans, or consumer and business loans that are not backed by assets, are the fastest growing segment of South Africa's credit market and are the country's own version of subprime loans. South Africa's unsecured loan position has grown at a 30 per cent annual compound rate since their introduction in 2007, when the NCA was signed into law. Unsecured lending has become increasingly popular with banks because they are able to charge up to 31 per cent annual interest rates, making these riskier loans more profitable than mortgage and car loans in the low interest rate environment of the past half-decade. Thus, the unsecured credit bubble is estimated to have boosted South Africa's gross domestic product ("GDP") by R219 billion from 2009 to mid-2013.[124]

Despite the shift towards a debtor-friendly framework for consumer debtors, it is submitted that the continued role of the banks in supporting a liquidation regime should not be

120. Ibid.

121. "BRICS" is the acronym for the formal association of the major emerging economies and refers to Brazil, Russia, India, China and South Africa.

122. See James "Money-Go-Round: Personal Economics of Wealth, Aspiration and Indebtedness – Africa" (2012) 82:1 *The Journal of the International African Institute* 27. In the same year, Chapter 6 of the 2008 Companies Act was introduced into South African law. The effect of the collapse of international financial markets in 2008 was buffered, to a large extent, by the timely introduction of Chapter 6 of the 2008 Companies Act in South Africa.

123. See Trading Economics "South Africa Unemployment Rate 2000–2015" available at http://www.tradingeconomics.com/south-africa/unemployment-rate.

124. See Colombo "A guide to South Africa's economic bubble and coming crisis" (24 March 2014) available at http://www.moneyweb.co.za/archive/a-guide-to-south-africas-economic-bubble-and-coming/; Morra "Consumer debt troubles set to grow" (14 October 2013) available at http://www.fin24.com/Economy/Consumers-debt-troubles-set-to-grow-20131014.

underestimated. The predominant creditors in most corporate insolvencies worldwide are banks, with bondholders second in most economies. South Africa is no different. The banks are the main providers of credit and are often secured creditors. Any insolvency regime must consider the bank's position in payments in liquidation and in rescue. It is a critical issue for legal systems to ensure that it is fair to reduce the risks of the banks via an insolvency or rescue regime. Ultimately, credit risk is borne by depositors and the bulk of the population who are bank customers.[125]

It is submitted that the shift of thinking from companies being pushed into a liquidation regime as opposed to one of rescue, was a very strong motivating factor when the South African business rescue legislation was being considered in 2007. The principle of a fresh start, rather than grinding the debtor down, was perceived generally to be a far more noble prospect.[126] The fact that many liquidations only resulted in distributions to secured creditors, with the defaulting directors and management being exonerated for any malfeasance, left concurrent creditors highly dissatisfied with the outcome. There had to be an alternative which could result in job retention and which enabled the debtor company to begin trading afresh, without the disabling effect of massive and unmanageable debt.[127]

Additionally, job retention was perceived to be a key aim of the business rescue legislation.[128] In a business rescue situation, employees are elevated to an improved position in that job losses need only occur in the ordinary course of attrition and in accordance with applicable labour laws.[129] Any employee working for a company under business rescue will be deemed to be a provider of post-commencement finance and be "preferred" in a business

125. For the role of the banks in bankruptcies, see Wood *Principles of International Insolvency* (2007) 6–7. In the recent curatorship in 2015 of African Bank Investments Limited (ABIL), the South African Reserve Bank had to step in to "bail out" the bank, lest there was a "rush" on the bank by deposit takers. See SARB *Press Conference: Remarks by the Governor of the Reserve Bank* (10 August 2014) available at https://www.resbank.co.za. In support of the contention that South Africa is shifting towards a more debtor-friendly insolvency regime, see Boraine, Evans, Roestoff and Steyn "The Pro-Creditor Approach in South African Insolvency Law and the Possible Impact of the Constitution" (2015) *Nottingham Insolvency and Business Law E-Journal 5* 77–83.

126. Also see comments by Sher *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, University of Johannesburg 2013, available at https://ujdigispace.uj.ac.za.

127. Disgruntled creditors had, for years, attempted to pursue reckless directors personally in terms of section 424 of the 1973 Companies Act. This litigation was however very expensive and drawn out. Thus, many "dishonest" directors and management could move on elsewhere without the threat of personal liability. Many of these directors ended up being appointed to other companies, despite the fact that the previous entity (of which they were directors) were left owing significant amounts to creditors.

128. Section 7(e), (f) and (k) of the 2008 Companies Act.

129. Section 136(1)(a)(i) and (ii) of the 2008 Companies Act.

rescue.[130] Trade unions are affected persons and can be actively involved in the business rescue proceedings.[131]

The preference and treatment of employees is a huge shift from the manner in which employees are dealt with in liquidations and provides an alternative option to the job losses that occur as a matter of course in a liquidation.[132]

It is further submitted that the new dispensation of a rescue culture had to include the political "buy in" by all stakeholders (especially creditors) who were required to work with both shareholders and the management of the company in securing a successful rescue of the company.[133] The social dynamic existing in South Africa (post-1994), where large institutional enterprises and the banks had historically been favoured in the restructuring and insolvency industry, started to change. The level of acceptance by stakeholders of a system linked to the compromise of debt began to increase. The fact that judicial management had failed and that liquidation was the only option left for dealing with the failure of companies, drove South Africa to look abroad to what was available elsewhere in respect of the restructuring of financially distressed companies in South Africa.

What had become clear to South Africans and those involved in restructuring practice, was that there was no sound and effective process to resuscitate or rescue the financially distressed corporate debtor. The historical mindset of having to always prove an advantage to the creditors in the context of consumer insolvency, it is submitted, left a legacy of creditor favouritism. The established restructuring regimes already applicable in overseas jurisdictions resulted in South African stakeholders questioning the options available to struggling companies that faced liquidation with no effective alternatives for resuscitation or rescue.

Judicial management was the only option available to the cash-strapped/insolvent debtor company. The problem was that judicial management had failed abysmally as a restructuring/rescue mechanism.

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130. Section 135(1) of the 2008 Companies Act.
131. Section 128(1)(a)(ii) of the 2008 Companies Act.
132. Section 38 of the Insolvency Act. See Loubser "The Interaction between Corporate Rescue and Labour Legislation: Lessons to be Drawn from the South African Experience" (2005) *International Insolvency Regime*. Also see Joubert, Van Eck and Burdette *The Expected Impact of Labour Law Principles on South Africa's New Corporate Rescue Mechanism (including a comparison with the position in the EU)* (8 April 2009) available at http://www.ntu.ac.uk/nls/document_uploads/100222.doc. Also see Loubser "Some Comparative Aspects of Corporate Rescue in South African Company Law" (LLD thesis, University of South Africa 2010).
133. See Levenstein "Shifting mindsets" (October 2011) *Without Prejudice* 29.

CHAPTER 3 : THE FAILURE OF JUDICIAL MANAGEMENT, THE CONTRIBUTION OF INFORMAL CREDITOR WORK-OUTS AND THE NEED FOR A CORPORATE RESCUE MODEL FOR SOUTH AFRICA, PRIOR TO THE 2008 COMPANIES ACT

3.1 INTRODUCTION

Prior to looking at the development of business rescue in South Africa before the introduction of the 2008 Companies Act, it is submitted that it is important to understand what procedures and mechanisms existed in South African law prior to business rescue and which process offered a mechanism to restructure companies under financial distress. One such a dispensation was judicial management.

The corporate restructuring landscape in South Africa had been initiated in 1926, with the introduction of judicial management in the Companies Act 46 of 1926 (the "1926 Companies Act"). Judicial management was a novel concept and introduced a process whereby distressed companies could restructure debt without having to go into liquidation. Sections 195 to 198 of the 1926 Companies Act authorised the court, in certain instances where a winding up order was applied for, to make an order for the appointment of a judicial manager.[134]

When the bill was first introduced into Parliament in 1923, the Minister of Justice, who piloted the bill through the House, made the following comments:

> In regard to the point made by the honourable member for Peninsula (South) [Sir Drummond Chaplin] … these sections are derived from the practice in England and America under which receivers in equity are appointed, in the case of an important concern in regard to which there is some fear that it will go into liquidation; one which can pay its debts and which can be helped by someone officially appointed for the purpose. Powers of that kind would be used sparingly by the courts. To take a hypothetical case. You might have a large wool factory getting into difficulties and which ought to be helped because it is an institution which helps the country. Then your court could intervene, when it is shown that this concern is solvent, and thus help it through its difficulties. I quite admit that this is a power that would not be used in any country very much, and has not been used much in England or America, but it might be used to save a concern, and it is for such sparing use that it has been inserted in the bill. The concerns you would like to help with this power are industrial concerns

134. See Burdette *A Framework for Corporate Insolvency Law Reform in South Africa* (LLD thesis, University of Pretoria 2002) 343 – 345.

> such as factories manufacturing articles in South Africa. You might be able to help a few of these concerns out of the mire at times.[135]

It was quite clear from these comments that judicial management was to be applied only in very limited circumstances – the object being to protect a vital industry.[136] This was considered to be a very desirable feature in a young country like South Africa, where primary industries and industrial undertakings needed every encouragement. However, in practice, these initial objectives were overlooked and judicial management applied to any company of any size, provided the court was satisfied that there was a probability that the company could overcome its difficulties.[137]

Thus, the inclusion of judicial management in the 1926 Companies Act was a completely new aspect and a departure from existing company law. It set up a system of judicial management for companies which were unable to pay their debts or whose affairs were in such a condition that, ordinarily, it would be just and equitable to wind them up. If the court was of the opinion that there was a reasonable probability that, if the company were placed under proper management, it would be enabled to meet its obligations, it was empowered to grant a judicial management order.[138] The effect of such an order was to keep the company alive but at the same time to take it out of the control of directors, who presumably had mismanaged the company's affairs. The immediate objective was to secure for the company a moratorium against its creditors. The ultimate object was that by providing the company with efficient management, it might be restored to normal control after paying off the creditors.[139]

The judicial management procedure was carried through to the 1973 Companies Act in section 427.[140] In the 1973 Companies Act, judicial management was placed into a separate chapter.

135. Hansard House of Assembly Debates Vol 6 1926-02-25 col 996–997.
136. Olver "Judicial Management: A Case for Law Reform" (1986) 49 *THRHR* 84.
137. Ibid.
138. Ibid.
139. Ibid 84–85.
140. Section 427 of the 1973 Companies Act. See Burdette "Unified Insolvency Legislation in South Africa: Obstacles in the Path of the Unification Process" (1991) *De Jure* 57. In the 1926 Companies Act, the judicial management provisions were inserted at the end of the chapter on winding-up, and were thus seen as an adjunct to liquidation.

Such was the impact of judicial management at the time, that in 1961, Australian legislators "copied" the principles of judicial management into Australian statute and called it "official management".[141]

Official management was inserted in the state-based Companies Act and subsequently adopted in Australian national scheme legislation. It was designed to allow companies that were in financial difficulties to be saved, but if that was not possible, to be wound up. However, due to the fact that this procedure required that all debts be paid in full within a set time, compliance became a major hurdle for insolvent companies.[142]

At the time, the incorporation of a judicial management procedure into Australian statute was considered "radical". It had been motivated by a desire to take a more constructive approach to insolvent companies in Australia. It was considered as an experiment in Australia but simply did not work. By 1961, the South African model had come under attack in South Africa as it was already viewed as a clandestine liquidation procedure. In Australia, similar concerns were immediately raised.[143]

In the Harmer Report,[144] it was noted that "official management" was rarely attempted.[145] In respect of judicial management, a major stumbling block to official management was that an official manager could only be appointed in respect of a company if the creditors formed the collective opinion that the company would pay its debts in full within a prescribed period of time. This objective was recognised as being futile and it quickly emerged that creditors could not honestly make such a statement from the outset of the procedure.[146]

In 1993, these provisions were removed from legislation by the incorporation of Part 5.3A of the Australian Corporations Act.[147]

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141. Anderson "Viewing the Proposed Business Rescue Provisions from an Australian Perspective" (2008) 1 (4) *PER* 107.

142. Ibid.

143. Harmer "An Overview of Recent Developments and Future Prospects in Australia" in Ziegel (ed) *Current Developments in International and Comparative Corporate Insolvency Law* (1994) 39.

144. Australian Law Reform Commission *Report, No. 45, General Insolvency Inquiry* (1988) (the Harmer Report). The Harmer Report was submitted by Ron Harmer on insolvency reform in Australia. In the 1960s, Australia imported judicial management into their legal system as a business rescue procedure, but used the term "official management" instead of judicial management. See Rajak and Henning "Business Rescue for South Africa" (1999) *SALJ* 265. However, as was the case with judicial management in South Africa, official management was a "remarkable failure". See Harmer "Comparison of Trends in National Law: The Pacific Rim" (1997) 23 *Brooklyn Journal of International Law* 139.

145. The Harmer Report, para 57.

146. Harmer "An Overview of Recent Developments and Future Prospects in Australia" in Ziegel (ed) *Current Developments in International and Comparative Corporate Insolvency Law* (1994) 41.

147. Australian Corporations Act, 2001 (as amended).

In South Africa, after being incorporated into the 1973 Companies Act, judicial management continued to be the sole "corporate rescue" mechanism available to companies in financial distress.[148]

Judicial management was introduced into South African law[149] when it was recognised that a developing economy could not readily permit companies which assist in the development of industries and commercial enterprises to be dissipated by winding-up and dissolution due to some temporary setback in cases where there was a reasonable probability that they would, if granted a moratorium, be able to overcome their difficulties, discharge their debts and become successful concerns.[150] Whereas the object of the liquidation of a company has always been the winding-up of the company's affairs and its ultimate dissolution, the object of judicial management was to save the company from such fate where there was a reasonable probability that by proper management or by conservation and employment of its resources, it might be able to surmount its difficulties and carry on trading.[151]

Judicial management was seen as a process that could be used by a company that was experiencing a temporary financial setback as a result of mismanagement or other special circumstances, and that would lead to it once again becoming a successful business concern. This was to be achieved by replacing the existing management of the company with a judicial manager who would take over the company's business with the purpose of restoring it to profitability.[152]

A judicial management order would usually (and almost of necessity) involve a moratorium on claims in the hope that this would ultimately lead to all creditors being paid and to the normal resumption of business.[153]

148. See Loubser "Judicial Management as a Business Rescue Procedure in South African Corporate Law" (2004) 16 *SA Merc LJ* 137.

149. Sections 427 to 442 of the 1973 Companies Act. See Smith and Boraine "Crossing Borders into South African Insolvency Law: From the Roman-Dutch Jurists to the UNCITRAL Model Law" (2002) 10 *ABI Law Review* 156.

150. Henning "Judicial Management and Corporate Rescues in South African Law" in *Insolvency Law and Practice* in Rajak (ed) *Insolvency Law and Practice* (1993) 303. Also see Henning "Judicial Management and Corporate Rescues in South Africa" (1992) 1 *TRW* 91–106.

151. Henning "Judicial Management and Corporate Rescues in South African Law" in Rajak (ed) *Insolvency Law and Practice* (1993) 304.

152. Burdette *A Framework for Corporate Insolvency Law Reform in South Africa* (LLD thesis, University of Pretoria 2002) 343. Also see Cilliers and Benade *Corporate Law* (2000) 478.

153. Henning "Judicial Management and Corporate Rescues in South African Law" in Rajak (ed) *Insolvency Law and Practice* (1993) 304. Also see Millin and Wille *Wille and Millin's Mercantile Law of South Africa* (1984) 917–921; Cilliers and Benade *Corporate Law* (2000) 683–697; Cilliers and Benade *Corporate Law* (2000) 478–492; Benade et al *Entrepreneurial Law* (2008) 411–422; Van Dorsten *Business Entities: A Practical Guide* (1993) 327–333; Loubser "Some Comparative Aspects of Corporate Rescue in South African Company Law" (LLD thesis, University of South Africa 2010) 17–43.

Essentially, a judicial management order vested the management of a unsuccessful company into the hands of a judicial manager under the supervision of the court, and divested the persons managing the company at the time of their powers of management. The court would grant such an order if it could be shown that the company had the ability to become a successful concern.[154]

In terms of section 427 of the 1973 Companies Act, where any company by reason of mismanagement or for any other cause was unable to pay its debts or was probably unable to meet its obligations and had not become or had been prevented from becoming a successful concern, and where there was a reasonable probability that, if it was placed under judicial management, it would be able to pay its debts or to meet its obligations and become a successful concern, the court may, if it appeared just and equitable, grant a judicial management order in respect of that company.[155]

The term "reasonable probability", as set out in section 427, created uncertainty. In *Noordkaap Lewendehawe Ko-operasie Bpk v Schreuder*,[156] the court held that the difference between the words "probable" and "possible" were material. The judge stated that in legal terminology, something that is possible is less sure to happen than something that is "probable".[157] The uncertainty regarding the exact meaning of the phrase "reasonable probability" was one of the reasons why judicial management was seen to be "outdated" and "unrealistic".[158] The preferred test was suggested to be "a reasonable possibility".[159]

An application for judicial management would in the ordinary course be brought by a creditor of the company. The judicial manager was obligated to assume the management of the company and recover and reduce into possession all of the assets of the company and to lay before certain meetings of creditors an account of the general state of affairs of the

154. Sections 427 and 432 of the 1973 Companies Act. See Loubser *Some Comparative Aspects of Corporate Rescue in South African Company Law* (LLD thesis, University of South Africa 2010) 17. It is clear from the requirements as well as case law that judicial management has only one recognised purpose, namely the rescue of the company itself, in its entirety. The rescue of only its business or a viable part thereof was not an acceptable outcome and neither was a better return for creditors and shareholders. See *Millman NO v Swartland Huis Meubeleerders (Edms) Bpk: Repfin Acceptances Ltd Intervening* 1972 (1) SA 741 (C) at 744–745; *Ben Tovim v Ben Tovim and Others* 2000 (3) SA 325 (C) at 332. Also see Blackman et al. *Commentary on the Companies Act* 15–3.

155. Section 427(1) of the 1973 Companies Act.

156. *Noordkaap Lewendehawe Ko-operasie Bpk v Schreuder* 1974 (3) SA 102 (A).

157. Blackman et al. *Commentary on the Companies Act* 110. Chapter 6 of the Act uses the term "reasonable prospect" which is required as part of the burden of proof for a business rescue resolution and court order to be granted in terms of section 129(1)(b) and section 131(4). Also see Joubert "'Reasonable possibility' versus 'reasonable prospect': Did business rescue succeed in creating a better test than judicial management?" (2013) 76 *THRHR* 550–552.

158. See Kloppers "Judicial Management Reform: Steps to Initiate a Business Rescue" (2001) *SA Merc LJ* 362.

159. See Burdette "Some Initial Thoughts on the Development of a Modern and Effective Business Rescue Model for South Africa" Part 1 (2004) *SA Merc LJ* 362.

company, a statement of the reasons why the company was unable to pay its debts or was probably unable to meet its obligations or had not become or was prevented from becoming a successful concern.[160]

Additionally, the judicial manager was obligated to prepare a statement of assets and liabilities of the company; a complete list of creditors; particulars as to the source or sources from which money had been or was to be raised for purposes of carrying on the business of the company, as well as the considered opinion of the judicial manager as to the prospects of the company becoming a successful concern and of the removal of the facts or circumstances which had prevented the company from becoming a successful concern.[161]

The judicial manager, if he was of the opinion that the continuation of the judicial management would not enable the company to become a successful concern, was obligated to then apply to the court, after notification to members and creditors, for the cancellation of the relevant judicial management order and an issue of an order for the winding-up of the company.[162]

3.2 THE FAILURE OF JUDICIAL MANAGEMENT

Judicial management was never generally accepted as an effective corporate restructuring process. It never really took off as an alternative to liquidation and was regarded as a "dismal failure".[163]

Failure of judicial management as a mechanism to effect a rescue became the norm, with a very limited number of actual rescues. Companies therefore had no alternative but to approach their creditors (mainly the financial institutions) for informal restructuring, whilst an informal agreement between creditors resulted in a "moratorium" which theoretically prevented creditors from presenting claims. These were popular as they were not costly and could be finalised in a fairly short time frame. The problem with the "informal compromise"

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160. Section 427(2) of the 1973 Companies Act.

161. Section 430 of the 1973 Companies Act.

162. Section 433 of the 1973 Companies Act. This procedure is quite similar, in certain respects, to that found in Chapter 6 of the 2008 Companies Act. See Loubser *Some Comparative Aspects of Corporate Rescue in South African Company Law* (LLD thesis, University of South Africa 2010) 17–42 for an analysis of the judicial management procedure. Also see Museta *The Development of Business Rescue Law in South African Law* (LLM dissertation, University of Pretoria 2011), available at repository.up.ac.za/handle/2263/27867.

163. Burdette "Some Initial Thoughts on the Development of a Modern and Effective Business Rescue Model for South Africa" Part 1 (2004) *SA Merc LJ* 241. For a useful summary of the failure of judicial management, see *Le Roux Hotel Management (Pty) Ltd and Another v E Rand (Pty) Ltd and Another* 2001 (2) SA 727 (C). Also see Burdette "The Development of a Modern and Effective Business Rescue Model for South Africa" (2004) Centre for Advanced Corporate and Insolvency Law (CACIL), University of Pretoria.

was that it took one greedy creditor to resist cooperating with the consortium and holding out for a “preferent payment” on claims (preferent claims in the sense that payment is received before other creditors are paid and without the benefit of a *concursus creditorum*, i.e. a levelling of the playing field where all creditors are dealt with in a specific ranking in insolvency).[164] Many of these informal restructurings either had to be sanctioned by way of a formal court procedure in terms of section 311 of the 1973 Companies Act[165] or, without further alternatives, the company had no choice but to apply for liquidation as there was no statutory moratorium on claims.[166]

Business rescue has now replaced the judicial management regime set out in Chapter 15 of the 1973 Companies Act. Judicial management was an attempt to provide an alternative mechanism to that of liquidating a near-insolvent company. Business rescue is a second attempt at achieving the same objective.[167]

The problem with judicial management in terms of the 1973 Companies Act was that in order for a moratorium on claims to become effective, a formal moratorium to prevent creditors from either enforcing claims against the company or alternatively launching proceedings for the winding-up of the company had to be applied for from the court. A provisional judicial management order would provide that all actions and proceedings, the execution of all writs, summonses and other processes against the company would be stayed during judicial management and may only proceed with the leave of the court.[168] Thus, a moratorium on enforcement actions against the company was not an automatic result of a judicial management order and had to be applied for. Since a moratorium is one of the major advantages of any rescue procedure, judicial management was unlikely to succeed without such an order.[169]

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164. Rajak and Henning “Business Rescue for South Africa” (1999) *SALJ* 265.
165. Section 311 of the 1973 Companies Act was the “compromise’ section of the old legislation. It has now effectively been replaced by section 155 of the 2008 Companies Act.
166. Rajak and Henning “Business Rescue for South Africa” (1999) *SALJ* 265. Also see Meskin *Insolvency Law and its Operation in Winding Up* (1990+) para 18.1.
167. Stein and Everingham *The New Companies Act Unlocked: A Practical Guide* (2011) 408. On judicial management as a procedure, see Loubser *Some Comparative Aspects of Corporate Rescue in South African Company Law* (LLD thesis, University of South Africa 2010) 17–43. Also see Kloppers “Judicial Management Reform: Steps to Initiate a Business Rescue” (2001) *SA Merc LJ* 359. This article sets out suggestions for a corporate rescue model to replace judicial management.
168. Section 428 (2) of the 1973 Companies Act.
169. Loubser *Some Comparative Aspects of Corporate Rescue in South African Company Law* (LLD thesis, University of South Africa 2010) 31–32. Also see Cilliers and Benade *Corporate Law* (2000) 478 at para 26.01–26.02; Blackman et al. *Commentary on the Companies Act* at 15–12 and 15–21.

There appeared to be no discernible reason why the legislation did not provide for an automatic moratorium resulting from both a provisional and a formal order of judicial management. There are compelling reasons why it should have done so. It was therefore entirely possible that a court could decide to grant a judicial management order but refuse to order a moratorium. In such a case, the judicial management would be virtually doomed to failure because the company was not protected from creditors enforcing their claims.[170]

In South African practice, judicial management was generally not favoured as a procedure since more often than not, the company would be placed into liquidation subsequent to the granting of the judicial management order:[171]

> The only form of business rescue regime which had operated in South Africa was judicial management. Judicial management was however a dismal failure in practice. One of the reasons for this failure was that liquidators had attempted to resuscitate troubled business. Judicial management orders were also being applied for at a stage when it was unlikely that the business could in fact be saved. In order to obtain an order for judicial management, the applicant had to prove that there was a "reasonable probability" that the company would once again become a successful concern if placed under judicial management. This burden of proof was too high.[172]

The prevailing view was that judicial management had become an unsupervised winding-up in that, invariably, once appointed, the judicial manager could also be appointed as the liquidator of the company.[173] As the fees for liquidation were often far higher than for judicial management, the potential for a conflict of interest remained. The practice of appointing professional liquidators as judicial managers also created difficulty as the objectives and duties of these two categories of persons remained diametrically opposed. The liquidator's function was to carry on the business with a view to stop trading and sell off assets as soon as possible. The judicial manager's objective was to carry on the business with a view to restoring it to financial health. The fact that the judicial management

170. Loubser *Some Comparative Aspects of Corporate Rescue in South African Company Law* (LLD thesis, University of South Africa 2010) 33.

171. Loubser "Tilting at Windmills? The Quest for an Effective Corporate Rescue Procedure in South African Law" (2013) 25 *SA Merc LJ* 437–438. For statistics reflecting the poor successes of judicial management, see Henning "Judicial Management and Corporate Rescues in South African Law" in Rajak (ed) *Insolvency Law and Practice* (1993) 308. On the shortcomings of judicial management, see Bradstreet "The New Business Rescue: Will Creditors Sink or Swim?" (2011) *SA Merc LJ* 361–362.

172. Burdette "Unified Insolvency Legislation in South Africa: Obstacles in the Path of the Unification Process" (1991) *De Jure* 57–58. Clearly, one of the reasons for the failure of judicial management was that the application came too late and when the company was already a candidate for liquidation and where the possibility of a rescue was already too far gone to be seriously or realistically considered.

173. Olver "Judicial Management: A Case for Law Reform" (1986) *THRHR* 86.

provisions were always seen as an adjunct to liquidation, doomed companies to ultimate winding up.[174]

The further requirement that to be eligible for protection under judicial management, a debtor company had to be seen as capable of recovery to the ultimate end point of where it would be able to repay all of its debts in full, is outdated, unrealistic and contrary to the wishes and interests of both creditors and debtors. This requirement was just too stringent and difficult to prove.[175] It is submitted that the requirement that all debts due had to be paid in full was reflective of the then prevailing pro-creditor culture existing in South Africa at that time.

Other criticisms included the fact that judicial management was too heavily reliant on court proceedings (which made it very expensive),[176] the fact that the company must be "unable to pay its debts" before an order for judicial management was granted (such an order then came too late for the company as it was already insolvent), the fact that judicial management only applied to companies and not to close corporations, partnerships or business trusts. Additionally, the lack of an effective cram-down procedure on dissenting creditors made it extremely difficult to force a judicial management to be approved by majority creditors who supported the judicial management process. All these factors served to inhibit the successful implementation of judicial management.[177] Loubser gives an accurate description of the situation:

> In South Africa… insolvency is generally regarded as a sign of failure, and a shame. There is a significant stigma attached to it and insolvent debtors are suspected of being either reckless or dishonest, or both. I believe that this view was a major contributing factor to the failure of judicial management in South Africa: the decisions of the courts in judicial management applications displayed a mistrust of this procedure which was regarded as an infringement on the rights of creditors because it prevented them from exercising their right to liquidate a company to obtain payment of their claims. Therefore judicial management was treated by the courts as a "special and extraordinary procedure" that could be ordered only under "very special circumstances" although nothing in the wording of the Act reflected such an intention.[178]

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174. Ibid.
175. Rajak and Henning "Business Rescue for South Africa" (1999) *SALJ* 268.
176. The procedure was made even more expensive by the need to firstly obtain a provisional order on the first application and then to approach the court a second time for a final judicial management order.
177. Rajak and Henning "Business Rescue for South Africa" (1999) *SALJ* 268.
178. Loubser "Tilting at Windmills? The Quest for an Effective Corporate Rescue Procedure in South African Law" (2013) 25 *SA Merc LJ* 453–454. For a synopsis of the main problems experienced with judicial management, see Stein and Everingham *The New Companies Act*

It is submitted that the historical focus on the interests of creditors in South Africa did not give judicial management a realistic prospect of being successful. Failure in business was seen to be a punishable event and one which was not generally acceptable to South African creditors.

A major inhibiting factor (alluded to above) of judicial management was the inability of the judicial manager to raise funding (post-commencement finance) during judicial management. The reason for this was that the favoured result in a judicial management was that the company be placed in a position where it would be able to pay all of its debts, both pre- and post-commencement of judicial management.[179]

A court order for judicial management could include granting the provisional or final judicial manager the power, subject to the right of pre-commencement creditors, to raise money in any way without the authority of shareholders and as would be considered necessary by the court.[180] The power to raise money in a judicial management was therefore not automatically part of the judicial manager's powers, but had to be specifically granted by the court. The court held in *Standard Bank of South Africa Limited v Pharmacy Holdings Ltd*[181] that this power should only be granted if the court was convinced that creditors and shareholders would not otherwise be prejudiced. Furthermore, the rights of existing creditors were not affected by the granting of this power, and it is clear from the wording of the 2008 Companies Act that the court did not have the power to order that such post-commencement finance would enjoy any preference over existing claims against the company. Thus the provision of post-commencement finance was clearly regarded as undesirable and inadvisable by the legislature, except in very special circumstances.[182]

Thus, it is submitted, the ability to have access to finance in a judicial management procedure was severely curtailed and did not provide the flexibility needed to ensure that the

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Unlocked: A Practical Guide (2011) 409; Loubser *Some Comparative Aspects of Corporate Rescue in South African Company Law* (LLD thesis, University of South Africa 2010) 43; Burdette *A Framework for Corporate Insolvency Law Reform in South Africa* (LLD thesis, University of Pretoria 2002) 345–351; Loubser "Judicial Management as a Business Rescue Procedure in South African Corporate Law" (2004) *SA Merc LJ* 137. Also see shortfalls of judicial management highlighted in Burdette "The Development of a Modern and Effective Business Rescue Model for South Africa" (2004) Centre for Advanced Corporate and Insolvency Law (CACIL), University of Pretoria 7–14.

179. Loubser "Post-Commencement Financing and the Ranking of Claims: A South African Perspective" in Parry (ed) *European Insolvency Law: Current Issues and Prospects for Reform* (2014) 32.
180. Sections 428(1)(c) and 432(3)(c) of the 1973 Companies Act respectively.
181. *Standard Bank of South Africa Limited v Pharmacy Holdings Ltd* 1962 (1) SA 245 (W) at 246.
182. Loubser "Post Commencement Financing and the Ranking of Claims: A South African Perspective" in Parry (ed) *European Insolvency Law: Current Issues and Prospects for Reform* (2014) 32.

company under judicial management could continue to trade on a practical and effective basis. Further, the prevailing pro-creditor culture existing in South Africa, pre-2011, inhibited judicial management's success as an effective rescue tool. Generally, it is submitted, creditors (and in the main the large financial institutions) did not support the process as it was considered a waste of time and was an irritant on the path to the ultimate liquidation of the insolvent corporate debtor.

Judicial management, although rarely successful,[183] was thus the natural precursor to a business rescue system to be introduced into corporate South Africa.[184]

The failure of judicial management and its inability to conform with international best practice rescue principles has been well documented:

> Judicial management has been a failure as a corporate mechanism since its inception, mainly due to the expense involved, the commencement standard, the fact that liquidators are used as judicial managers, the requirement that the company must already be insolvent before the mechanism can be used, and the fact that the company must repay all its debts before the judicial management order can be lifted. Judicial management is an expensive and time-consuming procedure, and the only real success stories have been with very large companies that can absorb the exorbitant costs. Besides a general moratorium which is not automatically granted by the court but has to be specifically requested by the applicant (section 428(4) of the Companies Act, 1973) judicial management does not conform in real terms to international best procedures in the field of corporate rescue.[185]

Clearly, judicial management had come from the old regime of creditor protectionism. It was not in line with the new-age rescue regimes found in international jurisdictions that supported the rescue of a company as being of greater importance than the need for creditors being paid in full. Rescue as opposed to liquidation was a far better outcome than expecting an almost illiquid company, through judicial management, placing itself in a position to pay all creditors in full.

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183. Judicial management had been seen by the courts as an extraordinary procedure and not as a viable alternative to liquidation. This caused many applications for judicial management to end up in liquidation (see *Le Roux Hotel Management (Pty) Ltd and Another v E Rand (Pty) Ltd and Another* 2001 (2) SA 727 (C)). Further pressures placed on the successful outcome of judicial management such as the requirement that there must be a "reasonable probability that the company will become a successful concern", resulted in such a high burden of proof to become unrealistic and difficult to prove (see *Tennowitz and Another v Tenny Investments (Pty) Ltd; Spur Steak Ranches (Pty) Ltd v Tenny Investments (Pty) Ltd* 1979 (2) SA 680.

184. For an evaluation of judicial management as a corporate rescue scheme, see Kloppers "Judicial Management: A Corporate Rescue Mechanisms in Need of Reform?" (1999) 3 *Stell LR* 423–435; Loubser "Judicial Management as a Business Rescue Procedure in South African Corporate Law" (2004) *SA Merc LJ* 137.

185. Burdette "Unified Insolvency Legislation in South Africa: Obstacles in the Path of the Unification Process" (1991) *De Jure* 135. Also see Kloppers "Judicial Management: A Corporate Rescue Mechanisms in Need of Reform?" (1999) 3 *Stell LR* 419–435; Kloppers "Judicial Management Reform: Steps to Initiate a Business Rescue" (2001) *SA Merc LJ* 317–378. See debate in Burdette *A Framework for Corporate Insolvency Law Reform in South Africa* (2002) 343 – 352.

An inherent difficulty with the successful implementation of judicial management was that South Africa remained embedded in a "liquidation before rescue" culture. No legislative measure introduced to reform judicial management, irrespective of its inherent merits, would succeed unless the courts, and creditors, ceased to regard liquidation as a right and corporate rescue as a very special privilege reserved for exceptional cases.[186]

In contrast to the South African judicial management procedure, it is submitted that all modern corporate rescue procedures have one fundamental principle in place and that is that creditors must accept less than a full pay-out on their claims when dealing with a financially distressed company, colloquially known as taking a "debt haircut". This fundamental premise has now resulted in South Africa's judicial management procedure being repealed. An agreed plan by which the future relations between the debtor and its creditors will be governed, should include the reduction of the debtors overall indebtedness:[187]

> Modern "corporate rescue" and reorganisation 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. Through judicial bankruptcy procedures, reorganisation seeks to maximise, preserve and possibly even enhance the value of a debtor's business enterprise, in order to maximise payment to the creditors of the distressed debtor.[188]

Judicial management was thus based on an incorrect premise that a protective moratorium on claims would only be available where there was a reasonable probability that if the debtor was placed under judicial management, it would be able to pay all of its debts or meet all of its obligations. This principle ignored the universal reality of creditors being prepared, for their own benefit, to forgive part of the debt. Debt forgiveness was universally a starting point for successful turnaround. Creditors would benefit far more from having the debtor back in the market place than from having to litigate against the debtor for recovery of debt, as stated by Rajak and Henning:[189]

> All modern corporate rescue regimes are united on one matter, the absence of which, possibly more than anything else, has helped to bring South Africa's judicial

186. Loubser "Judicial Management as a Business Rescue Procedure in South African Corporate Law" (2004) *SA Merc LJ* 137.

187. For an analysis of the distinction between business rescue and judicial management, see *De Bruyn v Conradie and Others* (18679/11 and 4455/14) [2014] ZAWCHC (31 March 2014).

188. Smits "Corporate Administration: A Proposed Model" (1999) 32 *De Jure* 83. Also see Trebilcock and Katz "The Law and Economics of Corporate Insolvency: A North American Perspective" in Rickett (ed) *Essays on Corporate Restructuring and Insolvency* (1996), where the following is stated at 7: "The collective interest of all creditors requires the maximisation of the aggregate value of the assets of the debtor. In many cases, an insolvent firm is worth more as a going concern than the sum value of its discrete assets sold on a piecemeal basis. In these situations, it is in the collective interests of all creditors that the business be preserved as a going concern."

189. Rajak and Henning "Business Rescue for South Africa" (1999) *SALJ* 286.

> management to its present perceived impotence. This is the recognition that the agreed plan by which the future relations between the debtor and its creditors will be governed may well include the reduction of the debtor's overall indebtedness.[190]

The failure of judicial management paved the way for a radically new rescue provision in South Africa which had to provide a mechanism where a specified majority of creditors could approve a plan under which it was possible for the debtor to emerge from protection and resume normal dealings in the commercial marketplace.

It is submitted that the failure of judicial management as a rescue procedure was recognised by corporate South Africa and stimulated the development of a rescue culture. It became widely recognised and appreciated that there were significant benefits to be gained by saving businesses rather than allowing them to implode into liquidation. The opportunity for creditors to continue trading with an entity, with the added benefits of boosting one's profits, became a sought-after outcome and one which culminated in the rescue procedures set out in Chapter 6 of the 2008 Companies Act. The need to compromise on debt had to be a fundamental element in achieving such an outcome.

3.3 INFORMAL CREDITOR WORK-OUTS AND THEIR CONTRIBUTION TO BUSINESS RESCUE

Prior to Chapter 6 of the Companies Act becoming part of South African law in May 2011, South African creditors had little choice but to invoke judicial management procedures in terms of section 427 of the 1973 Companies Act or place the company into a financial liquidation procedure in terms of Chapter 14 of the 1973 Companies Act.

An alternative (and which in certain circumstances remains as an alternative) was to consider the implementation of an informal creditor work-out. Due to the failure of judicial management (dealt with above), creditors had little choice, prior to 2011, but to consider informal creditor workouts and informal restructurings.

Informal creditor work-outs entail large financial institutions joining forces in consortiums to provide ailing companies with the necessary financial assistance to trade themselves out of their difficulties:[191]

190. Ibid.

191. Burdette *The Development of Modern and Effective Business Rescue for South Africa* (2004) 15. It is apparent that formal turnarounds tend to be more successful in debtor-friendly insolvency jurisdictions such as the US, as opposed to jurisdictions such as the UK and South

> By joining forces the risk is spread, and no single institution has to carry the full burden should the informal reorganisation ultimately fail. The lack of legislative provisions supporting such informal creditor workouts do however, limit their use in practice. One of the greatest drawbacks of this system is that it does not bind other creditors, and they are consequently free to apply or the liquidation of the debtor in appropriate circumstances.[192]

The manner in which informal compromises are conducted in South Africa follow, in many respects, the "informal creditor work-out" model, as it has become known in international jurisdictions. It is seen as one of the mechanisms to resolve a debtor's financial difficulties.[193]

Although not formally regulated in terms of legislation, informal creditor work-outs became popular in the period prior to the introduction of Chapter 6 of the 2008 Companies Act. South African creditor workouts entailed large financial institutions joining forces to provide ailing companies with the necessary financial assistance to trade themselves out of their difficulties.[194]

Informal creditor work-outs were very much a part of restructuring efforts in South Africa. From an international perspective informal work-outs were not a new phenomenon. A privately agreed reorganisation, agreed between the company and its main creditors, typically banks and bondholders, without any judicial intervention had been used extensively in international jurisdictions for quite some time. The market vernacular for this is a "work-out".[195]

Any private consensual work-out (informal compromise) would have to be assessed against the backdrop of the effect that rescue mechanisms of liquidation might have upon creditor recoveries. Generally, an informed work-out has some considerable advantages over a formal insolvency proceeding. Out-of-court work-outs generally are speedy, cost-effective

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Africa that have creditor-friendly insolvency systems. See Burdette "Legislative Framework for the Facilitation of Turnarounds" in Harvey (ed)*Turnaround Management and Corporate Renewal – a South African Perspective* (2011) 132.

192. Burdette *The Development of Modern and Effective Business Rescue for South Africa* (2004) 16. Thus in South Africa, a lack of a formal moratorium (a freezing of claims) will not prevent an aggressive creditor from "breaking ranks" from the consortium and proceeding to institute action for recovery of claims.
193. Ibid.
194. Burdette "Some Critical Thoughts on the Development of a Modern and Effective Business Rescue Model for South Africa" (2004) 16 *SALJ* 251–252.
195. Wood *Principles of International Insolvency* (2007) 31.

and can result in the debtor company being saved with creditors being paid in full or receiving a more satisfactory compromised amount.[196]

In South Africa, it was unclear how long this "informal work-out" sector had been active. The South African model provided an advantage in that it often took place under a veil of secrecy so that creditors, especially trade creditors, did not get wind of the debtor's threatening financial crisis. Banks, turnaround experts and the management of ailing businesses often cooperated to find a way to reorganise or turn around the business.[197]

The ability to reorganise debt through an informal compromise process certainly had its challenges and limitations, as stated by Burdette:

> However, there are also serious drawbacks to attempting an informal creditor workout in that there is no moratorium … to provide the ailing business with some much-needed breathing space and no cram-down provision to bind minority dissenting creditors. The absence of a moratorium means that there is nothing to prevent the creditors of an ailing business from bringing an application for the liquidation of the company, undermining any attempt at negotiating a successful informal turnaround. Should the plan devised under an informal turnaround fail to obtain the approval of dissenting minority creditors, this too could lead to the failure of the rescue of the business.[198]

It is submitted that prior to 2011, there was a recognition that without the "stay" or "moratorium" on creditors' claims, the ability to restructure or rescue a failing entity would be severely prejudiced. The imposition of a "calming" period, where the assets and value of the company could continue to be preserved, while the company went through its period of restructuring, was accepted as an essential for a successful rescue.

Problems encountered in a voluntary creditor workout in South Africa are summarised as follows:[199]

- Any efforts to enter into a compromise with creditors outside the current legislative provisions may lead to the formal processes of insolvency being implemented;

- No moratorium is created;

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196. Ibid 33.

197. Burdette "Legislative Framework for the Facilitation of Turnarounds" in Harvey (ed) *Turnaround Management and Corporate Renewal – a South African Perspective* (2011) 132.

198. Ibid.

199. Ibid. A further drawback was the fact that any further funding made available to the company in the period of the informal restructuring did not receive any "preference" or "ranking" if the company ultimately ended up in liquidation.

- Other (normally smaller) creditors cannot be bound by the informal procedures and/or agreements which in turn can lead to the implementation of the formal insolvency laws by such creditors (in other words there is no "cram-down" provision that can be enforced);

- Downsizing of the debtor's workforce is often required in order to make the restructuring a success; something that may be difficult taking into consideration South Arica's stringent labour laws.

Generally one would require one hundred percent of creditors to support the informal offer to creditors. If not, any creditor who remained unpaid could apply to court for the formal liquidation of the company on the basis that the company has acknowledged that it could not meet its financial commitments to creditors. Further, the requirement for all creditors to consent to the informal compromise averted the possibility of undue preferences and dispositions being set aside once a company was ultimately placed into liquidation.[200]

It is further submitted that the advantages of an informal compromise with creditors are numerous. The process is speedy and less costly than formal procedures because no court is involved. Generally, informal compromises were seen as an opportunity for creditors, on a "fast track" basis, to compromise claims of creditors without the need to go into a formal and costly liquidation process.

In practice, it is submitted that an informal compromise with creditors would only be successful if there were a small number of creditors (preferably, locally situated, sophisticated and made up mainly by financial institutions) who cooperated with one another to achieve the common goal of a binding compromise agreement. Any informal compromise would have to be consensual, effected within a short time frame and would be concluded by a small majority of creditors who genuinely wanted to support such compromise. The "buy-in" by creditors had to reflect an acceptance by such creditors to take a smaller dividend than they would receive if the company went into liquidation.

The section 311 compromise procedure found in the 1973 Companies Act provided a formal, court-sanctioned compromise for companies that required their debts to be

200. See sections 26–31 of the Insolvency Act.

restructured.[201] Whilst this study will not fully consider the mechanism of the section 311 compromise, it should be pointed out that prior to the introduction of the 2008 Companies Act, section 311 compromises provided financially distressed companies with a viable alternative to being fully wound up.

Generally, section 311 compromises would occur subsequent to the grant of a provisional winding-up order and enabled companies to compromise with their creditors (or a class of creditors) under the protection of a formal moratorium, which ultimately resulted in a binding compromise on all creditors. Such compromise would be sanctioned by the High Court.[202] It enabled the offeror in the compromise to make a proposal to creditors to effectively "cram down" the proposal on all parties, including dissenting creditors. Unfortunately, section 311 compromises were expensive, court-driven and time consuming.[203]

In the years prior to the introduction of the 2008 Companies Act, section 311 compromises became unpopular due to the procedure being too expensive and too court-driven. The South African Revenue Service (SARS) also set stringent guidelines in order for the benefits of tax-driven compromises to be enjoyed by offerors interested in acquiring the benefits of assessed losses.[204]

There was clearly a need for a streamlined process, similar to the "prepack" arrangements found in the US and the UK, where a speedy resolution would be found to compromise debt, without the need for a cumbersome court-driven process, and which could deliver an outcome for the company over a short period of time.[205] In South Africa, it is submitted that there was a need to take the "informal compromise experience" and convert it into an option for the company to get the buy-in of its creditors, pre-package a compromised deal on debt and, if necessary, get the court to sanction such compromise, within a short period of time.

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201. Section 311 of the 1973 Companies Act. An analysis of section 311 of the 1973 Companies Act and section 155 of the 2008 Companies Act falls beyond the scope of this thesis. The 2008 Companies Act now provides a similar opportunity in the new section 155 procedure. On section 311 compromises see Smith and Boraine "Crossing Borders into South African Insolvency Law: From the Roman-Dutch Jurists to the UNCITRAL Model Law" (2002) *ABI Law Review* 157–158; Stein and Everingham *The New Companies Act Unlocked: A Practical Guide* (2011). On section 311 compromises, also see Henning "Judicial Management and Corporate Rescues in South African Law" in Rajak (ed) *Insolvency Law and Practice* (1993) 309–315.

202. Stein and Everingham *The New Companies Act Unlocked: A Practical Guide* (2011) 446–447.

203. Ibid.

204. See PricewaterhouseCoopers "Back-door way of compelling SARS to compromise a tax debt" (2007) available at http://www.saica.co.za/integritax/2009/1475_Back_door_way_of_compelling_SARS.

205. See the guidelines proposed by INSOL to informal creditor workouts – INSOL *International Booklet: Statement of Principles for a global approach to multi-creditor workouts* (INSOL International, October 2000).

Section 155 of the 2008 Companies Act effectively replaced section 311 of the 1973 Companies Act.[206] It is submitted that section 155 offers a cost-effective, speedy solution to what is now being termed the "South African prepack". The "pre-pack" envisages the creditors of a financially distressed company meeting and negotiating with the representatives of the debtor company, in an effort to informally agree on a restructuring plan which would generally involve agreement on a period of a moratorium together with a plan to compromise debt. The section 155 compromise, by its nature, must commence with a rapid engagement by the company with its creditors. This pre-assessment of creditors' attitudes to agreeing to a compromise of debt is even more critical than the required pre-assessment in a business rescue, due to the fact that, while these negotiations are ongoing, there is no protection of a moratorium, as is the case in a business rescue. Once the attitude of creditors has been determined, the board of the company can then move to the next stage, namely the drafting of a proposal for consideration by creditors.[207] Often, it is submitted, the "pre-pack" is sanctioned in terms of the section 155 procedure.[208]

The fact that South Africa already had a system of informal creditor work-outs in place paved the way for the introduction of a business rescue model as well as the new section 155 compromise procedure in the 2008 Companies Act.[209]

As stated by Van der Walt, business rescue is a real alternative to an informal compromise:

> The purpose of business rescue legislation is therefore to provide a statutory safety net to prevent the unnecessary liquidation of financially distressed but economically viable companies when an informal workout has not been attempted. Alternatively, when an informal workout has been attempted, it risks failing, due to dissenting creditors or a lack of breathing space because of looming insolvency, claimants exercising their rights, legal action, onerous contracts, etc. Business rescue legislation seeks a settlement between debtors and creditors within a continuing and dynamic commercial relationship, rather than simply the recovery by creditors of their debts.[210]

206. Section 155 of the 2008 Companies Act.
207. See Klopper and Bradstreet "Averting liquidations with business rescue: Does a section 155 compromise place the bar too high?" (2014) 3 *Stell LR* 549–565.
208. See discussion on similar processes used in the UK "pre-pack" administration system – Chapter 5, para 5.2.1.
209. A full analysis of section 155 is not included in this thesis. See commentary on section 155 in Meskin, Kunst, Galgut, Delport, Vorster and Burdette *Henochsberg on the Companies Act 71 of 2008* (2011+) 536(a).
210. Van der Walt "A Turnaround Practitioner's View of New Business Rescue Legislation" in Harvey (ed) *Turnaround Management and Corporate Renewal: A South African Perspective* (2011) 144. The threat of a potential liquidation clearly required a situation where the interests of creditors had to be frozen for a period. The risk of going through an informal workout did not provide any certainty that this would be possible, without the imposition of a moratorium on claims.

It is submitted that the input that both business rescue and section 155 will have on informal workouts/compromises remains to be seen. Certainly, it is submitted, informal compromises will continue to play a role in the restructuring of financially distressed companies. Of course, the reality of having the difficult challenge of resuming a company without the benefit of a formal stay or moratorium on claims will make the formal business rescue process the preferred option. Creditors and companies in distress will find it far easier to engage where creditors are not aggressively pursuing claims in a liquidation or by way of formal legal actions.[211]

It is submitted that the role that informal compromises have played in developing a corporate rescue culture has been significant. The engagement between creditors, the company and its management, albeit on an informal basis, created an atmosphere of cooperation where there was a clear focus on principles such as the imposition of an (informal) moratorium and a willingness for creditors to consider a compromise on their claims. The development of informal compromise negotiations contributed towards the development of restructuring and gave the entity a second chance. The seeds of corporate rescue reform and the recognition that there was a need for a rescue procedure that was more formalistic and which could provide a binding outcome had been sown and soon became a reality.

3.4 THE NEED FOR A CORPORATE RESCUE MODEL IN SOUTH AFRICA

Prior to May 2011, judicial management had effectively been relegated to the history books. Careful consideration was now being given to the potential of the new business rescue regime set out in the draft of Chapter 6 of the 2008 Companies Act. The change in mind-set to debt forgiveness and the shift in South Africa's need to move from a liquidation culture to one of business rescue, made the introduction of Chapter 6 far easier than had been expected.[212]

South African courts have been quite firm and supportive of jettisoning the old judicial management regime and supporting the introduction of a new business rescue system. This

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211. See discussion in Searle *Will there be a need for informal loan workouts? A question from Chapter 6 of the New Companies Act* (Master of Management in Finance & Development dissertation, University of the Witwatersrand 2013) available on http://hdl.handle.net/10539/12912.

212. For argument in favour of a new business rescue system for South Africa, see Loubser "Tilting at Windmills? The Quest for an Effective Corporate Rescue Procedure in South African Law" (2013) 25 *SA Merc LJ* 438; Burdette "Some Initial Thoughts on the Development of a Modern and Effective Business Rescue Model for South Africa" Part 1 and Part 2 (2004) *SA Merc LJ* 241–262 (Part 1) 409– 46 (Part 2). See also Chapter 2, paras 2.3 and 2.4.

clearly reflected the urgent need for corporate rescue reform and the requirement of a robust and effective business rescue regime in South Africa:

> Business rescue is geared at saving significant costs, thus among others enabling financially distressed small (and big) companies to opt for it as a viable alternative to "last resort" liquidation. Unlike during judicial management, business rescue does not require that a company be restored to solvency, though this is of course one of the objectives of business rescue. As the definition (of business rescue) further demonstrates, business rescue is also a system that is aimed or geared at temporarily protecting a company against the claims of creditors so that its business can thereafter be disposed of (if concern could not be saved) for maximum value as a going concern in order to give creditors and shareholders a better return than they would have received had the company been liquidated.[213]

It is submitted that the court recognised that although one of the objectives of business rescue was to place the company in a solvent position, this was not the only outcome. An alternative was the disposal of the assets of the company which would result in creditors receiving a better dividend than they would receive in a liquidation.

In a useful summary of South Africa's historical judicial management process, informal rescue mechanisms and the need to embrace the new business rescue regime, Claassen J considered the need for a substantial change in corporate insolvency law with a proposed move away from what he termed a "liquidation culture". The judge confirmed that a company experiencing financial difficulty had little option but to consider either judicial management or compromises. Whilst judicial management had been a failure, compromises did not allow for a stay of both past and future legal proceedings against the company.[214]. Claasen J went on to state:

> The general philosophy permeating through the business rescue provisions is the recognition of the value of the business as a going concern rather than the juristic person itself. Hence the name "business rescue" and not "company rescue". This is in line with modern trends in rescue regimes. It attempts to secure and balance the opposing interests of creditors, shareholders and employees. It encapsulates a shift from creditors' interests to a broader range of interests. The thinking is that to preserve the business coupled with the experience and skill of its employers may, in the end prove to be a better option for creditors in securing full recovery from the debtor.[215]

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213. *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Limited* 2013 JDR 1019 (GSJ) at 3, paras 3-4.

214. *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others; Farm Bothasfontein (Kyalami) (Pty) Ltd v Kyalami Events and Exhibitions (Pty) Ltd and others* 2012 (3) SA 273 (GSJ) at 276–279.

215. Bradstreet "The New Business Rescue: Will Creditors Sink or Swim?" (2011) *SALJ* 362; Bradstreet "The Leak in the Chapter 6 Lifeboat: Inadequate Regulation of Business Rescue Practitioners may Adversely Affect Lenders' Willingness and the Growth of the Economy" (2010) *SA Merc LJ* 195. Note that section 7(k) states that one of the purposes of the 2008 Companies Act is to "provide for the efficient

It is not surprising that the new business rescue model has been welcomed as a significant improvement on judicial management. Business rescue, as its name suggests, recognises the value of the business entity as a going concern, rather than the entity itself. This is in line with the modern trend of international corporate rescue regimes, which places primary emphasis on saving the enterprise and the real business carried on by the juristic person, in whole or in part, rather than on the survival of the juristic person itself.[216] The new business rescue mechanism is concerned not only with repaying creditors, but also with protecting all affected parties by appointing a business rescue practitioner to ensure that the various interests at stake are equitably balanced within the constraints of the legislation.[217]

Further comments on this topic were made by Judge Binns-Ward in which he confirmed that the requirements for a supervision order for business rescue were materially different from those which pertained to judicial management. There was, in his view, a clear recognition that liquidation of companies resulted in "collateral damage, both economically and socially with the attendant destruction of wealth and livelihoods." Business rescue could avert "the deleterious consequences of liquidations where there was a reasonable prospect of salvaging the business of a company in distress".[218]

In *Merchant West Working Capital Solutions (Pty) Limited and Advanced Technologies and Engineering Company (Pty) Limited and Another*, Kgomo J referred to business rescue as a "novelty" and "innovative".[219]

Further comment on business rescue as compared to the old judicial management procedure was dealt with in *Swart v Beagles Run Investments 25 (Pty) Ltd*.[220] The court was of the

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rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders". This does not mean that the 2008 Companies Act shuns liquidation proceedings within the business rescue provisions. On the contrary, liquidation proceedings are still regarded as a possibility in several sections: 129(6), 131(8)(a), 132(2)(a)(ii), 135(4), 140(4), 141(2)(a)(ii), 145(4)(b), 150(2)(b)(vi), 155(3)(a)(iii) and 155(3)(a)(vi).

216. Bradstreet "The New Business Rescue: Will Creditors Sink or Swim?" (2011) *SALJ* 365.

217. Ibid.

218. *Koen and Another v Wedgewood Village Golf & Country Estate (Pty) Ltd & Others* 2012 (2) SA 378 (WCC) at 382. Clearly, the support for business rescue as an alternative to liquidation was gaining momentum. The positive outcome that would result if a company went through a successful rescue was obvious.

219. *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Limited* 2013 JDR 1019 (GSJ) 1 at para 1. For a useful comparison of judicial management and business rescue, see pp. 1–5.

220. In *Swart v Beagles Run Investments 25 (Pty) Ltd (four creditors intervening)* 2011 (5) SA 422 (GNP), Makgoba J referred to the old judicial management provisions which appeared in section 427(1) of the Old Act. Makgoba J concluded that unlike judicial management, where there had to be a "reasonable probability" that if the company was placed under judicial management, it would be enabled to pay its debts or meet its obligations and become a successful concern, under business rescue it must be "reasonably probable" that the company will become viable and capable of ultimate solvency and that it will, within a reasonable time, become a successful concern (428 at paras 23–25). Also see Stein and Everingham *The New Companies Act Unlocked: A Practical Guide* (2011) 409. Also see comments on *Swart v Beagles Run Investments 25 (Pty) Ltd (four creditors intervening)* 2011 (5) SA 422 (GNP) in Joubert "Ondernemingsredding uit die wegspringblokke. Is dit sterk genoeg?" (2011) *De Jure* 26.

view that it needed to be "reasonably probable" (as opposed to the judicial management test of "reasonable probability" of all debts being paid in full) that the company would become solvent for an order to be granted by the court.

It is submitted that a fundamental starting point for a successful business rescue process is a debtor-orientated approach, as is supported by Harmer where he states:

> [A] business rescue regime has a far better chance of succeeding if the insolvency system in which it is applied is debtor-friendly, as opposed to a creditor-friendly system of insolvency where business rescue regimes are not applied as successfully. This is certainly true of South Africa … South Africa has a creditor-friendly insolvency system, and it is submitted that the fact that the courts take a very conservative approach to insolvency and judicial management is a contributing factor in the failure of judicial management as a business rescue regime in South Africa.[221]

Harmer recognises, it is submitted, the paradigm shift that was required; that is a shift from the old regime of judicial management caught up in a pro-creditor mindset, to that of business rescue where the focus was on saving the debtor company (pro-debtor).

The need for a corporate rescue mechanism as opposed to the alternative of liquidation in South Africa was regarded by Bradstreet as a necessity.[222] Bradstreet was of the view that business rescue would be invoked where the insolvency was viewed as temporary and where the debtor was capable, with assistance, of returning to commercial life as an active and successful entity. Jobs would be saved, work progressed to its successful conclusion, debts paid to a greater extent than would be the case if the debtor was removed from commercial life and investments would be protected. The business rescue system was dynamic with the expectation of improvement and possible recovery back to normal business and entrepreneurial activity.[223]

Business rescue was clearly perceived as a move away from the old approach of advantage to creditors founded in laws relating to consumer/individual insolvency and from the principles of judicial management. The fresh start for debtors offered by business rescue is a "game changer" and one that had to be taken on board by South African creditors. The tension between the need to promote entrepreneurship and risk taking and allowing debtors to make a fresh start was dealt with by Rajak and Henning as follows:

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221. Harmer "Comparison of Trends in National Law: The Pacific Rim" (1997) 23 *Brooklyn Journal of International Law* 139.
222. Bradstreet "The New Business Rescue: Will Creditors Sink or Swim?" (2011) *SALJ* 362.
223. Ibid.

> If it is the case that there is at present in South Africa a cycle of suspicion both by lenders as to the capability of borrowers to operate in business responsibly and by would-be entrepreneurs with ideas and enthusiasm as to the preparedness of lending institutions to commit much-needed funds, that cycle must be broken in the interests of all. This cannot be done without risk. Yet it should be stressed that risk is at the very heart of successful business, that failure and insolvency are integral parts of such overall success, providing both for the rescue of potentially successful debtors and the elimination, commercially speaking, of hopelessly insolvent ones. A radically reformed business-rescue regime in South Africa would minimise the risk to the lender by carefully tailored monitoring provisions, taking account of the interests of borrowers who want the freedom and financial resources to help build the fresh infrastructure of the new South Africa and of the interests of lenders who want some security to set against the risk of lending.[224]

The clear tension between lenders (in the main banks) as creditors, borrowers (debtors) and entrepreneurs in the South African economy, resulted in less risk taking lest companies ended up in a disastrous liquidation process. However, the need to separate those hopeless businesses, doomed to failure for whatever reason, from those that had the foundations of a potentially successful enterprise, left South Africans hoping that a system could be put in place to rescue the latter entities.

Deliberations over the business rescue procedure continue unabated in our courts with judges often taking the opportunity to set out the "requisite prescripts" of the new legislation, as becomes clear from the following:

> This is an important difference or aspect that differentiates business rescue from its counterpart in the old Companies Act, 1974, namely, judicial management. Business rescue is geared at saving significant costs, thus among others enabling financially distressed small (and big) companies to opt for it is as a viable alternative to "last resort" liquidation.[225]

It is further submitted that while there clearly was a global move towards business rescue, South Africa started to realise that there was a need for effective, modern business rescue provisions under new insolvency legislation.[226] The "fresh start" approach, which had proved popular in the US States and Europe, had started to gain momentum in South Africa as well.[227]

224. Rajak and Henning "Business Rescue for South Africa" (1999) 116(2) *SALJ* 287.
225. See Kgomo J in *Redpath Mining South Africa (Pty) Ltd v Marsden NO and Others* (18486/2013) [2013] ZAGPJHC 148 (14 June 2013) 13–15 at paras 40–43. Also see Stein and Everingham *The New Companies Act Unlocked: A Practical Guide* (2011) 409–411.
226. Burdette "Unified Insolvency Legislation in South Africa: Obstacles in the Path of the Unification Process" (1991) *De Jure* 56–57.
227. Ibid 57.

SYNOPSIS OF PART 1

It is clear that the development of South African law from archaic judicial management procedures of making payment to the creditor in full, to a full-fledged rescue mechanism is remarkable. Having regard to notions such as "advantage to creditors" in sequestration applications and to an insolvency regime which inherently favoured the creditor, South Africa has achieved a significant shift in mind-set to a rescue regime which clearly favours the debtor.

The South African courts' persistent view towards favouring a creditor-orientated approach in sequestration applications had permeated the methodology adopted in South African insolvency law, resulting historically in a pro-creditor culture.

Obtaining debt relief by way of a sequestration application was often criticised, especially where a "friendly sequestration" allowed a creditor to dispose of his or her debts to the prejudice of creditors. Creditors often viewed sequestration applications with suspicion. These were often seen as an abuse of the system where dishonest applications resulted in the passing of the debt burden to creditors, taxpayers, and the South African economy. Courts would often dismiss such sequestration applications leaving debtors without any real relief in the form of a statutory discharge from their debts. The creditor oriented approach, combined with the need to prove an advantage to creditors, made it difficult for debt-laden individuals to start afresh, and with the necessary and required discharge of debt.[228] Discharge is a fundamental principle of modern insolvency law systems. South Africa had unfortunately fallen behind the rest of the world, with much-needed reform in consumer debt discharge.[229]

It is submitted that with the introduction of business rescue legislation, South Africa has now turned the corner in moving towards a debtor-oriented approach. With the introduction of the NCA and the CPA, South Africa has moved towards a pro-debtor culture. There is a real need for the legislature to remove the requirement for debtors to have to prove an advantage to creditors in a sequestration application.

228. Boraine and Roestoff "Revisiting the State of Consumer Insolvency in South Africa After Twenty Years: The Court's Approach, International Guidelines and an Appeal for Urgent Law Reform" (2014) 77 *THRHR* 351–374 (Part 1) 527–546 (Part 2).

229. Ibid.

It had become evident that judicial management had, by the late 1990s and 2000s, fallen out of favour with lawyers, creditors and other stakeholders confronted with companies in financial distress. Was it such a bad system for restructuring? Probably with amendments to sections of the judicial management legislation, it could have become a workable restructuring mechanism. However, it is submitted that judicial management was generally recognised as being too court-driven, expensive and time consuming and did not properly deal with the realities of debt compromise. Coupled with the fact that there was no automatic moratorium to stay claims, judicial management became a piece of discarded legislation. Creditors simply did not support it, the failure rate was too high and as a result, South Africa desperately required new and workable rescue legislation.

It is also submitted that with the collapse of judicial management as a restructuring tool for financially distressed companies, the introduction of the business rescue provisions in the 2008 Companies Act have been generally well accepted and supported the view that South Africa had now turned the corner with a newly focused attitude towards favouring the debtor.

The historical socio-political ramifications of a pro-creditor culture in South Africa had left insolvency and rescue reform in tatters. Judicial management did not work as an effective restructuring tool and thus rescue reform was sorely needed. The old regime's perceptions of favouring the rights and position of the "large institutional" creditors created an atmosphere of tension between creditors and the ailing debtor company.

Clearly, the mind shift from a pro-creditor or liquidation culture to one of business rescue will continue to be the major challenge for creditors and corporate South Africa in the years ahead. Successful business rescue is really all about the buy-in from all stakeholders and the recognition, that in order for the "good" companies to be saved, creditors will need to accept a compromise of their claims.

It was clear that in the period leading up to the Companies Bill,[230] there was a clear recognition of the need for a well-thought out business rescue process aimed at the rehabilitation of financially distressed companies.

230. The Companies Bill was first published in Government Gazette No. 31104 Notice 677 *Notice of introduction of a bill into Parliament: Companies Bill* (30 May 2008).

Prior to the 2008 Companies Act being implemented (and as far back as 2007 when the Bill was initially made available to the public for comment), there was a clear recognition that the liquidation of debtor companies was causing destruction of value and caused major job losses which affected the economy in South Africa in a very negative way. There was therefore a very strong need for a process which was similar to judicial management but which would require all creditors to buy into a compromise process, similar to the systems applicable in the US and the UK.[231]

Many informal compromise arrangements broke down, with the resultant liquidation process ensuing. This made life for creditors extremely frustrating and many directors ended up being sued personally,[232] in instances where they were not really to blame for the downfall of the company.

There was thus a need for a formal restructuring process. This ultimately culminated in the drafting of Chapter 6 of the 2008 Companies Act.

Prior to considering Chapter 6 of the Act in some detail, it is necessary to consider the availability of worldwide standards of best practice for insolvency and rescue. These are found in certain international instruments (tools) used in insolvency and corporate rescue systems which converge into international core principles (themes) applicable to corporate rescue and the compromise of debt.

An understanding of these best practice standards is important when one considers the relevance and applicability of such standards in the rescue procedures set out in Chapter 6 of the 2008 Companies Act.

231. It is submitted that the legislature did not merely look to transplant foreign rescue systems into South Africa. It was recognised that South Africa needed a unique and effective rescue regime, but based on international principles of rescue culture and systems. See discussion in Chapter 5, para 5.3.

232. In terms of section 424 of the 1973 Companies Act.

PART 2 – INTERNATIONAL BEST PRACTICE, RESCUE INSTRUMENTS, THE DEVELOPMENT OF CORPORATE RESCUE CULTURE AND COMMON RESCUE THEMES

CHAPTER 4 : INTERNATIONAL STANDARDS OF BEST PRACTICE AND INTERNATIONAL INSTRUMENTS USED IN INSOLVENCY AND CORPORATE RESCUE

4.1 INTRODUCTION

The rescue of insolvent companies presents complex problems for national legal systems. Not only should mechanisms be devised to determine the circumstances in which rescue procedures should be implemented, but the treatment of diverse groups affected by the insolvency must also be established.[1]

Corporate rescue mechanisms worldwide have drawn on principles and concepts from different jurisdictions and from international models to create standards of international best practice for corporate rescue. Throughout this study, reference will be made to these international best practice standards (tools/instruments) and to common core rescue themes. The purpose of referencing these, is to highlight such models and themes in an effort to see the extent to which the new South African restructuring regime mirrors or stacks up to these international standards and whether or not Chapter 6 has effectively incorporated all of these fundamental themes into the business rescue legislation.[2] The appraisal section (dealt with below) will consider the South African legislation and measure, to an extent, the commonality of such legislation with such international models and rescue themes.[3]

In order to appreciate the content and sophistication of international corporate rescue themes,[4] it is my view that it is important to gain an insight into these international standards of best practice and international instruments or tools for rescue. Thus in order to

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1. Parry *Corporate Rescue: An Overview of Recent Developments from Selected Countries in Europe* (2004) 1.
2. See Chapter 7, paras 7.3 – 7.9. The South African common rescue themes are mirrored with those international themes mentioned in Chapter 5, para 5.5.
3. See Chapter 8, para 8.1.
4. See these common corporate rescue themes identified in Chapter 5, para 5.5. Tools/instruments of rescue should be distinguished from common rescue themes. The tools/instruments of rescue are drawn and identified from various international organisations which have set best practice standards for restructuring regimes across the world.

properly appraise the mechanics and workability of the provisions of Chapter 6 of the 2008 Companies Act from an international perspective, a review of international tools of rescue is necessary.

The various tools/instruments mentioned below are a grouping of important organisation's best practice standards for dealing with distressed companies across the world. The study has identified these tools/instruments as having provided the highest level of restructuring/rescue guidelines available. Their status comprises of sophisticated restructuring tools that can be used as a base set of guidelines in any jurisdiction around the world, and especially in emerging jurisdictions where there is little or no restructuring legislation available.

4.2 INTERNATIONAL STANDARDS OF BEST PRACTICE (UNCITRAL LEGISLATIVE GUIDE ON INSOLVENCY LAW)

The United Nations Commission on International Trade Law ("UNCITRAL") was established by the United Nations ("UN") General Assembly in 1966 to reduce or remove the obstacles to trade created by the disparities between the national laws governing international trade.[5] With a focus on harmonisation and modernisation of international trade law, the Commission was regarded as the vehicle by which the UN could play a more active role in this field.[6]

UNCITRAL completed the *Legislative Guide on Insolvency Law* in 2004 with the goal of encouraging the adoption of effective national corporate insolvency regimes.[7] The Legislative Guide focuses on the key elements of an effective insolvency law and presents

5. The United National Commission on International Trade Law was established by the United Nations Commission on International Trade Law (UNCITRAL) by Resolution 2205 (XXI) on 17 December 1966. UNCITRAL plays an important role in developing a framework to harmonise and modernise the law of international trade and which includes areas such as insolvency. See https://www.uncitral.org.

6. See INSOL and UNCITRAL *Celebrating 20 years of collaboration* (May 2014) available at https://www.insol.org/_files/INSOL%20World/INSOL%20-%20UNCITRAL%20WEB.pdf) 1–2. As an intergovernmental body, the Commission comprises 60 member states elected by the General Assembly, which represent the world's various geographic regions and its principal economic and social systems. UNCITRAL conducts its business through working groups and the Commission. Working groups are, as the name suggests, the forums that carry out the day-to-day work of developing legislative texts. They are an amalgam of the 60 states that are members of the Commission, other UN member states that attend meetings as observers, as well as intergovernmental organisations and nongovernmental organisations that are invited to attend as observers. The commission secretariat (the Secretariat), which is based in Vienna, prepares and services annual meetings of the Commission and biannual meetings of six working groups, which prepare the substantive legal texts designed to harmonise international trade law. Of those six groups, one has been considering various aspects of insolvency law since 1995.

7. The final negotiations on the draft legislative guide on insolvency law were held during the 37th session of UNCITRAL in New York held from 14–21 June 2004 and the text was adopted by consensus on 25 June 2004. The General Assembly of the United Nations adopted the Legislative Guide in resolution 59/40 of 2 December 2004.

a detailed series of Legislative Recommendations (Recommendations) which include a discussion of various options and approaches.[8]

The World Bank and UNCITRAL, in consultation with the IMF, have prepared the Insolvency and Creditor Rights Standards for Insolvency and Creditor rights ("ICR") ROSC assessments (the ICR Standard). The ICR Standard combines both the principles and the recommendations in the document.[9] The ICR ROSC assessments are carried out using this methodology.[10]

The UNCITRAL *Legislative Guide on Insolvency Law* provides a comprehensive statement of the key objectives and principles that should be reflected in states' insolvency laws. It is intended to inform and assist insolvency law reform around the world, providing a reference tool for national authorities and legislative bodies when preparing new laws and regulations or reviewing the adequacy of existing laws and regulations.[11]

The guidelines aim at achieving a balance between the need to address a debtor's financial difficulty as quickly and effectively as possible, the interests of the various parties directly concerned with that financial difficulty (principally creditors and other stakeholders in the debtor's business), as well as public policy concerns, such as employment and taxation.[12]

The UNCITRAL *Legislative Guide on Insolvency Law* has direct relevance for international trade. It has become increasingly recognised that strong and effective

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8. The UNCITRAL Legislative Guide on Insolvency Law, it is submitted, sets the highest level of benchmarking for any rescue/restructuring regime applicable in any jurisdiction around the world. The comprehensive nature of the guide is of extreme importance when assessing the nature and efficacy of any restructuring regime. See the comparative analysis set out in Part 4, Chapter 8, para 8.1.

9. See INSOL Principles and Guidelines available at http://go.worldbank.org/HDA5J6D9HI.

10. For the ICR ROSC assessment methodology, see http://go.worldbank.org/LYCZB7H890 – Revised – December 2005. The purpose of the ROSC assessment is to evaluate the strength of a country's insolvency and creditor rights laws addressing creditor rights, legal frameworks, institutional frameworks and informal corporate work-outs and restructuring. The ROSC assessment recognises the need for effective bankruptcy law and frameworks as well as corporate work-outs and formal restructurings. From a restructuring perspective, the ROSC assessment criteria recognise that an enterprise is usually more valuable as a going concern than if it is liquidated because it is able to maximise asset value and preserve jobs. The aim is to restore an enterprise to financial viability if possible, by establishing an enabling environment that –
    - provides for the disclosure of accurate financial information;
    - encourages the provision of financing to viable distressed companies; and
    - provides for a broad range of restructuring activities.

    Also see INSOL ROSC Assessments available at http://go.worldbank.org/LYCZB7H890.

11. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 1–8.

12. UNCITRAL *Legislative Guide on Insolvency Law* Parts 1–4. Parts 1 and 2 were published in 2004, Part 3 in 2010 and Part 4 in 2013. Also see the Introduction, and Organisation and Scope of the Legislative Guide at 1–2. A total of 87 states, 14 intergovernmental organisations and 13 nongovernmental organisations participated in the elaboration of the text. The text was adopted by consensus on 25 June 2004. The United Nations General Assembly endorsed the Legislative Guide by Resolution 59/40 of 2 December 2004. See Burdette "The Development of a Modern and Effective Business Rescue Model for South Africa" (2004) Centre for Advanced Corporate and Insolvency Law (CACIL), University of Pretoria 17–31.

insolvency regimes are important for all states as a means of preventing or limiting financial crises and facilitating rapid and orderly workouts from excessive indebtedness.[13] Such regimes can facilitate the orderly reallocation of economic resources from businesses that are not viable to more efficient and profitable activities; provide incentives that not only encourage entrepreneurs to undertake investment, but also encourage managers of failing businesses to take early steps to address that failure and preserve employment; reduce the costs of businesses, and increase the availability of credit.[14]

The purpose of UNCITRAL's involvement in insolvency law was to foster and encourage the adoption of effective national corporate insolvency regimes. Its mandate was to establish best practices and to set a comprehensive statement of key objectives and core features for a strong insolvency debtor-creditor regime, including out of court restructuring and a legislative guide containing flexible approaches to the implementation of such objectives and features, including engagement on possible alternative approaches and identification of perceived benefits and the detriments of such approaches.[15]

The work done by UNCITRAL has dramatically changed the perception of insolvency practice and has allowed this area of law to gain substantial credibility in the development of insolvency regimes worldwide. Substantial input was obtained from the international insolvency community in establishing the *Legislative Guide on Insolvency Law* which has set the standard for insolvency regimes around the world. External consultation with INSOL International[16] and the International Bar Association[17] have assisted in this process.

In the introduction to the Legislative Guide, it is stated that its purpose is to assist in establishing an efficient and effective legal framework to address the financial difficulty of debtors. It is used as a guideline by legislative bodies when preparing insolvency and rescue laws in various jurisdictions.[18] The Legislative Guide aims to strike a balance between the need to address the financial difficulty of debtors and that of creditors and

13. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 1–8.
14. Ibid.
15. Official records of the General Assembly, 55th Session, Supplement No. 17 (A/55/17), paras 400–409; see Preface to UNCITRAL *Legislative Guide on Insolvency Law* Part 1 (2005) iii.
16. INSOL International is a worldwide federation of national associations of accountants, lawyers, insolvency practitioners, judges and academics who specialise in turnaround, restructuring and insolvency – see www.insol.org.
17. The International Bar Association (IBA), established in 1947, is the world's leading organisation of legal practitioners, bar associations and law societies. The IBA influences law reform and its Insolvency Committee is an official observer to the UNCITRAL Working Group in Insolvency Law. See www.ibanet.org.
18. UNCITRAL *Legislative Guide on Insolvency Law* Part 1 (2005) 1.

other parties with a stake in the debtors' business. Issues relevant to insolvency proceedings, the reorganisation of the debtor, public policy concerns and the impact that these processes have on the economy are dealt with in the Legislative Guide.[19]

International core themes of rescue and tools for insolvency practice are covered in the guide,[20] and which it is suggested would be desirable to be incorporated into jurisdictional laws of insolvency. The Legislative Guide provides recommendations and specific guidance on the manner in which legislative provisions might be drafted.[21]

It is important to note that the Legislative Guide does not seek to provide a single set of model solutions to address central insolvency issues, but rather assists in the evaluation of different approaches available and in enabling legislators to choose the most suitable in the national or local context.[22]

Best practice dictates that in order to establish a robust insolvency regime, key objectives need to be established in a balanced manner. It is imperative that whatever design is chosen for insolvency law, these key objectives are met, although these key objectives remain complimentary to and compatible with the legal and social values of the society in which it is based and which it must ultimately maintain.[23] It is submitted that these core objectives apply equally to the establishment of any rescue regime in any particular jurisdiction.

There are eight important key objectives of a robust and effective insolvency regime identified by UNCITRAL in the Legislative Guide, namely[24] –

- the provision of certainty in the market to promote economic stability and growth;
- the maximisation of value of assets;
- striking a balance between liquidation and reorganisation;
- ensuring equitable treatment of similarly situated creditors;

19. Ibid.
20. Certain of these core themes will be dealt with in Chapter 5, para 5.5.
21. UNCITRAL *Legislative Guide on Insolvency Law* Part 1 (2005) 1.
22. Ibid 2.
23. Ibid 10.
24. Ibid 10–14.

- provision for timely, efficient and impartial resolution of insolvency and rescue procedures;
- the preservation of the insolvent estate to allow equitable distribution to creditors;
- ensuring a transparent and predictable insolvency law that contains incentives for the gathering and dispensing of pertinent information;
- the recognition of existing creditor rights and establishment of clear rules for the ranking of priority claims.

These key objectives need to be carefully considered when one assesses the veracity of any rescue or insolvency regime applicable in any jurisdiction. If these core objectives "stack up", then one can safely say that the applicable rescue or insolvency regime will serve the jurisdiction effectively and with recognised benefits flowing to all stakeholders.[25]

When one specifically considers rescue or reorganisation in an insolvency regime, it is imperative to ensure that a balance is struck between liquidation and reorganisation. An insolvency law must seek to balance the advantages of near-term debt collection through liquidation (often in preference of secured creditors) against preserving the value of the debtor's business through reorganisation (often in preference of unsecured debtors and the debtor company).[26] Achieving that balance may have implications for other social policy considerations, such as encouraging the development of an entrepreneurial class and protecting employment.[27]

Further, a reorganisation regime must include the possibility of the reorganisation of the debtor as an alternative to liquidation, where creditors would not involuntarily receive less than in liquidation and the value of the debtor to society and to creditors may be maximised by allowing it to continue.[28] This is predicated on the basic economic theory

25. A discussion of how the South African provisions of Chapter 6 "stack up" against these key UNCITRAL objectives follows in Chapter 8, para 8.1.
26. UNCITRAL *Legislative Guide on Insolvency Law* Part 1 (2005) 11.
27. Ibid.
28. Ibid.

that greater value may be obtained from keeping the essential components of a business together, rather than breaking them up and disposing of them in fragments.[29]

The measure of best practice in a rescue or restructuring will be set by the regime being able to effectively protect the interests of as many parties as possible. These include rescuing the debtor company in financial distress and allowing it to continue to trade; protecting employment; protecting the interests of creditors, and encouraging the development of an entrepreneurial class.[30] If the regime can effectively protect and deliver on these key elements of best practice, the regime aligns with its economic, social and political goals. The benefits for the jurisdiction's economy as a whole will be the inevitable outcome.[31]

The impact of these principles on rescue philosophy is profound. Adopting a reorganisation/rescue approach must have as its aim not the establishment of a safe haven for moribund enterprises: that is, enterprises that are beyond rescue and which should be liquidated as quickly and effectively as possible, but rather the establishment of best practice regimes that can rescue companies that are worth saving and which entities can continue to contribute to the economy on an ongoing, sustainable basis.

Considering the extent and detail of the UNCITRAL Legislative Guide, any jurisdiction seeking to establish or improve on its insolvency or rescue regime can be confident that these guidelines will assist in the establishment of sound rescue and insolvency procedures.

4.3 INTERNATIONAL INSTRUMENTS

In addition to the best practice standards set by UNCITRAL, other organisations have set up structures and tools (instruments) to assist different countries and jurisdictions in establishing international principles of insolvency and rescue best practice. These tools include principles set by the World Bank,[32] the International Federation of Insolvency

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29. Ibid.
30. Ibid 14–15.
31. Ibid.
32. The World Bank is a United Nations international financial institution that provides loans to developing countries for capital programs. The World Bank is a component of the various World Bank Groups, and a member of the United Nations Developments Group. It contributes to the stabilisation of the global financial architecture in the area of insolvency and creditor rights through an integrated program. The program includes the promulgation of principles of insolvency and creditor rights. See www.worldbank.org. More recently the World Bank (in June 2012) completed their ROSC analysis on South Africa – see http://go.worldbank.org/LYCZB7H890 – South Africa – Insolvency and Creditor Rights ROSC.

Practitioners ("INSOL International"),[33] the European Union ("EU"),[34] the International Monetary Fund ("IMF")[35] and the European Bank for Reconstruction and Development ("EBRD").[36] Some of these organisations and their tools and instruments are discussed in the following sections.

4.3.1 THE WORLD BANK

In 2010, the need for the continued promotion and establishment of best practice standards for business insolvency systems was recognised by the then General Counsel and Legal Vice President of the World Bank Group, Anne-Marie Leroy, who made the following statement in this regard:

> In the aftermath of the Asian financial crisis, the international community in 1999 mandated the World Bank to identify internationally recognized best practices in the design of insolvency laws and the due protection of creditor rights. The Bank was also entrusted with the responsibility of assessing the effectiveness of domestic systems through the compilation of Reports on the Observance of Standards and Codes. This is the origin of the Bank's Principles for Effective Insolvency and Creditor Rights Systems, approved in 2001 and revised in 2005, developed in conjunction with partner organizations, international experts, and the international community. These Principles, together with the Recommendations of the UNCITRAL Legislative Guide on Insolvency Law, form the basis of the Bank's work in this area.[37]

As part of the World Bank/IMF Financial Sector Assessment Program ("FSAP"), the Reports on the Observance of Standards and Codes ("ROSC") provide a template based on the World Bank's principles, to assist countries in evaluating their own insolvency and debtor-creditor relation systems. The ROSC assessments on insolvency are conducted by World Bank staff and are supported by experts from other institutions. In addition, the

33. INSOL International is a worldwide federation of national associations of accountants and lawyers who specialise in turnaround and insolvency. Formed in 1992, INSOL has grown to some 44 member associations with over 10 000 professionals participating as members of the organisation. Ancillary groups include the judiciary, regulations, lenders and academics. It is a well-respected organisation and has become the leading insolvency association in the world. See http://www.insol.org.

34. The European Union has adopted regulations on insolvency proceedings which also provide for the recognition and enforcement of judgments and cross-border insolvency. The EU Regulations take precedence over any inconsistent provisions of the domestic laws of member states. See http://www.europe.eu/index-en.htm.

35. The International Monetary Fund (IMF) is an international organisation that was established in 1944 at the Bretton Woods Conference. The IMF works to foster growth and economic stability and promotes orderly and effective insolvency systems among its members. It consists of 188 member countries and is a specialised agency of the United Nations. See http://www.IMF.org.

36. The European Bank for Reconstruction and Development (EBRD) works to assist its countries of operations in their transition to viable and competitive market economics. The EBRD focuses on insolvency reforms in various former Eastern Bloc countries.

37. Leroy "Foreword" in Westbrook, Booth, Paulus and Rajak (eds) *A Global View of Business Insolvency Systems* (2010) available at https://www.openknowledge.worldbank.org/bitstream/handle/10986/13522/68423.pdf?sequence=1 xv–xvi.

World Bank provides technical assistance for countries developing their insolvency and creditor rights systems.[38]

Insolvency and creditor rights ("ICR") constitutes one of the twelve areas in which the joint World Bank and IMF initiative on Standards and Codes undertakes assessments.[39]

In order to carry out these assessments, the World Bank used the World Bank Principles for Effective Insolvency and Creditor/Debtor Rights Systems ("Principles")[40] and the UNCITRAL *Legislative Guide on Insolvency Law* ("Legislative Guide").[41]

These two complementary texts represent the international consensus on best practices and set forth a unified standard for ICR systems. In addition, they serve as a reference point for countries evaluating and strengthening their ICR systems.[42]

The World Bank and the IMF have drafted standards and codes in order to assist with the evaluation of countries and to create a sound investment climate (particularly for investors) in such jurisdictions. The World Bank Principles determine insolvency proceedings with international aspects such as jurisdiction, recognition of foreign proceedings, cooperation and assistance among courts in different countries, and choice of law.[43]

The Executive Summary to the Principles[44] sets out an overview of the key elements which include issues such as compatible credit and enforcement systems, collateral systems,

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38. See http://www.worldbank.org. A seminal aspect of the insolvency initiative is its active engagement in providing parties with capacity building apparition. The World Bank has hosted, sponsored and participated in various global and regional forums that have brought together key international experts and relevant regional practitioners. The forums offer opportunities for having discussions in the insolvency and creditor rights fields by providing access to specifically designed materials, relevant documentation, lectures, synopsis, seminars and online forum sessions. Also see Omar "Landscape of International Insolvency Law" (2002) 11 *INSOL International Insolvency Review* 192–198.

39. World Bank *Principles and Guidelines for Effective Insolvency and Creditor/Debtor Rights Systems* (revised 2015). An example of this is the annual INSOL Africa Round Table Conference which includes lawyers, bankers, insolvency practitioners, regulators and judges from the African continent to discuss insolvency law reform.

40. The World Bank *Principles for Effective Insolvency and Creditor/Debtor Rights Systems* (revised 2015) available at http://siteresources.worldbank.org/EXTGILD/Resources/5807554-1357753926066/2015_Revised_ICR_Principles(3).pdf. Note that this document contains principles centred around legal frameworks for creditor rights, insolvency, corporate rehabilitation, work-outs and restructuring and the interpretation of the instituted and regulatory insolvency systems. See Wessels *Cross Border Insolvency Law: Instruments and Commentary on International Insolvency Law* (2012) 1–97.

41. United Nations Commission on International Trade Law *UNCITRAL Legislative Guide on Insolvency Law* (August 2005) available at https://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf.

42. World Bank *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems* (2005).

43. See The World Bank *Principles for Effective Insolvency and Creditor/Debtor Rights Systems* (revised 2015) available at http://siteresources.worldbank.org/EXTGILD/Resources/5807554-1357753926066/2015_Revised_ICR_ Principles(3).pdf 1–3. In addition, the World Bank assists with cross-border insolvency issues such as those found in the UNCITRAL *Model Law in Cross-Border Insolvency* (1997).

44. The World Bank *Principles for Effective Insolvency and Creditor/Debtor Rights Systems* (revised 2015) available at http://siteresources.worldbank.org/EXTGILD/Resources/5807554-1357753926066/2015_Revised_ICR_Principles(3).pdf 4–9 gives a brief summary of the key elements set out in the principles.

credit information systems, informal corporate work-outs, elements of commercial insolvency, institutional and regulatory frameworks, transparency accountability and corporate governance, predictability of investments in emerging markets and the risks associated with funding in jurisdictions with uncertain insolvency systems.[45]

Some criticism has arisen in respect of whether the World Bank's approach is pro-creditor or pro-debtor. One needs to consider whether or not the insolvency systems proposed by the World Bank orientate towards an interference with the contractual rights of creditors (pro-debtor approach). The debate within the World Bank is to establish whether or not a law designed for a pro-debtor system tends to erode those rights and expectations to achieve rehabilitation of the businesses.[46]

It has been argued that the World Bank has attempted to balance insolvency systems between debtors and creditors. Worldwide the trend has been on convergence, with pro-creditor systems becoming more debtor-friendly and pro-debtor systems tilting back towards stronger creditor rights. The gradual convergence (seen in the UK, the US, Germany, Japan and now in South Africa) towards the promotion of corporate reorganisation supports this contention.[47] Pomerleano and Shaw describe such convergence as follows:

> This gradual convergence towards the midpoint of the continuum can be attributed in part to the impact of globalisation (global, business and financial markets), which increasingly forces countries to adopt a set of rules and systems conducive to investment and competition both domestically and globally."[48]

The World Bank thus strives towards achieving this balance. This is not to say that every country will strike the same balance as reflected in the World Bank principles or should necessarily aim for the middle of the pro-creditor/pro-debtor scale. Every country's approach will reflect its history, policy choices and the issues affecting a particular market

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45. World Bank www.worldbank.org/gild – Executive Summary. For further comment on the influence of the World Bank on Insolvency Law, see Halliday and Carruthers *How the World Bank created Insolvency Law* (6 October 2014) available at https://clg.portalxm.com/library/keytext.cfm?keytext_id=81. Also see Halliday and Carruthers *Globalisation, Law, Markets* (2009) Chapter 3; Burdette "The Development of a Modern and Effective Business Rescue Model for South Africa" (2004) Centre for Advanced Corporate and Insolvency Law (CACIL), University of Pretoria 31–32.
46. Pomerleano and Shaw *Corporate Restructuring: Lessons from Experience* (World Bank Annual Report 2005) 308.
47. Ibid.
48. Ibid.

at a particular time, and each country must therefore evolve with the changing needs of business, commerce and society.[49]

The World Bank principles and the assessment programme have proven to be an important development tool for promoting the Bank's goals of assisting client countries to achieve sustainable development. The principles are a functional diagnostic tool with which countries can better appreciate the impact that their creditor rights and insolvency systems have on establishing a strong investment climate and with which to consider how domestic systems measure up to an international set of norms on best practice.[50] Assessments also reveal how weaknesses in country systems can distort market behaviour and produce incentives or disincentives that affect the behaviour of business owners, lenders, and other creditors. The country assessment is not an end in itself. Rather, it is a tool for legislators and policymakers to take decisive action to adopt their systems to maximise commercial confidence and economic growth by creating responsive systems.[51]

The 2008 global financial crisis continues to drive the World Bank in its efforts to stabilise and develop financial systems. Alongside the formulations of standards of international best practice and the assessment of insolvency regimes across the globe, the World Bank continues to provide technical assistance to client countries and assists in building the capacity to create better insolvency systems on an ongoing basis.[52]

4.3.2 INSOL INTERNATIONAL (INSOL)

INSOL and UNCITRAL have been collaborating over the last 20 years in insolvency proceeding analysis and best practice development. Both organisations have been working

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49. Ibid. World Bank representatives have visited South Africa from time to time and in order to assess the development and status of liquidation and insolvency practice in the jurisdiction. The author has been interviewed by World Bank representatives on several occasions which included discussion on the current state of play of insolvency and rescue practice in South Africa (September 2009, March 2011 and April 2013). What became clear was the inability for corporations to effectively place themselves into a rescue process similar to those operating in the US and the UK. Marthinus (Tienie) Cronjé of the SA Law Commission on Insolvency has been instrumental in arranging these interviews and specifically with the aim of educating the World Bank representatives on developments and in particular the early drafts of Chapter 6 of the 2008 Companies Act and its practical roll-out since May 2011.

50. Ibid 376. Some criticism has been aimed at the World Bank's approach as being too prescriptive. See Halliday and Carruthers *Globalisation Law, Markets* (2006) Chapter 13; Halliday and Carruthers *How the World Bank created Insolvency Law* (6 October 2014) available at https://clg.portalxm.com/library/keytext.cfm?keytext_id=81. The legitimacy of the World Bank's insolvency norm has been dampened. The World Bank had an international reputation for its heavy-handed methods of pressurising weaker countries to change. Additionally, the World Bank was seen by many to represent US interests and approaches. These legitimacy problems resulted in a growing international movement to shift a global synthesis of insolvency norms away from the World Bank to UNCITRAL.

51. Ibid.

52. Leroy "Foreword" in Westbrook, Booth, Paulus and Rajak (eds) *A Global View of Business Insolvency Systems* (2010) available at https://www.openknowledge.worldbank.org/bitstream/handle/10986/13522/68423.pdf?sequence=1 xv–xvi. Also see publication entitled *Viewpoint – Debt Resolution and Business Exit* by the Debt Resolution and Exit Team of the World Bank Group Trade & Competitiveness Global Practice, July 2014, Note Number 343.

together to address the cross-border issues that affect the efficiency of insolvencies and the usefulness of insolvency proceedings to stakeholders. Joint initiatives include UNCITRAL's working group V which has resulted in a succession of publications for use by policy makers, legislators, insolvency practitioners, academics and judges.[53]

INSOL International was still a relatively young professional body in the early 1990s, but finding solutions to international problems was part of the organisation's *raison d'être*, and INSOL had incorporated an international committee from the outset to work on such matters. As an organisation, INSOL International first began to explore the idea of working with UNCITRAL in the middle of 1992. The 1993 INSOL conference in Melbourne focused on cross-border insolvency. Based on the delegates' reception of the topic at the conference, the INSOL International Council endorsed their support for the opportunity to work with UNCITRAL.[54]

As a result of the collaboration, INSOL International, together with UNCITRAL, were the fundamental drivers of the Model Law on cross-border insolvency.[55] Progress was made by way of working sessions in the period 1992–1997, a final text was adopted by consensus as the Model Law on Cross-border Insolvency on 30 May 1997. The text was endorsed by the General Assembly in its resolution 52/158 of 15 December 1997.[56]

In May 2001, INSOL (consumer debt committee) published a report with the goal of providing a helpful resource for countries undertaking a law reform process with regard to debt problems being experienced by individual debtors.[57]

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53. See INSOL and UNCITRAL *Celebrating 20 years of collaboration* (May 2014) available at https://www.insol.org/_files/INSOL%20 World/INSOL%20-%20UNCITRAL%20WEB.pdf), at INSOL's Regional Conference in Hong Kong, a First Asia Region Judicial Roundtable on Insolvency was held as a collaboration of UNCITRAL, INSOL and the World Bank. See report on www.uncitral.org/pdf/ english/news/Asia-Insolvency_Roundtable Report (24 March 2014). Delegates considered the changing global economy, development of cross-border trading, the complexity of company ownership structures and how their systems would be able to respond to court-user needs.

54. See INSOL and UNCITRAL *Celebrating 20 years of collaboration* (May 2014) available at https://www.insol.org/_files/INSOL% 20World/INSOL%20-%20UNCITRAL%20WEB.pdf) 1.

55. Ailola "The UNCITRAL Model Law on Cross-Border Insolvency: Its Efficacy and Suitability as a Basis for a SACD Convention" (2000) *Stell LR* 215.

56. See http://www.uncitral.org/unicrtal/en/ga/resolutions.html. Also see Fletcher *The Law of Insolvency* (2009) 1033–1062. Also see comments on INSOL International and the organisation's contribution to insolvency and rescue reform across the world and particularly in South Africa in Chapter 6, para 6.3.

57. See INSOL International "Consumer Debt Report: Report of Findings and Recommendations" (2001) available at http://www.insol.org or http://www.insol.org/pdf/consdebt.pdf.

Further collaborations between INSOL and UNCITRAL include work on the insolvency of corporate groups. Part 3 of the UNCITRAL Legislative Guide was adopted by the United Nations Commission as an additional part of the Legislative Guide on 2 July 2010.[58]

In addition, INSOL and the World Bank have consistently interacted on many insolvency forums over the years. Judicial colloquiums and meetings of academics from both organisations occur at various regional and international conferences on an annual basis. Further collaboration occurred with the publication of the INSOL Global Principles for Multi-Creditor Workouts.[59] Further collaboration occurs between INSOL and the IMF (particularly through INSOL Europe).

It is clear that INSOL is committed to striving towards international best practice principles and establishing insolvency protocols across a multitude of jurisdictions in an effort to provide input into the continued development of insolvency law around the world.

4.3.3 THE EUROPEAN UNION

The European Union ("EU") is an supranational legislative body, where the European Union Council represents national governments in the passing of legislation that is directly binding on member states. Voting is by majority and legislation can be passed against the will of some member states.[60]

On 29 May 2000, the EU adopted Regulation No. 1346/2000 on Insolvency Proceedings. It entered into force on 31 May 2002 and is not applicable to all member states. The EU Regulation on Insolvency Proceedings provides for recognition and enforcement of judgments and decisions, allocation of jurisdictional competence and harmonised choice-of-law rules. It is the most advanced effort so far to provide cooperation and coordination in cross-border insolvency cases, but is only applicable within the EU.[61]

58. Part 3 was endorsed by the United Nations General Assembly resolution 65/24 of 6 December 2010. UNCITRAL *Legislative Guide on Insolvency Law* Part 3.

59. INSOL "Global Principles for Multi-Creditor Workouts" (2000) available at www.insol.org/global-principles. See www.insol.org for the extent of further collaboration between INSOL, UNCITRAL, the World Bank and the IMF.

60. See Boraine *INSOL Fellowships Study Guide* (2013) *Core Notes on the Nature and Sources of International Insolvency Law* University of Pretoria 47.

61. Boraine *INSOL Fellowships Study Guide* (2013) *Core Notes on the Nature and Sources of International Insolvency Law* University of Pretoria 47. Also see Fletcher *The Law of Insolvency* (2009) 997–1032; Council Regulation (EC) No. 1346, 2000, 29 May 2000.

In 2002, a useful study was conducted by a group of insolvency specialists into the existing attitude in Europe to failure among the general public, the financial sectors and various business partners in the EU member states. A comparison was made with the existing situation in the US. The study was an excellent collection of relevant legal information and provided a critical analysis of the legal consequences of bankruptcy in Europe and the US at the time.[62]

It is important to note that the EU Regulation takes precedent over any inconsistent provisions of the domestic laws of the member states.[63] In December 2013, the European Commission ("EC") published a study on a new approach to business failure and insolvency.[64]

Flowing from this study, the EC issued a recommendation on "a new approach to business failure and insolvency" on 12 March 2014 (the "Recommendation"). Insolvency laws across the EU vary greatly from member state to member state in respect of procedures available to debtors in financial difficulty. Such differences served as disincentives for businesses and cross-border investments. The Recommendation is aimed at harmonising and encouraging greater coherence among national insolvency laws across the EU. It deals with suggestions to enable companies to restructure at an early stage to avoid insolvency and maximise returns to creditors, employees, owners and the wider economy.[65]

Highlights of the Recommendation are as follows[66] –

- Flexibility in restructuring procedures and an increase in the importance of keeping costs to a minimum;
- Access to a framework which allows the debtor to commence restructuring early on with the objective of preventing insolvency;

62. Philippe & Partners/Deloitte & Touche "Corporate Finance Bankruptcy and a Fresh Start: Stigma on Failure and Legal Consequences of Bankruptcy" (Brussels, July 2002) available at http://www.pedz.uni-mannheim.de/daten/edz-h/gdb/02/stigma_study.pdf.
63. For a full synopsis of the Regulation, see Fletcher *The Law of Insolvency* (2009) 999–1032.
64. See Bariatti and Van Galen *Study on a New Approach to Business Failure and Insolvency: Comparative Legal Analysis of the Member States' Relevant Provisions and Practices* (5 December 2014) available at http://www.insoleurope.com.
65. See European Commission "Commission Recommendation of 12-3-2014 on a new approach to business failure and insolvency" (12 March 2014) *European Commission* available at http://ec.europa.eu/justice/civil/files/c_2014_1500_en.pdf. Also see Hardy and Morris *European Union – European Commission Recommendation on a New Approach to Business Failure and Insolvency* (16 April 2014) available at http://www.mondaq.com/unitedstates/x/307240/Insolvency+Bankruptcy/European+Commission+Recommendation+On+A+New+Approach+To+Business+Failure+And+Insolvency 1.
66. Ibid 1–2.

- Limited court involvement in the restructuring process enabling the debtor to restructure, without the need to formally open court proceedings. While restructuring plans adopted by a majority of creditors and restructurings with new financing should be confirmed by the courts, the restructuring process should be conducted out of court as much as possible;

- Appointment of a mediator or supervisor by the court made on a case-by-case rather than on a compulsory basis, thereby enabling the debtor to maintain control of the company's management;

- The right of a debtor to request that a court grant a temporary stay of individual enforcement actions lodged by creditors, which stay should not interfere with the performance of continuing contracts and should have a duration that strikes a fair balance between the interests of the debtor and creditors. The EC recommends that the duration of a stay should not exceed four months, although this period can be renewed twice for a maximum of twelve months;

- Restructuring plan decisions made by a majority of the creditors within classes composed of creditors who have the same interests (for example, secured and unsecured creditors form difference classes);

- New financing, such as new loans and the selling of certain assets by the debtor, which have been agreed to in the restructuring plan and confirmed by the courts should not be declared void, voidable or unenforceable as improper transactions;

- Limited negative effects of bankruptcy on honest entrepreneurs in order to give them a second chance. Entrepreneurs should be discharged from their debts which were subject to bankruptcy after no more than three years.

Member states are invited to implement the principles set out in the Recommendation by 12 March 2015 and the EC will assess the implementation of the Recommendation in member states by 12 September 2015. Under Article 288 of the Treaty on European Union, a Recommendation is nonbinding and therefore there is no change in EU law until a regulation or directive is adopted. However, the Recommendation is an expression of political will and influence, and where Recommendations are not enacted by member states within a given time frame, policy warnings and enforcement through incentives and sanctions may be used.[67]

A new project developed under the auspices of the European Law Institute (ELI) has recently made recommendations relevant to the rescue of viable businesses. At a conference held in September 2014 in Croatia, the ELI made important progress in respect of establishing business rescue in insolvency law for Europe and has made a start of developing a Legislative Guide for Europe on Business Rescue.[68]

4.3.4 THE INTERNATIONAL MONETARY FUND ("IMF")

Over the years, the IMF has become increasingly involved in the promotion of orderly and effective best practice insolvency systems among its members. It is the IMF's view that reform in this area can play a major role in strengthening a country's economic and financial systems.[69]

In its report in 2009,[70] the IMF stated the following:

> An effective insolvency system provides an important pillar of support for the domestic banking system by enabling banks to curtail the deterioration of the quality of their claims, including claims on the corporate sector, whether through a court-approved restructuring or, where necessary, through an efficient liquidation. Insolvency reform can be particularly relevant for economies in transition, where it can play a critical role in addressing the problems of insolvent state-owned enterprises. In the context of financial crises, an orderly and effective insolvency system can provide an important means of ensuring adequate private sector contribution to the resolution of such crises. Finally, although insolvency procedures are implemented through the courts, the very existence of an orderly and effective insolvency system establishes incentives for negotiations between debtors and their

67. Ibid. The Recommendation has requested member states to put in place appropriate measures within one year. 18 months after the adoption of the Recommendation the Commission will assess the state of play based on the yearly reports of the member states to evaluate whether further measures to strengthen the EU approach on insolvency is required. See Wessels *A New Approach to Business Failure and Insolvency* (7 May 2014) available at http://leidenlawblog.nl/articles/a-new-approach-to-business-failure-and-insolvency. Also see European Commission Press Release dated 4 December 2014 where statements were made relevant to a "rescue and recovery" approach to insolvency to give viable businesses a second chance when facing financial difficulties. Modernised rules (IP/12/1354) will make it easier for businesses to restructure and for creditors to get their money back. The new proposed regulation is to replace the former European Insolvency Regulation (Regulation EC No. 1346/2000 on insolvency proceedings) which has been applicable since 31 May 2002. See http://ec.europa.eu/commission/2014-2019/journa.en.

68. See European Law Institute *ELI Business Rescue Project*. See also paper by Wessels *Business Rescue in Insolvency Law – Setting the Scene* (2014). Also see Omar "Four models for rescue: convergence or divergence in European Insolvency Laws?: Part 2" *International Company and Commercial Law Review* (2007) 18(5), 171–180.

69. See IMF *Orderly and Effective Insolvency Procedures: Key Issues* (1999).

70. Ibid 2–3.

> creditors, which may lead to out-of-court agreements being reached "in the shadow" of the law.[71]

The IMF works closely with INSOL International and various industry experts in formulating this report. The report confirms that orderly and effective insolvency procedures can reduce the severity of economic and financial crises. Effective and predictable procedures are necessary to enable creditors to collect on their claims. Without this ability the future availability of credit diminishes. Furthermore, without orderly procedures, the rights of debtors (and their employees) may not be adequately protected and different creditors may not be treated equitably.[72] Effective insolvency proceedings play a critical role in fostering growth and competitiveness and may also assist in the prevention and resolution of financial crises. Sound insolvency procedures induce greater caution in the incurrence of liability by debtors and greater confidence in creditors when extending credit or rescheduling their claims.[73]

The report highlights key issues in the area of insolvency and weighs the advantages and disadvantages of possible solutions. Certain preferences are expressed in "best practice" principles which look to assist jurisdictions in formulating or amending their insolvency legislation.[74]

One of the prevailing analyses in the report is the "pro-creditor" versus "pro-debtor" policy of the IMF. The Report focuses and highlights the conflict between a "pro-creditor" versus a "pro-debtor" regime. The IMF is of the view that these terms often have different meanings in different countries. For instance, in some countries a pro-debtor insolvency law is seen as favouring the management of the debtor company, thereby allowing it to retain control of the company or to negotiate from a position of strength with its creditors.[75] In other countries, insolvency law will be characterised as being pro-debtor primarily because it allows the enterprise to survive and the employees to keep their jobs, while the managers are replaced by an administrative officer and eventually a new owner of the enterprise. Similarly pro-creditor law may differ regarding the way it addresses the

71. Ibid 2.
72. Ibid 4.
73. Ibid.
74. Ibid.
75. Ibid.

respective rights of secured and non-secured creditors.[76] The IMF recognises that often secured creditors are the main beneficiaries of outright liquidation proceedings in which their collateral will ensure the full and prompt payment of their claims, while unsecured creditors may benefit from a rehabilitation procedure that will maximise the value of the debtor's assets and therefore the value of the unsecured creditor's claims.[77]

The IMF concludes on the question of pro-creditor versus pro-debtor as follows:

> In any event, experience shows that the degree to which an insolvency law is perceived as pro-creditor or pro-debtor is, in the final analysis, less important than the extent to which these rules are effectively implemented by a strong institutional infrastructure. In particular, given the complex and urgent nature of insolvency proceedings, effective implementation requires judges and administrators that are efficient, ethical and adequately trained in commercial and financial matters and the specific legal issues raised by insolvency proceedings. A pro-debtor law that is applied effectively and consistently will engender greater confidence in financial markets than an unpredictable pro-creditor law.[78]

The IMF and the World Bank serve, together, as institutions benchmarking country systems globally. This joint effort culminates in the various Reports on the Observance of Standards and Codes ("ROSCs").[79]

Since the early 1990s, the IMF has contributed to the development of best practice insolvency systems in many jurisdictions around the world with the emphasis on disseminating insolvency norms. The aforementioned report codifies the IMF's experiences into a homogeneous normative code. With the publication of the so-called "Blue Book", the IMF has now published its first comprehensive statement for IMF lawyers seeking to enact insolvency reform. The "Blue Book" focuses on universal normal culture prescriptions and provides policy alternatives for a wide variety of markets and legal systems.[80]

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76. Ibid.
77. Ibid.
78. Ibid.
79. See Pomerleano and Shaw *Corporate Restructuring: Lessons from Experience* (World Bank Annual Report 2005) 308–316. Also see the World Bank/IMF *Global Bank Insolvency Initiative*; Leekaw "The IMF/World Bank Global Bank Insolvency Initiative – Its Purpose and Principal Features" (10 March 2006) available at http://www.juridicas.unam.mx/sisjur/mercant/pdf/8-436s.pdf.
80. See Halliday and Carruthers *How the International Monetary Fund Created Insolvency Law* (12 September 2010) available at https://clg.portalxm.com/library/keytext.cfm?keytext_id=83; Halliday, Carruthers *Globalisation Law, Markets* (2006) Chapter 3; World Bank Law Resource Centre "The Bluebook – A Uniform System of Citation" (Harvard Law Review Association 2015) available at http://external.worldbankimflib.org/uhtbin/cgisirsi/?ps=Jri9dFh75w/JL/148620017/9#.

4.3.5 THE EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT

The European Bank for Reconstruction and Development ("EBRD") plays an important role in the reform of market economics of the former Eastern Bloc countries. The EBRD was established in 1991 and serves as an international financial institution promoting private and entrepreneurial initiatives in 27 "countries of operation". The Bank focuses its attention on five core commercial law areas: capital markets and corporate governance, concessions, telecommunications regulatory reform, secured transactions and insolvency.[81]

In the field of insolvency, and based on international standards set out in the UNCITRAL Legislative Guide and the World Bank's Principles, the EBRD has defined a set of ten core best practice principles for a modern insolvency law regime ("ILR"). The ILR Draft statement of Core Principles for an Insolvency Law Regime[82] establish principles which are meant to be guidelines only and deal more with the results to be achieved than with the process by which to achieve them. Nevertheless, the EBRD is committed to ensuring that the best practice standard be applied in accordance with the core principles of international standards, which will be a determinative factor for investors seeking to invest in any given country.[83]

The EBRD was one of the first international financial institutions to develop legal technologies for insolvency regimes. The EBRD created the Legal Transaction Survey, which was used to evaluate countries' laws in terms of their existences and effectiveness. Focus was on balancing debtor and creditor interests, insisting that reorganisation alternatives should form part of any insolvency law and anticipating the need for

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The Blue Book 80 contains guidelines on –

- Broad objectives policy makers should seek to attain;
- Specific elements of an effective bankruptcy system;
- A principal conclusion that summarises the preference of the Legal Department on each issue.

The Blue Book is a culmination by the IMF to establish formal views on the above issues. In order to ensure that the IMF did not propose norms in conflict with the recommendations of other organisations specialising in global insolvency, the IMF drew on the expertise of external organisations like INSOL and UNCITRAL and went as far as incorporating UNCITRAL's model law on cross-border insolvency into its final recommendations in order to legitimise its normative recommendations. See IMF *Orderly and Effective Insolvency Procedures* (1999) 4.

81. See http://www.ebrd.com. Also see Boraine *INSOL Fellowships Study Guide* (2013) 71.

82. ERBD *Core Principles* available at http://www.ebrd.com/cs/Satellite? (September 2004). A focus by the EBRD is on cross-border insolvency with clear rules for recognition, where appropriate of foreign court orders, and a clear mechanism for determining how conflicts between different jurisdictions should be resolved.

83. ERBD *Core Principles* available at http://www.ebrd.com/cs/Satellite?. Also see ERBD *Insolvency Office Holder Principles* (June 2007).

professionalised insolvency practitioners and the appointment of specialised commercial courts where competent judges are given adequate powers of discretion.[84]

Overall, the EBRD recognises that an essential component for the development of a market economy, particularly in early transition countries, is the presence of sufficient investments by both foreign direct investors and institutional lenders. In the past, the EBRD has demonstrated that a country's likelihood to attract foreign direct investment and bank credit increased directly proportional to the increase in effectiveness of that country's insolvency legislation.[85]

The EBRD has set its suggested laws against international standards and best practices as articulated by among others, the UNCITRAL *Legislative Guide on Insolvency Law* and the World Bank's *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems*.

In summary, it is submitted that all of the abovementioned tools/instruments, which in the main are driven and administered by international organisations and governments, serve to enrich the knowledge base of insolvency, rescue and legislatures across the globe. Innovative thinking, academic input and newly driven legislative initiatives all contribute to the development of restructuring processes and mechanisms.

It is submitted that certain stakeholders and states (governments) will have different (and often conflicting) views on the status of these organisations and the effectiveness of the tools that are in place. This can lead to criticism and disenchantment with the suggested processes. Political influences, the attitude towards preservation of employment, the status of creditors as opposed to the debtor, the extent and influence of the supervisor and the impact of discharge of claims and discharge from the rescue process, all add to the status and perceived ranking of the importance of such tools and instruments. It is however submitted that there can be no harm in robust debate around the stature and importance of these mechanisms which ultimately will serve in enhancing and developing restructuring and rescue laws worldwide.

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84. See Halliday and Carruthers *How the European Bank for Reconstruction and Development Created Insolvency Law* (6 September 2006) available at https://clg.portalxm.com/library/keytext.cfm?keytext_id=84.

85. ERBD *Core Principles* available at http://www.ebrd.com/cs/Satellite?. The EBRD regularly conducts assessments and surveys to measure the effectiveness of insolvency laws in its countries of operations.

It is further submitted that all of the abovementioned international instruments and tools used in insolvency and rescue mechanisms are critical for the activities of insolvency practitioners across the world. It provides set and defined best practice guidelines to assist in practice, and further contributes to the development of insolvency law across multiple jurisdictions (to the advantage of all stakeholders, including the courts). In addition to these formal guidelines, legislation has been drafted in various jurisdictions as to the manner in which such jurisdictions practically deal with insolvency and rescue processes. International corporate rescue culture principles in these foreign jurisdictions (including attitudes to the discharge of debt) must be understood prior to analysing common rescue themes applicable in restructuring processes in such jurisdictions.

CHAPTER 5 : COMPARATIVE CORPORATE RESCUE CULTURE AND COMMON RESCUE THEMES

5.1 INTRODUCTION

It is submitted that the preservation of the debtor company from one on the brink of insolvency to that of an economically viable entity is the fundamental goal of modern business rescue regimes worldwide. From ancient times, creditors' rights have always been considered most important and the prevalent concern has been the return to creditors of debt due. Up until quite recent times, particularly in South Africa, the creditor-friendly regime has been favoured by the law of insolvency and particularly in legislation governing the winding up of companies.

In ancient Roman times, if a debtor failed to discharge his debt the creditor was entitled to take the debtor and "bind him with a thong or fetters". Certain statutes went so far as to entitle creditors to "cut up the debtor's body". Without doubt the historical treatment of the debtor in a harsh and oppressive manner set the tone for the manner in which debtors were to be generally dealt with in modern times.[86]

Over time, the rehabilitation of a debtor company in modern rescue regimes has been accepted as a priority and creditors now have to accept a compromised position, since business always entails risks, as stated by Slomowitz AJ:

> It is sometimes forgotten that insolvency is not a crime … In a capitalistic society the return for risk is profit but the pitfall is loss and possible insolvency. With the best will in the world, a man's business may fail. Nonetheless the taking of legitimate business risks is the very cornerstone of our system.[87]

The term "benefit to creditors" has thus taken on a new meaning. Often the terminology is regarded as confusing. How is it possible that the term "benefit to creditors" can result in a situation where creditors suffer a loss? The term means that there must be an orderly

86. Smith *The Law of Insolvency* (1988) 5.
87. Slomowitz AJ in *Kruger v The Master and Another NO; Ex Parte Kruger* 1982 (1) SA 754 (W) at 758.

sharing on a just basis of all the assets in the insolvent estate, even though creditors may be awarded a dividend of some negligible amount.[88]

It is submitted that there are four fundamental and common themes of rescue that must be seen as a *sine qua non* to any successful restructuring regime.[89]

The first theme is the ability to restructure debt in a situation where a company is financially distressed and which is linked directly to an acceptance that creditors need not receive a payback of the full amount of their claim but that there must be an acceptance of a compromised amount. This first theme is fundamental to all modern rescue regimes that exist in international jurisdictions.[90]

The second fundamental theme in rescue is the "stay" or "moratorium" on claims. Without the ability to effect a stay or a moratorium on creditor claims against the debtor, the process will generally result in the collapse of attempts to restructure the financially distressed company. The automatic stay which applies upon the commencement of a formal business rescue process is one of the key elements in protecting the debtor company from ongoing claims from creditors, litigation, writs of execution and sales in execution. The debtor company needs to be ring-fenced and isolated from creditors' attempts to place themselves in a preferred position in respect of the company's assets. The automatic stay provides the company with breathing space and an ability to lock down or freeze all claims against the company, which prevents the debtor's assets and property from being dissipated.[91]

A third fundamental principle of rescue regimes worldwide is the ability to ensure that a rescue plan is approved, despite opposition from dissenting creditors. The will of the

88. Smith *The Law of Insolvency* (1988) 9.

89. See these themes set out extensively in the UNCITRAL *Legislative Guide on Insolvency Law Part 2* (2005) 9–33. The guide sets out key objectives and a suggested structure for an effective and efficient insolvency system which focus on the reorganisation of financially distressed entities. For the features applicable to reorganisation proceedings, see 27–30.

90. For the fundamental principles of creditors accepting a compromise on their claims, see the UNCITRAL *Legislative Guide on Insolvency Law Part 2* (2005) 11 and 27–30. Also see Ferriell and Janger *Understanding Bankruptcy* (2013) 1 and Rochelle "Lowering the Penalties for Failure: Using the Insolvency Law as a Tool for Spurring Economic Growth: The American Experience, and Possible Uses for South Africa" (1996) *TSAR* 315–316.

91. See the UNCITRAL *Legislative Guide on Insolvency Law Part 1 (2005)* 12 and the UNCITRAL *Legislative Guide on Insolvency Law Part 2* (2005) 83. Also see references on the need for a moratorium in Chapter 5, para 5.5.2.

majority must take priority over the will of the minority. Thus a democratic outcome must also persist in a restructuring regime.[92]

The “cram-down” on dissenting creditors is necessary as it allows those creditors that are supportive of the plan and the compromise being proposed to be able to vote out those creditors who are not willing to accept a compromised position. Generally, those dissenting creditors who do not wish to support a rescue plan must either be forced to go along with the majority or be forced to sell their claims (or be bought out), even at a negligible liquidation value. This allows the plan to be approved and implemented for the benefit of the debtor company, its shareholders, employees and the majority of creditors who wish to support such a rescue plan.[93]

A fourth necessary element is that of the “discharge”. Once a plan has been approved, all creditors’ claims must be discharged as against the debtor company. This would enable the company to commence business afresh and without the lingering burden of debt that existed prior to such company’s restructure. All debts that existed prior to the formal rescue regime becoming applicable are generally extinguished in terms of the discharge.[94]

This is in essence what gives a debtor company its “fresh start”: an ability to commence its business afresh, where its debts have been compromised by the plan.

Other fundamental themes applicable in restructuring or rescue regimes are the need for a corporate rescue culture; the identification of which entity would be in fact eligible for business rescue protection; the ability to enter the restructuring process and the barriers to entry into such rescue regimes; the level of involvement of the supervisor/practitioner; the role of the courts; the recognition of the rights of directors, creditors, shareholders and employees and the effect that the implementation of a business rescue process has on suppliers, customers, existing contracts and legal obligations. A most important aspect is the availability and need for post-commencement (debtor-in-possession) finance and the

92. See the UNCITRAL *Legislative Guide on Insolvency Law Part 2* (2005) 209–217. For an excellent analysis of business rescue plans in different international jurisdictions, see Pretorius and Rosslyn-Smith “Expectations of a Business Rescue Plan: International Directives for Chapter 6 Implementation” (2014) 18(2) *SABR* 108–139. Also see references in Chapter 5, para 5.5.6.

93. See the UNCITRAL *Legislative Guide on Insolvency Law Part 2* (2005) 226; Westbrook, Booth, Paulus and Rajak (eds) *A Global View of Business Insolvency Systems* (2010) available at https://www.openknowledge.worldbank.org/bitstream/handle/10986/13522/68423, pdf?sequence=1 156; Ferriell and Janger *Understanding Bankruptcy* (2013) 765–766; Epstein and Nickles *Principles of Bankruptcy Law* (2007) 102–103; Howard *Bankruptcy Overview: Issues, Law and Policy* (2002) 83–84. See references in Chapter 5, para 5.5.6.

94. See the UNCITRAL *Legislative Guide on Insolvency Law Part 2* (2005) 281–284. Also see Westbrook, Booth, Paulus and Rajak (eds) *A Global View of Business Insolvency Systems* (2010) available at https://www.openknowledge.worldbank.org/bitstream/handle/10986/13522/68423,pdf?sequence=1 160. See references in Chapter 5, para 5.5.7.

manner in which such funders are treated in the process. Ultimately the development of the business rescue plan and its implementation will be fundamental in ensuring that the restructuring efforts are achievable and that the company is rescued.[95]

The UK, US, Canada and Australia have had sophisticated corporate recovery regimes in place for decades. It is submitted that it is in these modern jurisdictions that we gain insight into the conceptualisation and understanding of the essential elements relevant to a restructuring process which averts liquidation for troubled companies. These jurisdictions have been chosen as comparative regimes due to the fact that, in the author's view, the South African business rescue legislation is most closely aligned with the legislation in those jurisdictions. The South African legislation draws on the common rescue themes which exist in these various jurisdictions. The various similarities to the South African rescue legislation are referred to in the section dealing with Chapter 6 of the 2008 Companies Act.[96]

5.2 MODERN RESCUE REGIMES

5.2.1 THE UNITED KINGDOM

The Insolvency Act, 1986, as amended by the Insolvency Act, 2000 (the "UK Insolvency Act"), which governs formal corporate rescue mechanisms in the UK, became operative on 29 December 1986. The term used to refer to corporate recovery procedures in the UK is in fact "insolvency procedures".[97]

Prior to the UK Insolvency Act, the major corporate recovery procedures available consisted of liquidation and receivership. Receivership only came into existence on the back of a floating charge, a particular kind of security frequently used in contracts in terms of which companies borrowed money from banks and by which such borrowings were secured on all of the company's assets.[98]

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95. See the UNCITRAL *Legislative Guide on Insolvency Law Part 2* (2005) 38–286.
96. See Part 3, Chapter 7. Also see Chapter 8, para 8.1.
97. See terminology used in the Insolvency Act, 1986 (as read with the Enterprise Act, 2002). See Fletcher *The Law of Insolvency* (2009) 15–26; Rajak *Company Rescue and Liquidation* (2013) 75–127.
98. See Rajak *Company Rescue and Liquidation* (2013) 1. The floating charge allowed a receiver and manager to be appointed to the company where they were empowered to restore an ailing enterprise to profitability and return it to its former owners. In certain cases, a disposal of the whole or part of the business as a going concern would occur. In either case, the presentation of the profitable parts of the enterprise had been seen to be to the advantage of the employees, the commercial community and the general public – see Cork Report, para 495.

The UK Insolvency Act resulted from the findings of the so-called Cork Report that commenced in 1977 with the appointment of a committee tasked with investigating the status of insolvency law at that time. Recommendations on corporate reform were published in 1982.[99]

While the Cork Committee praised the system of receivership and manager, it also recommended the more court-based system of administration. The UK Government supported the Cork Committee's recommendations and considered the introduction of the administrator procedure as a valuable addition to existing insolvency procedures. Government were concerned as to the level of control exercised by the receiver and manager appointed by the floating charge holder.[100] The floating charge invariably included a provision which enabled the bank to take control of the borrower when interest was in arrears or there were signs of existing or impending business failure. Thus, the Cork Committee acknowledged that receivership depended for its existence on there being a creditor of the failing company, whose claim was secured by a floating charge. What was needed, was something to plug the gap when a borrower failed or was about to fail, but where there was no creditor with a floating charge to appoint a receiver. This, in turn, led to the Cork Committee's recommendation of a new rescue institution, namely administration. At the same time, as the process had been preferred by the banks for a lengthy period of time, administrative receivership was retained.[101] It had the merit of speed and informality – no courts or lawyers were necessary for a receivership to be brought into existence. The UK Insolvency Act gave priority to receivership, which was renamed "administrative receivership". In effect it gave the floating charge holder the choice, either to appoint an administrative receiver or allow a petition for the court appointment of an administrator.[102]

The Cork report concluded that many insolvent companies, rather than being placed into liquidation, could have been rescued. At the time, these companies did not have any formal

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99. Cork *Insolvency law and practice: report of the review committee (the Cork committee)* (Cmnd. 8558) (1982) at para 496. The Cork report was a critical development of modern insolvency law in the UK. It involved a comprehensive report on insolvency and resulted in a complete overhaul of UK insolvency law.

100. Criticism of receivership forming close alliances between the receiver and the bank caused it to be ultimately disbanded as a method of restructuring. The power to sell assets and destroy viable businesses was of concern. Rajak *Company Rescue and Liquidation* (2013) 2–3.

101. Ibid 2. Ultimately, administrative receivership was retained to an extent by the Enterprise Act, 2002. The UK legislature bowed to the bank/receiver lobby and gave priority to the bank to appoint a receiver where in the case of an insolvent company, either an Administrative Receiver or an Administrator could be appointed. The Enterprise Act, 2002 (in time) virtually eliminated the Administrative Receivership (it was, however, retained for certain large public/private partnership operations). See ibid, 5–7.

102. Ibid.

corporate rescue procedures open to them. In the Cork report it was proposed that businesses should rather be sold as going concerns, thus preserving the workforce and the businesses.[103] The preservation of the company as a commercial enterprise is a favourable outcome. The report of the Cork Committee, delivered in April 1981, recorded the following:

> The business or commercial insolvent presents an entirely different picture from the private or consumer insolvent. The failure of such an insolvent has wide repercussions, not only upon those intimately connected with the conduct of the business, such as directors, shareholders and employees, but on other interests, such as suppliers, etc. The effect of the failure upon the realizable value of stock, plant and goodwill can be disastrous, and not infrequently there is a general feeling of desperation, which needs to be resolved. A modern manifestation of this is the sit-in by workers, seeking by their physical presence to ensure that their jobs will not be lost, by having some new organisation carry on the business. We believe that a concern for the livelihood and well-being of those dependent upon an enterprise, which may well be the lifeblood of a whole town or even a region, is a legitimate factor to which a modern law of insolvency must have regard. The chain reaction consequent upon any given failure can potentially be so disastrous to creditors, employees and the community, that it must not be overlooked.[104]

In the Cork Report, the following two aims "of a good modern insolvency law" were identified in respect of English law:[105]

> (i) to recognise that the effects of insolvency are not limited to the private interests of the insolvent and his creditors, but that other interests of society or other groups in society are vitally affected by the insolvency and its outcome, and to ensure that these public interests are recognised and safeguarded;
>
> (j) to provide means for the preservation of viable commercial enterprises capable of making a useful contribution to the economic life of the country.

In addition to these statements on the general aims of English insolvency law, the Cork Report stated the following in regard to the appointment of administrators as a form of business rescue:

> 498. Under our proposals, an Administrator may be appointed for all or any of the following reasons:
>
> (a) to consider the reorganisation of the company and its management with a view to restoring profitability or maintaining employment;

103. Cork Report at para 193.
104. Ibid at paras 203–204.
105. Ibid at paras 198–199, 54–55.

(b) to ascertain whether a company of doubtful solvency can be restored to profitability;

(c) to make proposals for the most profitable realisation of assets for the benefit of creditors and shareholders;

(d) to carry on the business where this is in the public interest but where it is unlikely that the business can be continued under the existing management.[106]

These recommendations culminated in the introduction of a new formal rescue procedure, namely the administration procedure which is regulated by Part II of the UK Insolvency Act.[107]

Historically, the UK insolvency law regime was always seen as a creditor-friendly regime, in contrast to the "debtor-focused" regime contained in the Bankruptcy Code of the US.[108]

The main result envisaged is the repayment of creditors with some form of maintenance of the priority of creditors' claims coupled with the rescue of the company as a going concern.[109]

In July 2001, the administration procedure was subjected to further reform due to the findings contained in the White Paper published by the Insolvency Service[110] in the UK. The Enterprise Act, 2002 was a result of this process and came into effect on 15 September 2003. As a result of the introduction of the UK Insolvency Act, the UK brought British business rescue right into line with what has been virtually a worldwide phenomenon of corporate rescue development, described as follows by Rajak:[111]

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106. Ibid at para 498. See also Goode *Principles of Corporate Insolvency Law* (2011) 267–323 for a useful discussion of administration under English law. The so-called Harmer Report (Australian Law Reform Commission *Report, No. 45, General Insolvency Inquiry* (February 1988)) followed similar principles when recommending the introduction of voluntary administration as a form of business rescue in Australia – see the Harmer Report, Chapter 3.

107. Belcher *Corporate Rescue: A Conceptual Approach to Insolvency Law* (1997) 13. Also see Fletcher *The Law of Insolvency* (2009) 2–27. These mechanisms are fairly complex and other than the administration procedure (a true rescue procedure) such other procedures fall beyond the scope of this study. For a full analysis of Administration, Receiverships and Formal Arrangements with Creditors, see Rajak *Company Rescue and Liquidation* (2013), Chapter 2 1–78.

108. Belcher *Corporate Rescue: A Conceptual Approach to Insolvency Law* (1997) 13. For a comparison between rescue regimes in the UK and US, see Ziegel *Control and Corporate Rescue* available at www.univie.ac.at/bwl/ieu/lehre/55061/.../CG/debtor-in-possession.pdf (2014) 46.

109. Belcher *Corporate Rescue: A Conceptual Approach to Insolvency Law* (1997) 13.

110. An agent of the UK Department of Trade and Industry (now the Department of Business, Enterprise and Regulatory Reform). See Deloitte & Touche *Report on Bankruptcy and a Fresh Start: Stigma on Failure and Legal Consequences of Bankruptcy* (Deloitte & Touche Corporate Finance, Report July 2002).

111. See the Enterprise Act, 2002. Also see Rajak "The Culture of Bankruptcy" in Omar (ed) *International Insolvency Law: Themes and Perspectives* Part 1 (2013) 3.

> All rescue regimes pursue the same goal and face the same problem – trying to ensure that protection is given only in suitable cases, where there is a good chance of recovery and rehabilitation. Giving a business the benefit of the rescue regime means preventing the enforcement by creditors of their claims and this is a serious infringement of rights which are fundamental to creditors in any capitalist society. This moratorium carries the added risk of being abused by no-hopers simply seeking a further few months of being kept alive on the equivalent of a life support machine despite already being in a terminal condition. Creditors are obviously prepared to tolerate interference with their rights where their debtor recovers because then their claims will be paid in full – and the debtor will be available for further business in the future. But an artificially protected debtor that doesn't make it out of the hospital is very likely to leave an even smaller estate than would have been available had the debtor company gone straight into liquidation.[112]

Legislation principally applicable to the insolvency of companies incorporated in England and Wales is the UK Insolvency Act and the Enterprise Act, 2002.[113]

The new company administration procedure introduced by the UK Insolvency Act, is applicable exclusively to companies and is a result of proposals made in Chapter 9 of the Cork report. It provides a variety of effective alternatives to the winding up of an insolvent, or near insolvent company, where there are reasonable prospects of reviving the company as a going concern.[114]

The administration order procedure, as advocated by the Cork report, creates a rehabilitative procedure that would be generally available, rather than being dependent first on the existence of a floating charge and secondly upon the taking of appropriate initiatives by the administrator so appointed.[115] The Enterprise Act, 2002 effected a relaunch of the administration procedure in an effectively altered guise.[116] Section 249 of the Enterprise Act preserves the special administration regimes applicable to certain types of companies, as established under separate statutes by which the companies in question are governed.[117]

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112. Ibid 23. Rajak recognises the fact that a business rescue process would seriously infringe on the rights of creditors in enforcing their claims. The benefits however of placing the debtor back into the marketplace, to continue to trade with such creditor, must be an alternative worth exploring.
113. See Leonard *Restructuring and Insolvency – Getting the Deal Through* (2013) 131. Further details of insolvency procedures are set out in subordinate legislation, the most important of which is contained in the Insolvency Rules, 1986. Interim and further amendments have been made to the Rules and consultation on further amendments to the Rules are expected. See an analysis of the Enterprise Act and "remodelled administrators" in McCormack, G *Corporate Rescue Law: An Anglo American Perspective – Corporations, Globalisation and the Law* (Edward Elgar Publishers 2008) Chapter 2 – Corporate Restructuring Law in the UK 298–301.
114. Fletcher *The Law of Insolvency* (2009) 513.
115. Ibid 514.
116. Sch. B1 to the UK Insolvency Act, 1986.
117. See Fletcher *The Law of Insolvency* (2009) 523–524.

Many reorganisations in the UK result from informal negotiations with creditors outside any formal insolvency or restructuring procedure.[118] In the UK, formal restructuring can occur by way of Company Voluntary Arrangements ("CVAs").[119] A CVA is an agreement between a company, its shareholders and its creditors and is used as a restructuring tool for companies in financial distress. It is a procedure under Part 1 of the UK Insolvency Act where the directors (or a liquidator or administrator) propose a reorganisation plan which typically includes delayed or reduced debt payments or a capital restructuring.[120] Subsequent to the elimination of administrative receivership, there has not really been a revolution in UK insolvent company administration. The biggest development to have occurred is the development of the "pre-pack".[121] This process refers to the operation by which the sale of the business of the company debtor is sized up, the business valued, its buyer identified and other appropriate factors connected with the sale are undertaken before the onset of the administration. This allows the transfer of the business to take place as soon as the administration process has commenced.[122] The "pre-pack" has ushered in a new-style form of administration.[123]

The pre-pack process in the UK appears to meet the objectives of a successful administration. It is a company rescue with the assistance of the duly appointed administrator.[124]

Notwithstanding, "pre-pack" administration has been criticised in some quarters in recent years. Opponents of the process have said it lacks transparency, it results in deals being negotiated in secret behind closed doors and that the process does not result in the best value being achieved for businesses. Proponents argue that the "pre-pack" administration has gone a long way to preserving value for distressed companies in the UK.[125] The

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118. Graham *Graham Review into Pre-pack Administration* (2014) 3 available at www.gov.uk/…/graham-review-into-pre-pack-administration. Also see Walton, Umfreville "Final Report to the Graham Review: Pre-Pack Empirical Research – Characteristic and Outcome Analysis of Pre-Pack Administration" *University of Wolverhampton* (2014) 544; Walters "Statutory erosion of secured creditor's rights: Some insights from the United Kingdom" *University of Illinois Law Review Volume 2015* 544.
119. Pt 1 of the Insolvency Act 1986 (sections 1–7 inclusive).
120. Ibid. See further comment on the UK CVA procedure in para 2.3.1. Also see Rajak *Company Rescue and Liquidation* (2013) 3–74 and Fletcher *The Law of Insolvency* (2009) Chapter 15, 477–512.
121. See Rajak *Company Rescue and Liquidation* (2013) 32–36.
122. Ibid 32.
123. For the advantages of pre-packs see ibid 33.
124. For legal precedent on pre-packs see ibid 34–36.
125. Graham *Graham Review into Pre-pack Administration* (2014) 3 available at http://www.gov.uk/…/graham-review-into-pre-pack-administration.

advantages include preservation of jobs and allowing companies to continue to contribute to the UK economy as a whole.[126]

Currently, administration is dealt with by the provisions contained in Schedule B1 to the UK Insolvency Act as inserted by the Enterprise Act, 2002. Recent developments include an attempt by the Insolvency Service to modernise and consolidate all existing insolvency legislation[127] including the publication of a new set of insolvency rules.[128]

Although a company in the UK can achieve a successful financial reorganisation without the need to enter into any formal insolvency procedure, if creditors are not generally supportive of the restructuring process or do not have confidence in the management of the company, it may be necessary to place the company under formal administration. It allows an insolvent company to continue to trade while protected from creditors by way of a moratorium. This gives the company sufficient "breathing space" to be reorganised and refinanced.[129]

5.2.2 THE UNITED STATES

In the second half of the 19th century, stakeholders in the US began to look towards rehabilitation models for financially distressed companies.[130] A strong move from "debtor repression to debtor protection" and a "redefinition of insolvency from sin to risk, from moral failure to economic failure" began to occur.[131]

The treatment of debtors in early bankruptcy laws was severe as a result of early bankruptcy law being a creditor-driven process. The concept of voluntary bankruptcy initiated by the debtor is a modern invention. Grounds for the change in the treatment of bankruptcy started in the US, which jurisdiction became the leading exponent of a new

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126. Ibid 5.

127. Latest developments appear regularly on the Insolvency Service website at http://www.insolvency.gov.uk.

128. For an excellent analysis of the United Kingdom Administrative Receivership and Administration process, see Broc "Company Voluntary Arrangements and the Rescue Culture in the Light of the Insolvency Act" in Broc and Parry (ed) *Corporate Rescue: An overview of Recent Developments from Selected Countries in Europe* (2004) 134–168. Also see Fletcher *The Law of Insolvency* (2009) 88–89. Also see McCormack *Corporate Rescue Law: An Anglo American Perspective – Corporations, Globalisation and the Law* (2008) Chapter 2 – Corporate Restructuring Law in the UK 43–47.

129. Leonard *Restructuring and Insolvency – Getting the Deal Through* (2013) 135. See Fletcher *The Law of Insolvency* (2009) 3–6. Also see Rajak *Company Rescue and Liquidation* (2013) 75–127; McCormack *National Report for England – Commencement of Insolvency Proceedings* (2012) 234–283.

130. On developments in the US see Rajak "The Culture of Bankruptcy" in Omar (ed) *International Insolvency Law: Themes and Perspectives* (2013) 14–17; Jackson *The Logic and Limits of Bankruptcy Law* (1986) 2–19; Ferriell and Janger *Understanding Bankruptcy* (2013) 2–6.

131. Rajak "The Culture of Bankruptcy" in Omar (ed) *International Insolvency Law: Themes and Perspectives* (2013) 32.

business rescue culture. The sentiment of a rescue culture emanated from the US's early history as a country of immigrants eager for a fresh start, with a general optimism about the future and the potential of the US economy.[132]

The US came to see bankruptcy as a necessary part of a society that valued entrepreneurial risk and over the years became known for a developing rescue culture aimed at debtor protection.[133] The US approach of the "fresh start" in bankruptcy has proved extremely influential in the subsequent development of business rescue legislation across the world.[134]

The new world order of debtor discharge helped to change attitudes in a world in which the discharge of debts became an accepted solution to the problems of insolvency. Four interrelated trends contributed to the evolution of modern ways of viewing lending and borrowing:[135]

- Business in general and credit in particular became increasingly depersonalised. The emergence of the corporation as a dominant form of ownership and management as well as a growth in the reliance on the sale of stocks or shares as the principal method of raising capital assisted in the development of a debt forgiveness culture.

- Changes in the scale and geographical scope of business activity also contributed to the depersonalisation of credit relationships. Remoteness of traders contributed towards a lack of intimacy in the conduct of business. By depersonalising relationships, the trend of debt discharge became more acceptable. Whom one did business with counted for less than before. What mattered was that the books showed accounts in good standing.

- Development to more formal and legalised business relationships resulted in contracts for debt becoming the norm. If the borrower defaulted, sooner or later the lenders would sue. Grace periods for debt and absolute forgiveness did not

132. Ibid 33.
133. Ibid.
134. For an overview of international bankruptcy approaches see Flessner "Philosophies of Business Bankruptcy Law: An International Overview" in Goode (ed) *Principles of Corporate Insolvency Law* (2011) 19–28.
135. Coleman *Debtors and Creditors in America, Insolvency Imprisonment for Debt and Bankruptcy 1607–1900* (1974) 270.

disappear, but slowly became less common, especially amongst corporate and larger lenders. The legal order contributed towards this trend. Development of the law facilitated orderly disposition of debt recovery actions and the growing number of professionally trained lawyers encouraged lenders to resort to litigation as the normal, prudent and routine way to enforce contracts for the recovery of debt. The legalisation of these debtor-creditor relationships led directly to the gradual acceptance of bankruptcy relief as an equitable, rational and systematic way of writing off bad debts.

- Lastly, the speculator or promoter became prominent in driving the high-risk segment of American businesses. This contributed to the formation of attitudes essential to the discharge of debt. The spirit of entrepreneurship led to a more sophisticated and riskier way of doing business.

As the 19th century advanced, more and more Americans became more tolerant towards debt and attracted to speculative ventures. Bankruptcy in the US thus became a viable and necessary concept. The old order of debt imprisonment thus gave way to the concept of debt forgiveness and discharge.[136]

The Bankruptcy Reform Act was introduced in the US in 1978 and made significant changes to bankruptcy practice. This culminated in the current US Bankruptcy Code, 1978 (the "US Bankruptcy Code")[137] which had the following effect:[138]

- It expanded the availability of bankruptcy as a remedy, by no longer requiring that debtors be insolvent;

- It expanded the exemptions available to individuals seeking relief, thereby improving a debtor's chance for a fresh start;

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136. Ferriell and Janger *Understanding Bankruptcy* (2013) 2.

137. This Act was preceded by the Report of the Commission on the Bankruptcy Laws of the United States. The commission, chaired by Harold Marsh Jr, a member of the Council of the Section of Corporation, Banking and Business Law, focused on the causes and philosophy of bankruptcy. Recommendations in changes to the legislation were made. Subsequent to the Bankruptcy Reform Act becoming law in 1994, the President of the US established the National Bankruptcy Review Commission. The Commission's role is to investigate and study issues relating to the Bankruptcy Code on an ongoing basis, to solicit divergent views on the operation of the bankruptcy system, to evaluate the advisability of proposals, and to prepare reports to be submitted to the President, Congress and the Chief of Justice. See National Bankruptcy Review Commission available at http://govinfo.library.int.edu/nbrc/report/04commis.html.

138. Rochelle "Lowering the Penalties for Failure: Using the Insolvency Law as a Tool for Spurring Economic Growth: The American Experience, and Possible Uses for South Africa" (1996) *TSAR* 317–318. See also Ferriell and Janger *Understanding Bankruptcy* (2013) 709; Epstein and Nickles *Principles of Bankruptcy Law* (2007) 84–110; Howard *Bankruptcy Overview: Issues, Law and Policy* (2002) 77.

- It consolidated the three different business reorganisation chapters under the Act into one chapter (Chapter 11) which allowed both the restructuring of secured debt and continuance of the debtor in possession.

The introduction of Chapter 11 of the US Bankruptcy Code set about real reform for the rescue of financially distressed companies.[139] The US Bankruptcy Code focuses primarily on paying creditors, and adopts a broader-gauge approach. What is appropriate in dealing with a single-creditor dispute doesn't necessarily apply when a debtor faces complete financial collapse.[140] In this situation, American legislative policy supported the concept that, along with paying creditors, the court must also take into account other matters, such as preserving jobs; giving the debtor a fresh start; preserving asset value, equitable division of assets and losses among creditors; proper concern for the interests of taxing authorities, and entities charged with maintaining public health and safety and protecting the interest of pensioners. In short, American bankruptcy law insists upon looking after all interests affected by a debtor's failure. These interests are taken into account holistically, with no single one predominating.[141]

5.2.3 **CANADA**

The Parliament of Canada enacted the Companies' Creditors Arrangement Act ("CCAA") in 1933,[142] to provide a mechanism through which a company could attempt to negotiate an arrangement with its creditors. This was enacted during the Great Depression when there was a significant need to protect corporations against aggressive creditors. The CCAA further permitted a court to stay enforcement proceedings of secured creditors. Amendments to the CCAA in 1953 restricted its application to companies that had issued bonds or debentures under a trust indenture. This restriction seriously limited the availability of the statute. The CCAA was revived in the early 1980s, during an economic recession, where the courts, conscious of the unavailability of an effective regime for

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139. See McCormack *Corporate Rescue Law: An Anglo American Perspective – Corporations, Globalisation and the Law* (2008) Chapter 3 – Fundamental Features of the US 78–117.

140. See the analysis of Chapter 11's contribution to the US economy in Ibid, Chapter 9 – Conclusion 301–306.

141. Rochelle "Lowering the Penalties for Failure: Using the Insolvency Law as a Tool for Spurring Economic Growth: The American Experience, and Possible Uses for South Africa" (1996) *TSAR* 317–318. For an analysis of possible reform to Chapter 11 see Wessels and De Weijs *International Contributions to the Reform of Chapter 11 U.S. Bankruptcy Code* (2015). In particular, see the discussion on the recommendations set out by the American Bankruptcy Institute (ABI) at 39–41. See also Ferriell and Janger *Understanding Bankruptcy* (2013) 709–806; Kilborn *Two Decades, Three Key Questions and Evolving Answers in European Consumer Insolvency Law: Responsibility, Discretion and Sacrifice* (17 December 2007) available at http://SSRN.com/abstract=1080252 753–785.

142. The Companies' Creditors Arrangement Act, R.S.C. 1985. See Wood *Bankruptcy and Insolvency Law* (2009) 326–328 for eligibility under the CCAA.

corporate restructuring, recognised "instant trust deeds" for the sole purpose of qualifying corporations to restructure under the CCAA. The CCAA then rapidly became the primary vehicle through which corporate restructuring was affected.[143]

The proposal provisions of the Bankruptcy and Insolvency Act ("BIA") were amended in 1992[144] to permit an insolvent debtor to make a proposal to both secured and unsecured creditors with the threshold for acceptance only of a majority of creditors holding two-thirds of the value of the claims. Although it was anticipated that the proposal provisions of the BIA would become the primary means for restructuring financially distressed enterprises, the CCAA continued to be employed to restructure corporations, primarily large enterprises. This gave rise to the existence of dual commercial restructuring regimes, a highly distinctive feature of Canadian insolvency law. Thus an insolvent debtor would usually need to make an assessment of advantages and disadvantages of restructuring under each regime in order to maximise the chances of success.[145]

During the period 2005 to 2007, insolvency reforms proceeded on the basis that the two general commercial restructuring regimes should be kept separate. This was based on the view that the CCAA is more flexible and better suited to resolving the multitude of issues that arise in connection with restructuring of larger businesses. The rule-based approach of the BIA was viewed as being more suitable for small- and medium-sized enterprises, where fewer court applications reduced the cost of restructuring. These reforms continued to adhere to the policy of convergence under which differences between the two regimes were to be minimised. However, many significant differences continue to exist between the two.[146]

The CCAA was originally intended to apply to companies with complex financial structures and a large number of investor creditors. The purpose of proceedings under the CCAA is to attempt to reach a compromise restructuring of the debtor's obligations to its creditors. The Bankruptcy and Insolvency Act, 1985, sits alongside the CCAA together

143. Also see Ibid 13–26.
144. The Bankruptcy and Insolvency Act, R.S.C. (1985) (as amended in 1992). See Wood *Bankruptcy and Insolvency Law* (2009) 326–328 for eligibility under the BIA.
145. Anderson "Viewing the Proposed Business Rescue Provisions from an Australian Perspective" (2008) 1 (4) *PER* 34–36.
146. Ibid.

with the Winding-up and Restructuring Act, 1985. However, all rescues are dealt with in terms of the provisions of the CCAA.[147]

In 1997 the CCAA was amended to modernise it. The Canadian parliament did away with the restriction in the legislation which had provided that the CCAA only applied where a company had an outstanding issue of lands under a trust deed. By the introduction of subsection 3(1) the CCAA is now available to any insolvent debtor company and its affiliates provided that the total creditor claims against the company or its affiliates exceed CAD 5 million.[148]

5.2.4 AUSTRALIA

The Australian business rescue procedure is found in Part 5.3A of the Corporations Act, 2001 (the "Australian Corporations Act"). Australia's corporate insolvency provisions form part of its general company law statute.[149]

Australian company law generally has developed and evolved from statutes in individual states. Despite the integration of commercial activity throughout Australia, company legislation did not always provide for consistent treatment, even in matters of corporate insolvency.[150]

In relation to provisions aimed at "rescuing companies in financial difficulties", the earliest adopted procedure was the scheme of arrangement. The development of these sections in Australia followed almost directly from the equivalent English provisions contained in the Joint Stock Companies Arrangement Act of 1870.[151]

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147. McDougall and Fleming *ADR in Cross-Border Canadian Corporate Restructuring* (presentation to International Bar Association 7 – 9 May 2006) 2.

148. Ibid. Also see Ben-Ishai "National Report for Canada" in Faber, Vermunt, Kilborn and Richter (eds) *Commencement of Insolvency Proceedings* Oxford International & Comparative Insolvency Law 3.

149. Anderson "Viewing the Proposed Business Rescue Provisions from an Australian Perspective" (2008) 1 (4) *PER* 2. Australia embraced corporate rescue and restructuring with the advantage of regulation in the 1980s. It has proved immensely successful with small- and medium-sized enterprises, and has reduced the cost of restructuring Australian companies without the need for court approval. While court involvement was meant to be minimised, a substantial body of case law has been developed since the inception of corporate rescue practice (Part 5.3A) in 1993. See comments by Anderson and Morrison "The Australian corporate rescue provisions: how do they compare?" in Omar (ed) *International Insolvency Law: Reforms and Challenges* 171–203.

150. Anderson "Viewing the Proposed Business Rescue Provisions from an Australian Perspective" (2008) 1 (4) *PER* 3.

151. In 1889, Queensland inserted provisions equivalent to Section 2 of the UK Act of 1870. New South Wales and Victoria followed in 1892. In 1937, all Australian states, except Western Australia, had adopted almost identical provisions to those of Section 20 of the 1908 United Kingdom Act.

"Official management" was inserted in the state-based Companies Acts and subsequently adopted in national scheme legislation in 1961. This procedure was based on the South African judicial management procedure. It was designed to allow companies that were in financial difficulties to be saved, but if that was not possible to be wound up. However, due to the fact that this procedure required that all debts be paid in full within a set time, compliance became a major hurdle for insolvent companies.[152] In the Harmer Report[153] it was noted that "official management" was rarely attempted.[154] In 1993 these provisions were ultimately removed from legislation by the incorporation of Part 5.3A into the Australian Corporations Act.[155]

Economic conditions in Australia were the catalyst for the instigation of the Harmer report in 1988. However, it was not until the severe economic downturn of 1990 that legislation implementing corporate reforms was introduced. The reform of the existing provisions was a result of an emphasis on the continuity of business and subsequent employment; a key feature of corporate insolvency.[156]

In enacting Part 5.3A, the Australian legislature adopted the recommendation of the Harmer Report and introduced a new voluntary procedure for companies which gave the company and its creditors flexible alternatives to deal with companies' financial affairs.[157] The insertion of Part 5.3A in 1993 (as read with section 435A) in the Australian Corporations Act allowed for corporate rehabilitation in Australia. The aim of the procedure is to ensure that the business, property and affairs of the company are administered in a way that maximises the survival chances of the company (or as much of it as possible). However, if that is not possible, the secondary object is that the return to

152. Anderson "Viewing the Proposed Business Rescue Provisions from an Australian Perspective" (2008) 1 (4) *PER* 4.

153. Australian Law Reform Commission *Report, No. 45, General Insolvency Inquiry* (February 1988) (the Harmer Report). It was submitted by Ron Harmer on Insolvency Reform in Australia.

154. The Harmer Report, para 57.

155. Australian Corporations Act, 2001 (as amended). The Harmer Report designed the procedure with the aim that it would be capable of swift implementation, as uncomplicated and inexpensive as possible, and flexible, providing alternative forms of dealing with the financial affairs of the company: Harmer Report at para 54. Part 5.3A's Explanatory Memorandum suggested that the new legislation would provide for: "speed, and ease of commencement of administration, minimisation of expensive and time-consuming court involvement and formal meeting procedures, flexibility of action at key stages in the administration process, and ease of transition to other insolvency solutions where an administration does not by itself offer all the answers". See the views of Sunderberg J in *Dallinger v Halcha Holdings (Pty) Ltd (admin appointed)* (1995) 18 ACSR. Also see Symes and Duns *Australian Insolvency Law* (2012) 264–295.

156. Anderson "Viewing the Proposed Business Rescue Provisions from an Australian Perspective" (2008) 1 *PER* 4. Also see Symes *National Report for Australia: Commencement of Insolvency Proceedings* (2012) 1–41.

157. See Symes and Duns *Australian Insolvency Law* (2012) 603.

creditors and members is better than would have resulted from an immediate winding up.[158]

The expected outcome of a voluntary administration process is the execution of a deed of company arrangement ("DOCA").[159] If the DOCA is executed, it will lead to another administration, governed by the terms of the DOCA.[160]

It has been accepted in Australia that it is possible to use the procedure despite there being no intention to have the company or its business survive. The second object is considered to be a worthwhile goal in itself, so as to justify the adoption of the procedure in preference to moving directly into a winding-up procedure.[161]

As is evident from the above brief analysis of the rescue mechanisms applicable in the above jurisdictions, each of such jurisdictions has a working and effective system to rescue financially distressed companies.[162] The essential features and themes of the various regimes are dealt with below,[163] and further will be seen to be mirrored (to an extent) in the South African business rescue legislation. Some comparative analysis will be undertaken when Chapter 6 of the 2008 Companies Act is dealt with later in the thesis.

5.3 INTERNATIONAL CORPORATE RESCUE CULTURE

Corporate failure clearly frustrates the objective of growing a sustainable economy. Continued liquidation of viable companies would have the unfortunate consequences of watering down the economic prospects of any country. Failure, however, does happen. It is something which in certain circumstances might be unavoidable and could occur as a result of bad management, a lack of financial support or a change in circumstances in a particular industry or in the economic climate as a whole.

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158. Anderson "Viewing the Proposed Business Rescue Provisions from an Australian Perspective" (2008) 1 (4) *PER* 5–6. These contain provisions and objectives very similar to those set out in Chapter 6 of the South African Companies Act, 2008. See Symes and Duns *Australian Insolvency Law* (2012) 264–295.
159. Section 449A of the Australian Corporations Act.
160. Symes and Duns *Australian Insolvency Law* (2012) 611 and 677 – 723.
161. Anderson "Viewing the Proposed Business Rescue Provisions from an Australian Perspective" (2008) 1 (4) *PER* 6.
162. For an analysis of the impact that history has played in the development of certain of these insolvency systems in countries such as the USA and the UK, see Martin "The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation" *B.C. Int'l & Comp. L. Rev* (2005) 28(1) Article 2 1–77.
163. See Chapter 5, para 5.5 under the various common rescue themes.

The role of the historical development of insolvency law in the insolvency system of any modern or emerging jurisdiction, should not be underestimated. It is not good enough to merely transplant one set of reorganisation or insolvency rules from one country to another. A careful analysis must take place as to the societal attitudes towards debt and financial failure in the context of the liberalisation of bankruptcy and insolvency laws and the increase in the availability of credit around the world.[164]

The question needs to be asked: does culture shape law or does law shape culture? Historically, culture has taken a leading role by informing society of what laws are necessary and appropriate.[165] Many governments with developing economies are aware of the need to develop insolvency systems but in certain instances fail to respond to prevailing cultural conditions. The danger of transplanting insolvency laws from elsewhere, with different cultural attitudes towards debt forgiveness, is a sensitive matter and can result in new systems being strangely out of place in other societies.[166]

The availability of credit is directly linked to the ability of a company to survive through robust insolvency procedures, as is confirmed by Leroy:

> Credit is one of the major driving forces of the world economy, and particularly in an adverse economic climate, its ready availability enhances predictability and commercial confidence. Properly designed, insolvency and creditor rights laws play an important role in economic development, by facilitating the provision of credit in the first place, by encouraging the preservation of distressed but viable enterprises, and by ensuring that the assets of irremediably failing businesses are redeployed to more promising uses.[167]

Furthermore, insolvency law as a concept is often viewed with scepticism and negativity. The positive spin of the restructuring mechanisms in place around the world alleviates the morbid fascination of watching companies fail, accompanied by the often-heard comment

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164. Martin "The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation" *B.C. Int'l & Comp. L. Rev* (2005) 28(1) Article 2 1.

165. Ibid 1–2.

166. Ibid 2.

167. Leroy "Foreword" in Westbrook, Booth, Paulus and Rajak (eds) *A Global View of Business Insolvency Systems* (2010) available at http://hdl.handle.net/10986/13522. What has driven the need for and the development of a corporate rescue culture? Sound company legislation and a developed insolvency regime significantly assist in the development of a country's economy. Additionally, world economies have always bought into the philosophy that economic risk-taking contributes tremendously to the economic wellbeing of a country. The greater number of companies that are floated means the greater number of jobs created, thus promoting wealth for citizens and for the community and country as a whole.

of “I told you so”. The morbid nature of insolvency regimes and practices are often not properly understood:

> Insolvency law is often misunderstood as a sort of legal mortuary when in fact it is a hospital where the assets and expertise of a business injured by management mistakes or the vagaries of the free market are recapitalized or re-channelled to renewed productivity and social benefit. The insolvency process is uniquely intertwined with many other aspects of a country’s laws. It is also the ultimate scale in that the rights of entrepreneurs, workers, and creditors must be properly balanced if an economy is to reach its maximum potential. Those characteristics make its study both important and intellectually rewarding.[168]

Insolvent companies confront two ultimate possible consequences: one leads to closure and corporate death; the other to reorganisation and corporate rebirth. If the former occurs, the company ceases to function as a going concern. Its assets are liquidated and distributed to pay off creditors and most, if not all, employees lose their jobs.[169]

In contrast, when firms are reorganised by means of a business rescue plan there is a fair prospect that not all assets are liquidated, workers remain employed, shareholders preserve their wealth, creditors get repaid (albeit not all of their claims), suppliers retain a customer and the company continues to trade on a solvent basis. The successful corporate rescue or reorganisation benefits almost all of the interested parties.[170]

But if the benefits of a successful reorganisation are shared, the risks of failure are not. Should a company fail for a second time, it is the creditors who will lose additional funding. A corporate reorganisation is like a gamble in which shareholders, creditors, managers, suppliers and employees win with success, but where only creditors bear the costs of failure. It is a “can’t lose” situation for the former groups and a “can’t win” for the latter.[171]

This uneven distribution of benefits and costs would affect how different stakeholders view the choice between insolvency/liquidation and a corporate rescue/reorganisation. Secured creditors would no doubt favour a liquidation. In a reorganisation, secured creditors would

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168. Westbrook, Booth, Paulus and Rajak (eds) *A Global View of Business Insolvency Systems* (2010) available at http://hdl.handle.net/10986/13522 5.
169. Carruthers and Halliday *Rescuing Businesses: The Making of Corporate Bankruptcy Law in England and the United States* (1998) 244.
170. Ibid.
171. Ibid.

gain the least if it succeeds, and they lose the most if it does not.[172] In contrast, shareholders, managers and employees generally favour corporate rescue through reorganisation because they have little to lose, and everything to gain. Liquidation leads to job losses and worthless shares, but reorganisation can protect jobs and preserve equity value.[173] However, in achieving this goal, a balance must be struck between the interests of various stakeholders. As Parry states:

> If a system is to effectively enable value to be preserved, and to avoid unnecessary expenses generated by attempts to rescue hopeless companies, it will need to achieve an effective balance between the interests of competing groups. To draw a simplistic division, on the one hand the members, directors and employees of the company may wish for the business to continue trading; and on the other creditors may prefer that the business be liquidated sooner rather than later in order that their losses can be curbed. A system that is geared heavily towards meeting the needs of the first group may bring social benefits, in particular through the continued employment of the workforce. However, such a system may enable rescue procedures to be used in cases where there is no reasonable hope of success and losses to creditors may be increased in consequence. These losses may mean that any benefits flowing from the prolonged trading of the company are outweighed in the long term by the impact of the unnecessary costs of this prolonged trading. On the other hand a system that favours the interests of creditors may provide insufficient support to struggling but viable companies and this may generate unwarranted social costs.[174]

Parry recognises the tension between the advantages and disadvantages of rescue procedures and the impact that such procedures can have on groups that might have different interests in either rescuing the company, or placing it into liquidation. What is clear is that there is no benefit in prolonging the agony of a failed enterprise by attempting to rescue what is a hopeless cause.

US law is often said to be pro-debtor[175], as it allows for easy access to the Chapter 11 process; is based on “debtor-in-possession” principles; has the automatic stay; existing security interests can be “primed” or “trumped” by a DIP financier and creditors (including secured creditors) can be “crammed down” (forced to accept a reorganisation plan against their wishes) by the US Bankruptcy Court in certain circumstances. In the UK,

172. Ibid 245.
173. Ibid.
174. Parry *Corporate Rescue: An Overview of Recent Developments from Selected Countries in Europe* (2004) 3–4.
175. La Porta et al. “Law and Finance” (1998) 106 (6) *Journal of Political Economy* 1113.

administration is seen to be pro-creditor as the process has mechanisms to automatically displace management and replace such management with the administrator.[176]

With political pressures worldwide focused on the preservation of jobs and the continuance of the company as an economic concern contributing to fiscal profit, it is corporate rescue (where the debtor is now being specifically considered) which has come to the fore in recent years.

The major thrust of insolvency reform across many international jurisdictions over the last 20 years has been the development of legislation designed to both facilitate and promote business reorganisations. From Europe to Asia to the Pacific, the notion of corporate rescue has found favour with policy makers, politicians and practitioners.[177]

Hunter gives a relevant description of what is meant by a "rescue culture" when he defines it as follows:

> What then [is meant] by the term "rescue culture"? It is a multi-aspect concept, having both a positive and protective role, and a corrective and a punitive role. On one level, it manifests itself by legislative and judicial policies, directed to the more benevolent treatment of insolvent persons, whether they be individuals or corporations, and at the same time to a more draconian treatment of true economic delinquents. On another level, it entails the adoption of a general rule for the construction of statutes, which is deliberately inclined towards the giving of a positive and socially profitable meaning (rather than a negative or socially destructive meaning), to statutes of socio-economic import. Of such statutes, insolvency legislation may justly be regarded as the paramount example.[178]

Rescue is also defined as a "major intervention necessary to avert the eventual failure of the company".[179]

Insolvencies are inevitable in any modern economy. They occur in healthy and poor economic conditions and occur even more so when the economy is in decline. When

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176. See discussion in McCormack *Corporate Rescue Law: An Anglo American Perspective – Corporations, Globalisation and the Law* (2008) Chapter 9 – Conclusion 292–296.

177. Much of this development stems from the introduction of the Chapter 11 Bankruptcy Code 1978 (US) and the recommendations of the Cork Report in the UK in respect of the development of a more suitable rescue regime in the UK. See Vriesendorp and Gramatikov "Impact of the Financial Crisis" (2010) *INSOL International Survey* 2.

178. Hunter "The Nature and Functions of a Rescue Culture" (1999) *Journal of Business Law* 491.

179. Belcher *Corporate Rescue: A Conceptual Approach to Insolvency Law* (1997) 4. The term "corporate rescue" is used broadly to denote statutory corporate insolvency procedures that offer an alternative to liquidation. These procedures have been introduced in many jurisdictions in order to achieve economic results that are potentially better than those that might be achieved under liquidation, by preserving and potentially improving the company's business assets through rationalisation. Such procedures may have different potential outcomes and will not always result in the salvage of the company, as opposed to the business. See Parry *Corporate Rescue: An Overview of Recent Developments from Selected Countries in Europe* (2004) 2.

financial opportunities exist and ready finance is available, company directors establish or expand their businesses and take on financial commitments. Such activity brings with it the concept of "risk and return". In such scenarios there are always going to be those who miscalculate their capacity to repay, or who are not as competent in business as they thought. Some suffer bad luck or peculiar misfortune, resulting in their becoming unable to pay their debts to creditors.[180] As a result, their companies go into decline and their ability to continue falters. Corporate rescue legislation is there to give protection to the insolvent company from its creditors and to assist in the recovery of assets and moneys for the benefit of the creditors. The aim is to recoup losses and to allow the company a chance to be rehabilitated.[181]

The phenomenon of insolvency or bankruptcy is universal. At the forefront of all such procedures is the creditor's undoubted right to seek recovery of its debt.[182]

Generally, the most important method of enforcing monetary obligations in most countries is through the seizure and sale of the debtor's property.[183] Creditors protect themselves by taking up different levels of security. For instance, a secured creditor would secure an interest in the debtor's property at the commencement of a transaction by registering a security interest to guarantee payment of the debt. Upon default, such interest can generally be enforced by way of a court order. Unlike a secured creditor, an unsecured creditor must first obtain a judgment in court and then obtain enforcement of that order by court execution processes or by way of debt enforcement/collection procedures. This approach presupposes an opportunity to obtain payment of a debt outside of insolvency procedures. Unsuccessful debt enforcement would, in most cases, end up in an insolvency or restructuring procedure.[184] If insolvency ensues as a result of a debtor being unable to pay, the debtor's affairs will be placed before the court for the protection of all creditors.[185]

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180. Murray and Harris *Keay's Insolvency* (2014) 3–5. For fresh-start policies being implemented in Israel, see Efrat "The Historical Evolution of the Fresh Start Policy in Israeli Bankruptcy Law" (1999) 32 *Vanderbilt Journal of Transnational Law* 49–114.

181. Ibid.

182. Rajak "The Rescue of Insolvent Companies in the United Kingdom" (1995) 20(1/2) *JJS* 3–4. For the manner in which the discharge of consumer debt has been dealt with in Europe, see Kilborn *Two Decades, Three Key Questions and Evolving Answers in European Consumer Insolvency Law: Responsibility, Discretion and Sacrifice* (17 December 2007) available at http://SSRN.com/abstract=1080252.

183. UNCITRAL *Legislative Guide on Insolvency Law* Part 1 (2005) 9–10.

184. Rajak "The Rescue of Insolvent Companies in the United Kingdom" (1995) 20(1/2) *JJS* 7.

185. Ibid.

As stated by Jackson, the moral foundation and jurisprudence of bankruptcy are well established from both a creditor's and a debtor's point of view:

> Bankruptcy law can and should help a firm stay in business when it is worth more to its owners alive than dead. That is a far cry, however, from saying that it is an independent goal of bankruptcy law to keep firms in operation. Not all businesses are worth more to their owners – or to society – alive than dead, and once one recognizes that, one has to identify *which* firms bankruptcy law should assist and why. Saying that bankruptcy law "exists" to help keep firms in operation helps not at all in drawing that line. Instead, a theory of what bankruptcy law can and should do is necessary.[186]

Jackson famously described the role of bankruptcy law as reducing the incentive for individual enforcement against the assets of a distressed company. Allowing creditors to race to collect assets from the insolvent debtor would result in the dismemberment of the firm and result in a worse overall return for creditors as a whole.[187] Creditors would prefer bankruptcy law to impose a stay on creditor action, keeping the firm together and maximising the aggregate return (creditor-wealth maximisation), which respected pre-insolvency contractual rights and which divided proceeds of the sale of assets *pari passu* amongst unsecured creditors. The breakup of the company should be avoided at all costs.[188]

Others argue that bankruptcy law should have a more redistributional role based on fairness and on the interests of a wider group of stakeholder interests including employees. Judges should decide on whether the company should be saved or not, and this decision should not be left to self-interested and powerful creditors.[189]

Again, it is submitted, there is no point in keeping a company going within a rescue process without a realistic business rescue plan or a reorganisation model that can assist the company to survive well into the future. Sick companies without any future prospects of success, should be terminated (usually by way of liquidation).

Debtors in financial difficulty must be allowed (or provided with the opportunity) to survive. From the creditor's point of view, bankruptcy procedures create an opportunity for

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186. Jackson *The Logic and Limits of Bankruptcy Law* (1986) 2.
187. Jackson "Bankruptcy, Non-Bankruptcy Entitlements and the Creditors Bargain" (1982) 91 *YLJ* 85 7.
188. Ibid. This view is considered to be supportive of a "contractarianism" analysis of bankruptcy law.
189. Warren "Bankruptcy Policy" (1987) 54 *The University of Chicago Law Review* 775. Also see discussion on the theories of insolvency law in Chapter 2, para 2.3 below.

a fair and orderly process resulting in the distribution of the debtor's assets. As a collective process, bankruptcy does limit the enforcement by any one creditor of his or her rights against the debtor, to the detriment and prejudice of other creditors:[190]

> A legal regime of insolvency never exists in a vacuum. From the perspective of creditors, such a system is necessary in large part in response to a weakness or failure in a coordinate system. An insolvency regime benefits creditors primarily by addressing two major weaknesses of the system of ordinary enforcement of obligations (collections); namely, (1) ineffective mechanisms for finding value and the resultant waste caused by individual creditors' blindly pursuing enforcement actions to the detriment of themselves and other creditors, and (2) inequitable distribution of available value to one or a few aggressive or sophisticated creditors, to the detriment of the collective of all creditors. These weaknesses theoretically could be overcome without a separate insolvency system if the enforcement system were restructured. Proposals for such an approach have arisen in some countries, though to date, lawmakers seem to have concluded that adopting an insolvency system represents a more efficient and effective means of increasing payment to creditors and enhancing the fair distribution of such payments among all creditors. These benefits and the arguments that support them are largely identical in the context of insolvency of both debtors engaged in business and "pure" consumers, and they have existed largely unchanged since the very advent of the idea of a formal response to financial distress.[191]

The conceptualisation of a corporate rescue culture must have as its foundation the need to provide alternatives to debt enforcement procedures and insolvency. The alternative option, namely, to restructure the debtor's financial obligations, must, of necessity, balance the rights of debtors and creditors:

> Insolvency laws and institutions are critical to enabling States to achieve the benefit and avoid the pitfalls of integration of national financial systems with the international financial system. Those laws and institutions should promote restructuring of viable business and efficient closure and transfer of assets of failed businesses, facilitate the provision of finance for start-up and reorganisation of businesses to enable assessment of credit risk, both domestically and internationally.[192]

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190. Jackson "Bankruptcy, Non-Bankruptcy Entitlements and the Creditors Bargain" (1982) 91 *YLJ* 85 4. Also see UNCITRAL *Legislative Guide on Insolvency Law* Part 1 (2005) 27.

191. The World Bank *Insolvency and Creditor/Debtor Regimes* (Report 77170) available at http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2013/05/02/000333037_20130502131241/Rendered/PDF/771700WP0WB0In00Box377289B00PUBLIC.pdf 20–21. Clearly, the alternative rescue process assists in creating a fair and increased distribution to creditors, better than would result from a liquidation. However, a response to the problems being encountered by the financially distressed debtor cannot allow creditors to help themselves (by enforcement mechanisms) to the assets of the company, while other creditors stand by and watch the value of the company being eroded and thereby prejudiced by such unilateral creditor actions. See discussion by McCormack in the UK and US mechanisms for restructuring and whether such systems are in fact pro-creditor or pro-debtor in McCormack *Corporate Rescue Law: An Anglo American Perspective – Corporations, Globalisation and the Law* (2008) Chapter 9 – Conclusion 306–307.

192. UNCITRAL *Legislative Guide on Insolvency Law* Part 1 (2005) 10.

The rights of entrepreneurs, investors, suppliers, customers and lenders will all have to be considered. The availability of quality information is a key driver for a successful recue process:

> An efficient enforcement mechanism can produce one of two good results, either the collection of the debt or the filing of an insolvency proceeding by the debtor, the party with the best information about its financial condition and the need for such a proceeding. Forcing the debtor to the choice puts that decision in the hands of the party with the relevant information and provides strong incentives to make the correct decision. On the other side of the coin, the availability of a reorganisation procedure to help a debtor who is unable to pay immediately, but is arguably viable in the long term reduces the risks that might otherwise exist in giving the creditor an enforcement mechanism that operates with summary procedures and with minimum delay.[193]

The concept of creating a protective regime for insolvent companies has been in existence since companies were first created. Companies, after all, were established as entities to be used to do business, coupled with the concept of limited liability. Almost all commercially developed societies allow unpaid creditors an undisputed right to liquidate and extinguish the insolvent corporate debtor.[194] This right is often subject to stern disapproval. Extinguishing a corporate debtor who is unable to pay now, but who will clearly be able to pay later, is a course of action wholly lacking in common sense.[195] The potential of the debtor company, which may be significant, will be destroyed, employees will be rendered redundant, work in progress will be lost with possible serious consequences for suppliers and customers, trade creditors may receive only a small dividend or no dividend at all, and directors and shareholders will forfeit an investment which might have been sustainable and of substantial benefit.[196]

The consequences of insolvency for companies have always had a severe and significant impact on society at large.[197] The number of insolvencies in England in the late eighteenth century, during the American Depression in the 1930s as well as other instances of corporate failure required legislative intervention.[198] Legislative intervention attempts in the early development of trade were based on oppressive medieval regimes that used a

193. Westbrooke et al. *A Global View of Business Rescue Insolvency Systems* (2010) 8.
194. Rajak "The Rescue of Insolvent Companies in the United Kingdom" (1995) 20(1/2) *JJS* 4.
195. Ibid.
196. Ibid 5.
197. Omar "Thoughts on the Purpose of Corporate Rescue" (2011) *Journal of International Banking Law* 2.
198. Ibid.

fault-based concept to punish the debtor. Although limited liability may have spared investors from losing everything, the infamy of insolvency still attached to those who had conducted business with entrepreneurs and individuals whose failure had a profound effect and who were directly responsible for the loss of capital, employment, production and trading prospects as a result of insolvency. Early insolvency legislation was aimed at administering a painless end to financially distressed companies. There were no regrets about the destruction of companies, because in part, failure was seen as a consequence of individual errors, which had to be punished.[199]

Until quite recently, bankruptcy laws were geared to maximising creditor recovery through the orderly liquidation of the insolvent company's estate, after which some societies provided the bankrupt company with a discharge of its debt. This is what is termed "liquidation" or "bankruptcy". Historically, bankruptcy laws focused on creditors and were not concerned with the rehabilitation or rescue of debtor companies or the restoration of their financial health.[200]

Liquidation as the sole purpose of bankruptcy was questioned, as it did not yield the largest recovery to the creditors in many cases. It did not attempt to facilitate the continuation of the debtor company's enterprise on any basis. Supporters of liquidation, on the other hand, justified its benefits. Liquidation has been traditionally justified because it provided the most orderly and efficient means of dealing with an insolvent and the claims in his or her estate and provided an effective means to deal with the debtor's fraud.[201]

More recently, an economic justification for liquidation has also been advanced, as being a process that allows the pooling of a debtor's assets for the benefit of all creditors, and a centralised liquidation of those assets. This allowed not only maximisation of the debtor's estate, but yields cost savings benefitting private creditors and society.[202]

This old-world view of bankruptcy practice was not user-friendly and fast became outdated. Over time, liquidation as the sole purpose of bankruptcy law has been questioned

199. Ibid. It has been said that bankruptcy is the darker side of the American dream, the side no-one wishes to talk about or experience for themselves. For this reason, there will always be a stigma attached to bankruptcy, an inherent shame, and perhaps a sense of failure. But like it or not, bankruptcy is a necessary evil. See Goren "Chip away at the stone: The validity of pre-bankruptcy clauses contracting around section 363 of the Bankruptcy Code" (2006–2007) *NY Law School LR* 1078.

200. Smits "Corporate Administration: A Proposed Model" (1999) *De Jure* 82.

201. Ibid. Also see UNCITRAL *Legislative Guide on Insolvency Law* Part 1 (2005) 10.

202. Smits "Corporate Administration: A Proposed Model" (1999) *De Jure* 82–83.

as not yielding the largest recovery to creditors in many cases. In the US, railroad reorganisations promoted the reduction of legal claims against a debtor which could be supported by the foreseeable net operating income of the debtor. This was accomplished by restructuring the financial configuration of the debtor involving issuing new debt and equity in accordance with the claimant's priorities and in many cases the elimination of junior claimants and stakeholders.[203]

Over recent decades, beginning with the US in 1993,[204] a number of countries (France, Germany, Canada, Australia and the UK) have expanded their bankruptcy laws to provide an alternative to liquidation through "reorganisation" or "rehabilitation" of legal relations between the debtor company and its creditors to allow the business to continue operations. This procedure is loosely characterised as "corporate rescue".[205]

The current US bankruptcy system grew out of the unique capitalist system prevalent in the US, where capitalism rewards entrepreneurship as well as extensive consumer spending. As a result, the US has implemented a forgiving business reorganisation model to encourage risk taking and economic growth. The aim is to keep economic players alive and active in the game of capitalism. Thus the US insolvency system (Chapter 11, in the context of reorganisation) reflects the social system which exists in that country and which addresses, to a large extent, that society's ills.[206]

Internationally, corporate rescue is now associated with what is termed the revival of companies on the brink of economic collapse and the salvage of economically viable units to restore production capacity, employment and the continued rewarding of capital and investment.[207]

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203. Ibid 83.

204. Since 1978, the US Bankruptcy Code 11 USC's 101 been amended several times with the latest amendment on 6 October 1994 by the Bankruptcy Reform Act of 1994, Pub L No. 103–394 (1994).

205. Smits "Corporate Administration: A Proposed Model" (1999) *De Jure* 83.

206. Martin "The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation" *B.C. Int'l & Comp. L. Rev* (2005) 28(1) Article 2 3.

207. Omar "Thoughts on the Purpose of Corporate Rescue" (2011) *Journal of International Banking Law* 2. Also see UNCITRAL *Legislative Guide on Insolvency Law* Part 1 (2005) 28:

> Additional factors supporting the use of reorganisation include that the modern economy has significantly reduced the degree to which the value of the debtor's assets can be maximized through liquidation. Where technical know-how and goodwill are more important to the operation of a business than physical assets, the preservation of human resources and business relations are essential elements of value that cannot be realised through liquidation. Also, long-term economic benefit is more likely to be achieved through re-organisation proceedings, since they encourage debtors to take action before their financial difficulties become severe. Lastly, there are social and political considerations that are served by the availability of reorganisation proceedings, which protect, for example, the employees of a troubled debtor.

The starting point of a need for the intervention of a corporate rescue process must be a crisis which threatens the very survival of the company. Companies experiencing such crises are usually described as troubled or distressed, and generally financial distress is the prelude to failure.[208]

As a result of the negative perceptions surrounding the extinction of the insolvent debtor company, modern corporate thinking was aimed at finding alternatives to such drastic action. Thus, the concept of corporate recycling through business or corporate rescue has become the favoured result.[209]

A regime in which an insolvent corporate debtor might be protected in the expectation of an improvement in its financial condition has fast become an acceptable phenomenon in developed and developing commercial societies.[210] Ultimately, the debtor must be protected because of the fundamental belief that saving businesses is in the public interest, and preventing the enforcement of claims by creditors is a price worth paying to achieve this goal.[211]

Corporate rescue regimes are aimed at preventing the waste and prejudice that occurs with the liquidation of companies.[212] In many instances, insolvent companies and their businesses cannot be saved and liquidation is the only alternative.[213] Considerable benefit may derive from preventing the liquidation of the company or the destruction of the business by its piecemeal sale. It is inevitable that rescues will be attempted in unsuitable as well as in suitable cases. An attempted rescue in an unsuitable case may result in substantial losses to creditors which could have been prevented if the company had gone

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Also see a useful comparison of corporate rescue culture between the UK and Australia – Anderson, Morrison "Is corporate rescue a realistic ideal? Business as usual in Australia and the United Kingdom" (2015) 3 *Nottingham Insolvency and Business Law E-Journal* 23 417–435.

208. Belcher *Corporate Rescue: A Conceptual Approach to Insolvency Law* (1997) 39.

209. Ibid.

210. Rajak "The Rescue of Insolvent Companies in the United Kingdom" (1995) 20(1/2) *JJS* 5.

211. Ibid 29.

212. Ibid 31. Also see UNCITRAL *Legislative Guide to Insolvency Law* Part 1 (2005) 27:

> Re-organisation, however, does not imply that all of the stakeholders must be wholly protected or that they should be restored to the financial or commercial position that they would have obtained had the event of insolvency not occurred. It does not imply that the debtor will be completely restored or its creditors paid in full or that ownership and management of an insolvent debtor will maintain and preserve their respective positions. Management may be terminated and changed, the interests of equity holders may be reduced to nothing, employees may be retrenched and the source of a market for suppliers may disappear. In general, however, reorganisation does imply that whatever form of plan, scheme or arrangements is agreed, the creditors will eventually receive more than if the debtor were to be liquidated.

213. Rajak "The Rescue of Insolvent Companies in the United Kingdom" (1995) 20(1/2) *JJS* 31.

directly into liquidation. The benefit of successful rescues is clearly the preservation of employment, the completion of work in progress and the return to financial health of its business. This must therefore be compared to the additional cost to creditors occasioned by unsuccessful rescue attempts.[214]

Limited liability for companies was a consequence of the separation of investment and entrepreneurship and the prospect of transferring the risk of management to the entrepreneur.[215] Capital investors felt sufficiently rewarded if their investment resulted in the payment of an adequate rate of return on their investment.[216] This, in essence, equated their investment to a loan, although usually made through the subscription of shares and a participation in the formal institutions of the company, i.e. the board of directors. As stated by Omar, the principle of limited liability offered protection for the investor against the risks of bad management and the failure of the company to be successful:

> It also offered a limit to the maximum investment that could theoretically be wagered and thus put a price to the investment enabling individuals to assess the risks for their personal economies and their investment strategies.[217]

The advantages of limited liability for investors and entrepreneurs weighed against the consequences of corporate failure, meant that the success or failure of companies had to be judged by their performance in the market. In the early stages of insolvency practice, the state was loath to intervene in the affairs of failing companies. The state was seen to be a neutral arbiter and the market was to be left to regulate itself.[218]

Ultimately, and in recent years, the state has become more interventionist and insolvency legislation worldwide has had no choice but to take into account the effects on the economy resulting from a decline in manufacturing capacity and large-scale insolvencies, across most Western economies.[219] Clearly, the development of corporate rescue

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214. Ibid.
215. Omar "Thoughts on the Purpose of Corporate Rescue" (2011) *Journal of International Banking Law* 2. At the heart of the development of a corporate rescue culture is the concept of "limited liability" in a company context. The prospect of entrepreneurs and investors being able to take risks by way of the establishment of a company, is at the very core of what drives any economy. The ability to trade with the knowledge of corporate limited liability protection provide directors with comfort in that, in principle, they could avoid personal liability if their companies ended up in a liquidation process.
216. Ibid.
217. Ibid 3.
218. Ibid.
219. Ibid.

mechanisms has been the result of the increasing dependence of all economies on international trade and the rise of global tides of economic depression.[220]

Corporate rescue culture thus took on a life of its own. The reappraisal of the role of insolvency legislation was critical and alternatives to the pure liquidation of companies had to be found. Liquidation in most jurisdictions is not seen as the desirable result. What has become far more important is the rescue and preservation of the economic benefits that flow from the continued existence of a company. Preservation is a desirable end for the insolvency process, either as a reconsolidation of the company's economic health and wellbeing or as a restructuring with the excision of the unviable elements of the company.[221]

Corporate rescue has as its fundamental starting point the ultimate benefits which flow from the rescue of a company.[222] The balancing of the diverse interests of stakeholders against the benefits of salvaging a financially distressed company is the challenge which has troubled academics and lawyers alike over the years.[223]

The key objectives for any insolvency/corporate rescue regime must be to ensure that such a regime aligns itself to the legal and social values of the society in which it is based and which it must ultimately sustain. An insolvency or corporate rescue regime must include the striking of a balance between a liquidation outcome and that of reorganisation. The balance between a near-term debt collection process through a liquidation (often the preference of secured creditors) against preserving the value of the debtor company's business through reorganisation (often the preference of unsecured creditors and the debtor), is critical in ensuring the promotion of economic stability and growth in any jurisdiction. The value of the debtor company being allowed to continue should not be underestimated. This is predicated on the basic economic theory that greater value may be

220. The 2008 financial crisis which commenced with the filing of Chapter 11 of the company Lehman Bros in the US, kick-started a massive downturn in the world economies. The 2011–2013 economic crises in Greece, Italy and in Europe are a constant reminder that all economies are vulnerable to sustained fragility, even in today's modern and sophisticated economies.

221. Omar "Thoughts on the Purpose of Corporate Rescue" (2011) *Journal of International Banking Law* 3.

222. Ibid 4. This debate often leads to political fall-out where one group of stakeholders (such as creditors) believe that they are being treated unfairly when compared to other groups (such as shareholders).

223. Ibid.

obtained from keeping the essential components of a business together, rather than breaking them up and disposing of them in fragments.[224]

It is submitted that these principles equally apply to the need to sustain potentially viable companies that are financially distressed. Reorganisation proceedings serve to benefit society as a whole and are critical in enabling countries to sustain valuable businesses and ongoing employment across the globe. The principle and main objective of establishing a business rescue culture must be to establish a mechanism for saving companies rather than ending them with the consequent fallout as a result. The negative stigma and loss of confidence that is associated with an insolvency should be averted if possible. Corporate rescue must reflect current and prevailing views of what makes up the concept of corporate rescue and what drives the economies and governments of the day within each peculiar jurisdiction.[225]

It is important to understand that cultural attitudes play a tremendous role in the efficacy of bankruptcy and insolvency systems. As more and more consumer and business credit becomes available around the world, the countries that are affected will need to enact effective and accepted discharge and fresh start principles. More transplantation of these principles from systems such as the US, are likely to be ineffective. Careful cognisance must be taken of the extent of credit availability in a particular jurisdiction in order to avoid the extensive social costs that could result from too much credit in jurisdictions that do not accept financial failure.[226]

Any regime which involves rescue requires a degree of support from the commercial environment. The continuation of a business trading in the shadow of insolvency will probably require additional funding and will at the very least require existing creditors to postpone and/or compromise their claims. Somewhat paradoxically, it can be that just when rescue is needed the most, the practical reality may be that businesses will not be saved if there is insufficient support available either by way of additional credit or because

224. UNCITRAL *Legislative Guide to Insolvency Law* Part 1 (2005) 11. Also see The World Bank *Insolvency and Creditor/Debtor Regimes* (Report 77170) available at http://www-wds.worldbank.org/external/default/WDSContentServer/WDSP/IB/2013/05/02/000333037_20130502131241/Rendered/PDF/771700WP0WB0In00Box377289B00PUBLIC0.pdf 27–28.

225. For an excellent review of distressed companies and reasons for failure in the US, see Harner, Griffin "Facilitating Successful Failures" (2013 – 2014) *Florida Law Review* 3–55. In this study, reference is made to the role of directors and management in contributing to the number (some 80 000) of corporate failures in the US.

226. Martin "The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation" *B.C. Int'l & Comp. L. Rev* (2005) 28(1) Article 2 1.

other creditors are so financially stressed themselves that they are unable or unwilling to support any potential rescue.[227]

It is clear that corporate rescue is driven ultimately by the buy-in of stakeholders exposed to companies in financial distress which are on the brink of financial collapse. The opportunity to intervene by introducing a mechanism for recovery is what drives the corporate rescue culture.

In summary, corporate rescue is complex. It goes well beyond the mere enforcement of private rights. It is a concept which drives the success or failure of enterprises and affects the livelihood of individuals and communities. Rescue procedures must integrate the characteristics and interests of a wide variety of players, including directors, large institutional creditors, small-trade creditors and insolvency practitioners. All of these interests need to be aligned and reconciled within the overarching policy goals of the law. Thus the establishment of sound international principles for rescue of viable enterprises has been commonly agreed to be beneficial to all interested parties and to the economy in general.[228]

It is submitted that the bedding down of a corporate rescue culture in any jurisdiction is directly linked to the general acceptance by creditors and other stakeholders that a restructuring process which results in a compromise of debt will enable a viable company to be rescued and allow it to continue to trade on a solvent basis into the future. Corporate rescue culture is thus based on the principle of debt compromise and creditors accepting less than their full claim within the rescue process.

5.4 CREDITORS AND THE COMPROMISE OF DEBT

In all restructuring regimes, certain fundamental core rescue themes are prevalent. However, it is submitted, the core and critical theme is the need for creditors to accept the principle of the discharge of debt (compromise), that is, the acceptance of a corporate rescue culture. Acceptance of such debt compromise can result in a perceived erosion of contractual positions between lenders and debtor companies.

227. Vriesendorp and Gramatikov "Impact of the Financial Crisis" (2010) *INSOL International Survey* 2.

228. Brupbacher "Functional Analysis of Corporate Rescue Procedures – A Proposal from an Anglo-Swiss Perspective" (2005) *Journal of Corporate Law Studies* 106.

The term *pacta sunt servanda* (sanctity of contract) is an internationally recognised principle of contract law. The "contract has to be respected" and it binds a person to its promises and protects the interests of the promisee. This supports the notion of commercial certainty and promotes sustainable and effective economic activity.[229]

Different legal concepts exist in all legal systems dealing with the issue of "changed circumstances" and where one of the parties to a contract is excused from the performance of its obligations when a contract has become unexpectedly onerous to perform.[230]

The collapse of a company into a reorganisation or insolvency process causes parties to become unable to meet their contractual obligations which results in the destruction of mutually established contractual obligations; such as creditors expecting to be repaid their full debt, as due in terms of a contractual obligation. Thus, the frequency and intensity of financial collapses of entities result in negative repercussions on the traditional binding force of contracts. This contributes to the watering down of the long-established principles of *pacta sunt servanda*.[231]

It is submitted that where a creditor is forced by way of restructuring legislation to take a "debt haircut" or "a compromise", this certainly can be argued to be a statutory infringement of a creditor's right to rely on a debtor having to fulfil its contractual obligations to repay its debt. Notwithstanding, and as set out above, international rescue and restructuring methodology insists on debt compromise and places the future trading ability of the entity (with all its resultant advantages) first, notwithstanding the impingement of the principle of *pacta sunt servanda*.

Historically, creditors have been seen as the most critical stakeholders in a reorganisation of a company, and creditors' interests remain paramount. The term "advantage to creditors" provides certain hurdles for companies that seek to reorganise themselves serving the best interest of the debtor company and not necessarily that of creditors.

229. See Maskow "Hardship and Force Majeure" 40 (1992) *Am. J. Comp.* 658. Also see discussion on the foundation of the *pacta sunt servanda* principle from Roman law times to Roman Dutch law in Visser "The principle *pacta sunt servanda* in Roman and Roman-Dutch Law with specific reference to contracts in restraint of trade" (1984) *SALJ* 641.

230. Flambouras "Comparative remarks on CSIG Art 79 & PECL Arts 6:11. 8:108" (2002) available at http://www.cisg.law.pace.edu/cisg/text/peclcomp79.html.

231. See discussion in Serozan "General Report on The Effects of Financial Crises on the Binding Force of Contracts: Renegotiation, Rescission or Revision" 17 (2016) B Başoğlu (ed) in *Ius Comparatum – Global Studies in Comparative Law* 3–29. Also see Yeung "Certainty over Clemency: English Contract Law in the Face of Financial Crisis" in The Effects of Financial Crises on the Binding Force of Contracts: Renegotiation, Rescission or Revision" 17 (2016) B Başoğlu (ed) in *Ius Comparatum – Global Studies in Comparative Law* 285–305.

Clearly, friction between these two stakeholders from a reorganisation perspective creates significant challenges.[232]

In the US it is generally accepted that there is good cause for continuing the business of the company as creditors may receive more from reorganisation in a Chapter 11 procedure, than they would from the liquidation. Jobs are saved, the tax base is preserved and generally the company is left better off than they would be if the business or its assets were to be closed or sold at auction. The basic requirement for the US courts' approval of a plan is that it pays creditors more than if the business were to be liquidated.[233]

At the heart of insolvency law lie two problems –

- balancing the interests of insolvent debtors in a fresh start against those of their creditors who wish to be paid; and
- balancing the interest of competing creditors with meritorious claims against a pile of assets that is, by definition, too small.

Remarkably, bankruptcy law and reorganisations often succeed reasonably well at both, providing a way out of trouble for hopelessly swamped debtors, while also providing a reasonably efficient means to adjust creditors' claims.[234]

In order to weigh up the rights and aspirations of the debtor against that of creditors, such analysis is centred around whether bankruptcy is seen as a debtor's remedy as opposed to it being a creditor's remedy.[235]

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232. Wood *Principles of International Insolvency* (2007) 4. At the most basic level, an insolvency proceeding protects creditors' equality by preventing disorderly and discriminatory individual grabs, and ensuring that the proceeds of the debtor's assets are divided between the creditors according to a bankruptcy ladder or hierarchy of payment.

233. Rochelle "Lowering the Penalties for Failure: Using the Insolvency Law as a Tool for Spurring Economic Growth: The American Experience, and Possible Uses for South Africa" (1996) 2 *TSAR* 315–316. Also see Westbrook, Booth, Paulus and Rajak (eds) *A Global View of Business Insolvency Systems* (2010) available at http://hdl.handle.net/10986/13522 126. For the fundamental principles of creditors accepting a compromise on their claims, see the UNCITRAL *Legislative Guide on Insolvency Law Part 2* (2005) 11 and 27–30.

234. Ferriell and Janger *Understanding Bankruptcy* (2013) 1. Balancing the rights of creditors and debtors is always a challenge in any developed insolvency regime. Debtor-friendly insolvency systems allow debtors to enter a bankruptcy or insolvency procedure with very few prerequisites. The laws are therefore primarily designed to assist financially distressed debtors and not as a mechanism to assist creditors in obtaining payments of the amounts owed to them. In creditor-friendly insolvency systems, the insolvency laws are aimed at assisting the creditors rather than being a mechanism to assist the debtor. South Africa (prior to the introduction of Chapter 6 of the 2008 Companies Act) had a creditor-friendly insolvency system in that the insolvency laws were designed to assist creditors in obtaining payment of their claims on an equitable basis from the available assets in the estate. Most insolvency systems strive to maintain a balance between assisting struggling debtors while at the same time ensuring that at least some protection is afforded to creditors. In October 2005, the US brought about large scale amendments to the US Bankruptcy Code, effectively making their bankruptcy laws more creditor friendly. See Burdette "Legislative Framework for the Facilitation of Turnarounds" in Harvey (ed) *Turnaround Management and Corporate Renewal – a South African Perspective* (2011) 132.

The historic concept of the "fresh start" for an honest but unfortunate debtor is central to American insolvency law. The debtor surrenders its assets to the trustee and receives a second chance to make a fresh start. Bankruptcy is seen as a financial rebirth. After the debtor's estate is administered through a bankruptcy or administration procedure, the debts are discharged and the debtor begins a new financial life, unencumbered by its previous debts.[236]

Long before providing honest debtors with a fresh start was considered part of the purpose of insolvency law, bankruptcy was available as a creditors' remedy. Even when bankruptcy law supplied no redemption for the debtor, it was designed to provide an efficient and orderly system to collect and distribute an insolvent debtor's assets among competing creditors. These purposes remain intact. Bankruptcy procedures are designed to preserve the value of a business debtor's assets and to divide them equitably among creditors.[237]

The restructuring of a debtor company in financial distress will revolve around the extent of property and assets available to distribute to creditors as opposed to what can be achieved in a restructuring of the debtor. A debtor with a viable business plan will always win the day as opposed to a distribution of assets on a winding up of such entity. If there is more debt than the company's cash flow can sustain, keeping a business in operation may provide greater payment opportunities to creditors than closing its doors and selling off assets piecemeal.[238]

The natural desire of every creditor is to be paid in full. This desire is often unattainable in the circumstances of a debtor company that is experiencing financial distress. The equally natural desire of the debtor company that is financially distressed is to be released from the burden of its liabilities. The latter cannot be achieved without commensurate sacrifices being required of unpaid creditors. At the level of community or society, these issues need to be resolved.[239] Questions of public policy will need to be addressed in the interests of maintaining general confidence in the integrity of legal obligations that are ultimately based on credit. Balanced against this interest is that of society's attitude towards the

235. Ferriell and Janger *Understanding Bankruptcy*(2013) 2.
236. Ibid 3.
237. Ibid 4.
238. Ibid 5–6.
239. Fletcher *The Law of Insolvency* (2009) 1–2.

enforcement of debts in the hands of a creditor. If too strict and inflexible a policy is adopted towards the enforcement of debts and the penalisation of those who default, this can lead to disincentives to business initiative and enterprise, which, for all their attendant risks, ultimately bring about economic volatility and contribute towards corporate failure.[240]

The dilemma of having a pro-creditor versus a pro-debtor culture, will drive the manner in which a restructuring regime will be legislated in a particular jurisdiction. One needs to weigh up the benefits of having an entrepreneurial regime where companies are enabled to take risks and thereby generate profit for the company, its stakeholders and for the economy as a whole, against the need to protect creditors who remain unpaid at the commencement of a financial restructuring or rescue process.[241]

Those who provide finance for industry (large and small) may seek a largely pro-creditor system. Those who are seeking finance for the debtor company would want a system whereby a temporary moratorium against debts in times of insolvency and financial distress are readily obtainable. It is essential for each of these interest groups to recognise the genuine concerns of the other.[242] A too strict or cautious approach to the issue of how to trigger a moratorium, may snuff out any embryonic entrepreneurial culture, to the detriment of all. Likewise, protection from litigation, even while assets and finance are wasted as creditors look on helplessly, unable to act in their own or in anyone else's interests, will be the quickest route to a drying up of sources of finance for industry and to the creation of an industrial desert.[243]

The benefits of a well-established business rescue regime for creditors are obvious. Lending institutions and general creditors are bound to benefit from increased lending and the ability to supply goods and services to increasingly successful and better-trained entrepreneurs in any economy. The maximisation of returns is the strategic objective. There should be a strong motivation by creditors to maximise a return on assets. Of course, there has to be a balancing of the exposure of losses for all parties involved in the insolvency proceedings. Regard must be had to the preservation of contractual

240. Ibid.
241. For an analysis of the protection of creditors or debtors, see Wood *Principles of International Insolvency* (2007) 4–5.
242. Rajak and Henning "Business Rescue for South Africa" (1999) *SALJ* 274–275.
243. Ibid.

relationships that can be undermined through the insolvency process. A balance must be struck between the interests of a rapid liquidation process and longer term efforts to generate more value for creditors.[244]

It is apparent that the development of insolvency and rescue practice has culminated in the acceptance of the principle that there is no benefit in burdening the debtor who is unable to pay its debts with severe or permanent disabilities.[245] The fresh-start principle is the distinguishing and fundamental feature of insolvency law, as stated by Loubser:

> The reasoning behind the modern viewpoint is that in a capitalist society people should be encouraged to take business risks which, if successful, will result in economic growth and the creation of new job opportunities. However, taking risks implies the possibility of failure, and should the positive results not be achieved, the failed entrepreneur should be assisted and encourage to become economically productive again as soon as possible, or, as it is generally termed, to make a fresh start.[246]

The move towards this viewpoint is a worldwide trend, and because of the changed aims and results now strived for, it has resulted in a totally new attitude regarding the process which should be followed when a debtor reaches a point of insolvency and is unable to pay its debts.[247]

This modern way of thinking relevant to the approach taken of dealing with the insolvency of consumer debtors, has found its way into the corporate rescue culture as embodied in modern reorganisation processes.

Debt forgiveness on the part of creditors to a company in financial distress remains a controversial topic. Why should creditors take on the burden of inept management and provide the debtor company with the opportunity to start over? The bankruptcy discharge in the US bankruptcy system has the effect of freeing a debtor from pre-existing obligations and is commonly termed “a fresh start”. The philosophy is that creditors must provide the debtor with the opportunity to “begin anew” or a “chance to start over”.[248]

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244. UNCITRAL *Legislative Guide on Insolvency Law* Part 1 (2005) 12.
245. Loubser “Ensuring Advantage to Everyone in a Modern South African Insolvency Law” (1997) *SA Merc LJ* 325.
246. Ibid 326.
247. Ibid.
248. Gross *Failure and Forgiveness: Rebalancing the Bankruptcy System* (1997) 91.

Punishing the debtor for non-payment of debt remains a controversial issue in the US:

> American society is thus torn between two desires: not to punish too severely and not to grant complete freedom as a solution, we are drawn to a monetary solution. But whereas money may work as an appropriate solution outside of bankruptcy (where assets are sufficient to repay everyone), it is problematic within the bankruptcy context.[249]

It is submitted that the alternative offered by a restructuring as opposed to liquidation, must in itself be of "advantage" to creditors, as ultimately such a process will either result in –

- the debtor company continuing to trade, albeit with a compromised pay-out to creditors and with the prospect of doing business with the company in the future; or
- the reorganisation of the company, delivering to creditors a better dividend then they would have received in a liquidation.

It is also submitted that any jurisdiction wishing to reorganise a financially distressed company must carefully weigh up the interests of creditors, as opposed to the interests of the debtor company. Such an attitude might be tainted (one way or the other) by the historical role that the banking fraternity has taken worldwide in the development and establishment of a pro-creditor versus a pro-debtor culture. Thus, the principle of a compromise of debt being accepted by creditors when faced with a company in financial distress, remains a cornerstone to rescue dispensations around the world.

It is further submitted that the legislative regime applicable in any particular jurisdiction will play a crucial role in managing the outcomes of a distressed company that becomes the subject matter of an insolvency or restructuring mechanism. The divergence of the laws of insolvency and restructuring is critical to establishing a balance between either rescuing the company or terminating the company's existence by placing it into liquidation. Clear and defined options must be made available to distressed corporate entities to enable them (or their creditors) to choose the most viable and workable rescue option available.[250]

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249. Ibid 92.
250. See comments by Paterson "Rethinking the Role of the Law of Corporate Distress in the Twenty First Century" (2014) *LSE Law Society and Economy Working Papers* 27 available at http://www.lse.ac.uk/collections/law/wps/wps.htm. The author debates a new taxonomy. The law of corporate distress comprised of insolvency law and restructuring law. The paper reframes the unifying aim of the law of corporate distress as the facilitation of the reallocation of resource in the economy to best use, and draws a distinction between insolvency law's role in reducing the incentive for individual enforcement and restricting law's role in providing a deadlock resolution procedure.

Applying corporate rescue themes coupled with well thought through rescue legislation, should allow these objectives to be achieved.

5.5 COMMON RESCUE THEMES

It is submitted that all of the jurisdictions mentioned above have as a fundamental starting point: the need to maximise recoveries and promote stability of the potentially failing entity. What corporate rescue brings about, is the ability to ensure that all stakeholders form a partnership or alliance aimed at successfully saving the corporate entity. The benefits of doing so are apparent. The weighing up of the importance of the extraction of payment of historical debt versus resuscitating the corporate to enable it to continue to trade is the challenge. By implementing new age rescue regimes with fundamental principles and themes to enable a viable rescue mechanism, the benefits of job preservation, the boosting of the economy and the future contribution of the rescued entity to the marketplace must be of benefit to all stakeholders. These regimes involve experienced insolvency and business rescue practitioners, the courts, trade unions and employee groups, shareholders, distressed debt lenders and creditors, all working together towards a common goal, namely the rescue of the troubled entity. Rescue culture principles and themes enable us to understand the mechanisms in place to promote the renegotiation and restructuring of debt within the corporate rescue context.

Before considering business rescue in South Africa, we consider certain core fundamental common rescue themes which are applicable to most modern rescue regimes around the world. These essential themes are the cornerstones to any business rescue culture which has, as its premise, an acceptance by creditors to take a compromise on their claims. The acceptance of taking a compromise on debt enables financially distressed companies to be restructured and ultimately rescued.

When any jurisdiction considers the implementation of a rescue regime, it is submitted that certain essential rescue themes must form a feature, must be dealt with and are non-negotiables in the restructuring context.[251] It is submitted that these include seven core rescue themes:[252]

251. See Rajak and Henning "Business Rescue for South Africa" 1999 *SALJ* 262, for the essential elements of a business rescue regime. At 263–264, the authors set out the common key components which any modern business rescue regime should include, such as the type of

- the eligibility, ease of entry and duration of the rescue process;
- the "stay" or moratorium on claims;
- the manner in which the company is managed while under rescue;
- the treatment of creditors, contracts and employees;
- the manner in which the company is financed while under rescue;
- the formulation of a workable rescue plan and the ability to cram down the plan on dissenting creditors; and
- the ability to discharge creditors' claims.

These seven common rescue themes are dealt with in more detail below.

5.5.1 ELIGIBILITY FOR, ENTRY INTO AND DURATION OF THE RESCUE PROCESS

The type of entity which would be eligible for a business rescue/restructuring filing might differ in various jurisdictions. A fundamental starting point would always be some form of financial distress or insolvency. The manner in which entities enter into and exit from the rescue process might also differ from jurisdiction to jurisdiction.

The ease and eligibility of entry into a business rescue process is often referred to as a "gateway". Some jurisdictions have a single gateway, while others have multiple gateways.[253] Most jurisdictions recognise two points of entry for an entity to be eligible for the protection of a moratorium from creditor claims and an opportunity to have debt restructured. An entity that is commercially insolvent, that is, a company that cannot pay its debts as and when such debts fall due in the ordinary course of business, would

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entity eligible for the protection of a rescue regime, the mechanism by which an eligible entity should move from unprotected status to protected status, the burden of proof required to enter into a rescue regime, the nature of the protection, by whom is the business of the debtor to be administered and the process which enables the debtor to emerge from the protective regime (after an agreed plan has been approved). Also see comments on fundamental principles of rescue in Chapter 4, paras 4.1–4.2 and in Chapter 5, para 5.1.

252. These core rescue themes were originally identified as being necessary provisions in a rescue regime and in line with modern jurisdictions – see Rajak, Henning *Business Rescue for South Africa* (1999) 263–264. The "seven core rescue themes" referred to here, have been adapted by the author and are highlighted as essential rescue themes for any modern and effective rescue regime. Later in the study, the South African rescue regime, as set out in Chapter 6, is compared and appraised against these fundamental core principles of rescue – see Chapter 6 and specifically Chapter 8, para 8.1.

253. See Rajak *Company Rescue and Liquidation* (2013) 80–82.

certainly be a candidate for rescue intervention by way of formal process. Likewise an entity that is factually insolvent, that is, a company whose liabilities exceed its assets (balance-sheet insolvency), would also be a candidate for formal restructuring or insolvency (liquidation). Financial distress, whether tested by way of a forward-looking test for distress or where the company is on the verge of insolvency, would be the necessary requirement for business rescue protection.[254]

The essence of the concept of insolvency consists in a debtor's ultimate inability to meet its financial commitments. In the UK insolvency is tested in a similar manner to the above:

> The traditional way of identifying this state of affairs is by the so-called balance sheet test of insolvency – upon a balance of the debtor's liabilities and assets, the former exceed the latter with the consequence that it is impossible for all the liabilities to be discharged in full. A different – but commercially more useful – indicator of financial distress is known as the "cash-flow" test, which is based on the objective demonstration of the debtor's inability to meet obligations at the time of falling due.[255]

The legal entity, once it reaches the financial position referred to above, must consider the drastic step of financial liquidation or some form of restructuring. It should be noted that many countries allow a debtor company to obtain protected status when it is not actually insolvent. The US and Australia do not even require a showing of imminent insolvency.[256]

The privileges of "limited liability" were initiated in the UK and ultimately founded the principle of separate corporate legal personality. A company is capable of incurring and acquiring legal liabilities and of engaging in commercial activities in its own right, and is consequently capable of undergoing insolvency in separation from those individuals who are its members or controllers.[257]

254. Ibid.

255. Fletcher *The Law of Insolvency* (2009) 1.

256. Ibid. The US takes an extreme view and requires no showing of insolvency, actual or imminent. There is no requirement under the US Bankruptcy Code that the debtor company must be insolvent to file for a voluntary petition under Chapter 11. In contrast, most countries (including South Africa) still require that a debtor "qualify" for bankruptcy (they require a showing of actual or imminent insolvency). In South Africa one of the qualifying tests must be applicable, if a company is to consider commercial or factual insolvency or financial distress, insolvency (liquidation) or business rescue. Historically, there is a marked distinction between personal and corporate insolvency. In the UK, personal insolvency is referred to as "bankruptcy" and in South Africa as "insolvency" or "sequestration".

257. Fletcher *The Law of Insolvency* (2009) 12–14. As the concepts of the modern limited liability company emerged during the first half of the 19th century it began to be possible for the members of incorporated companies to limit their personal liability, and thus to create a distinction between corporate and individual insolvency. By the late 19th century, insolvency law in England had evolved into specialised branches – individual and corporate – and the provisions of insolvency law contained in two separate and distinct statutes: the Bankruptcy Acts (for individuals) and the Companies Acts – administered judicially by different courts under different sets of procedural rules. Many countries around the world follow these distinct separate systems of law and developed statutes along very similar lines. These countries include Australia, New Zealand, the Republic of Ireland and South Africa.

A social and economic distinction must thus be drawn between business debtors and consumer debtors. Business debtors acquire debts while conducting business, whereas consumer debtors would acquire debts through the acquisition of goods and services for their own personal use and consumption, and not as part of a business operation.[258]

This distinction between business debtors and consumer debtors tends to be followed in most countries, with the development of two parallel and sometimes overlapping systems.[259] In the US, Chapter 11 (the business reorganisation chapter) of the US Bankruptcy Code applies to business debtors. Limited liability companies, partnerships and individuals engaged in business all qualify as business debtors.[260]

In Canada, prior to commencing restructuring proceedings, it is necessary to determine if the debtor meets the statutory eligibility requirements imposed by the Canadian insolvency regime.[261] In order to be eligible under the CCAA or the BIA, both regimes require that the debtor be bankrupt or insolvent.[262]

The CCAA has stricter statutory eligibility requirements.[263] Such companies would include federal and provincial corporations as well as any foreign corporations having assets or doing business in Canada. The CCAA therefore adopts an eligibility requirement that depends upon the legal form of the business entity. Non-corporate business entities such as partnerships cannot restructure under the CCAA.[264]

The BIA adopts fewer restructure eligibility conditions. These provisions are not limited to corporations but apply to persons generally. Individuals and non-corporate business entities restructure under this regime. Unlike the CCAA, the BIA does not impose a financial threshold based on outstanding claims against the debtor.[265]

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258. Rajak and Henning "Business Rescue for South Africa" (1999) *SALJ* 270.
259. Ibid.
260. Ibid 271. See Ferriell and Janger *Understanding Bankruptcy* (2013) 709–710;. Epstein and Nickles *Principles of Bankruptcy Law* (2007) 45–48.
261. Wood *Bankruptcy and Insolvency Law* (2009) 326–328. Either the Companies Creditors' Arrangement Act (CCAA) or the Bankruptcy and Insolvency Act (BIA) would be applicable; the former applying to companies and the latter applicable to corporations and individuals generally.
262. For an understanding of the term "insolvency" in Canadian legislation, see Wood *Bankruptcy and Insolvency Law* (2009) 22.
263. CCAA, section 3(1). In order to be eligible, the debtor company must have total claims against it in excess of CAD 5 million.
264. Wood *Bankruptcy and Insolvency Law* (2009) 328.
265. Ibid.

In the UK, until recently, companies registered under the UK Companies Act, 1985, were the only entities eligible for the UK Statutory Business Rescue Regime.[266] However, since the enactment of the Insolvent Partnership Order, 1994,[267] the full range of statutory business rescue regimes has been available to partnerships.[268]

Consequently, in both the US and the UK, insolvent business debtors may seek the protection of business rescue regimes, irrespective of whether those debtors are companies incorporated under the provisions of a Companies Act, partnerships or individual traders.[269]

It is submitted that the opportunity for rescue should be limited to commercial entities (in certain jurisdictions, insolvent business debtors) that are commercially insolvent, in that such entities cannot pay their ongoing liabilities to creditors as and when they fall due. The need for the stay or moratorium on claims in the period of restructuring continues in order to give the financially distressed company a respite from the ongoing pressure of having to meet claims of creditors when cash flow is at a minimum. The introduction of post-commencement finance and a restructuring of the debt will enable such an entity to submit a plan which will incorporate creditors' claims being discharged to an extent, and allowing the entity to continue trading on a solvent basis into the future.

Different jurisdictions approach the entitlement to apply for a reorganisation regime in different ways.[270] The manner in which entities can enter a rescue regime might be made more difficult by the requirement of a formal entry through a court procedure. Some jurisdictions allow applications by both debtors and creditors, and some only allow debtor applications. What is important is that both debtors and creditors recognise the ability and opportunity to commence reorganisation proceedings and should have the choice to do so.[271]

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266. Section 8 of the UK Insolvency Act, 1986 read with Section 251 of the UK Insolvency Act, 1986 and Section 735(1)(a) of the UK Companies Act, 1985. See Fletcher *The Law of Insolvency* (2009) 87–93.
267. Insolvent Partnerships Order 1994 (SI 1994/2421).
268. Rajak and Henning "Business Rescue for South Africa" (1999) *SALJ* 271.
269. Ibid 273.
270. See McCormack *Corporate Rescue Law: An Anglo American Perspective – Corporations, Globalisation and the Law* (2008) Chapter 4 – Entry Routes and Control (UK and US Systems) 118–155.
271. Burdette "Legislative Framework for the Facilitation of Turnarounds" in Harvey (ed) *Turnaround Management and Corporate Renewal – a South African Perspective* (2011) 135. Commencement standards set the requirements that must be met in order to enter the relevant procedure. In most jurisdictions, this requirement would appear to be the failure of a debtor to meet its financial obligations as they fall

Debtor companies that require the intervention of a restructuring process must apply at an early stage of financial distress in order to ensure that a reorganisation results in maximum recovery for creditors and will benefit the company and all stakeholders.[272]

In a typical scenario, the failure of a borrower to repay a loan will generally give rise to a power in the hands of the lender to seek the assistance of the courts in enforcing the claim for repayment. Any filing for rescue or formal restructuring prohibits the lender from enforcing the debt due and thus interferes with the law of contract (*pacta sunt servanda*, i.e. the sanctity of contract).[273]

Different jurisdictions apply different requirements to the commencement standards required by creditors when restructuring proceedings are commenced.[274] It is thus a sensitive matter to frame legislation which provides for this interference. Legislators need to be careful not to contribute to an undermining of confidence in respect of the normal anticipated consequences of commercial dealings. Clearly, a filing for court declarations of financial rescue, bankruptcy or legislation would interfere with the creditors' right to enforce payment of debts due to them.[275]

In the UK, the commencement of a process requires an order of a competent court following the fulfilment of certain criteria for eligibility. The basic requirement would be the need to show insolvency or near-insolvency.[276] The exercise of the court's judicial discretion in accordance with well-established legal principles will define the mechanism which places the company into the necessary formal procedure.[277]

Under UK insolvency law, there are two commencement standards, namely insolvency (liabilities exceed assets) and illiquidity (the debtor is unable to meet its debts as they fall

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due, but in some jurisdictions factual insolvency, as determined by the balance sheet test, is the requirement. Also see Rajak *Company Rescue and Liquidation* (2013) 81–82.

272. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 53–54.
273. Rajak and Henning "Business Rescue for South Africa" (1999) *SALJ* 273. Also see UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 53.
274. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 54.
275. Rajak and Henning "Business Rescue for South Africa" (1999) *SALJ* 274.
276. Section 8 of the UK Insolvency Act as read with para 3 of Sch. B1 (purpose of administration). See Rajak *Company Rescue and Liquidation* (2013) 81–82 and Fletcher *The Law of Insolvency* (2009) 527–529.
277. Rajak and Henning "Business Rescue for South Africa" (1999) *SALJ* 274. See also Rajak *Company Rescue and Liquidation* (2013) 83–85. Also see comments by Lord Hoffman in *In Re Harris Simons Construction Ltd* [1989] 1 WLR 368. Here the English courts ruled that an administration order would only be made when such order is "likely to achieve" the company's survival as a going concern and where there was a real prospect that such order would enable the whole or part of the company's undertaking to survive or at least would enable the administrator to effect a more advantageous realisation of assets than in a winding up.

due in the ordinary course of business). Administration orders will be granted in the UK if the statutory declaration filed reflects that the company is, or is likely to become, unable to pay its debts and the company is not in liquidation. There are other items of prescribed information that must also be provided. In the UK, a company may enter administration in one of two ways: by way of court order upon a formal application to court, or by the filing of a prescribed series of documents (out-of-court route). Such documents can be filed by the company, its directors or the holder of a qualifying floating charge over the company's assets.[278]

In Australia, any company registered under the Australian Companies Act[279] can place itself into voluntary administration, if such company is insolvent or is likely to become insolvent.[280] The procedure is initiated by the company's directors, by a secured creditor whose security extends over all or most of the company's assets, or by a liquidator or provisional liquidator of the company. The procedure of voluntary administration is fairly simple and cost-effective. It requires no more than a simple written appointment of an administrator without any requirement for a petition to the court. The administrator appointed is an independent, professionally qualified accountant who specialises in insolvency.[281]

In Australia there is no court involvement in the mechanism by which the administration comes into operation. Unlike in the UK and South Africa, the Australian method of entry into voluntary administration is less cautious. In Australia, the court is generally not involved in the process. The court does have a general non-intervening supervisory role if required. The procedure established by the Australian legislation allows creditors to enforce their rights only if they are required to protect perishable property; if the creditor has a charge over the whole or substantially whole of the company's property, or by way of special leave of the court.[282]

278. See para 2 of Sch. B1 to the UK Insolvency Act. Also see Fletcher *The Law of Insolvency* (2009) 524–530. Also see Rajak *Company Rescues and Liquidation* (2013) 99.
279. Corporate Law Reform Act of 1992.
280. See section 436A(1) of the Australian Corporations Act. An appointment of an administrator can also be effected by a liquidator (section 436B(1)) or by a secured party (section 436(c)(ii)).
281. The qualification requirements for an administrator are found in section 448(B)2 of the Australian Corporations Act. Rajak and Henning "Business Rescue for South Africa" (1999) *SALJ* 274.
282. Symes and Duns *Australian Insolvency Law* (2012) 265–269. Also see Murray and Harris *Keay's Insolvency* (2014) 607–608.

Any eligible debtor in the US who proceeds in good faith may commence a Chapter 11 case by filing a petition for a voluntary reorganisation.[283] These proceedings commence with the filing of a petition and the payment of the necessary filing fee.[284] A debtor company need not be insolvent, either on a cash flow or balance sheet basis. A Chapter 11 filing immediately triggers an automatic stay of claims and creates the Chapter 11 estate.[285] A Chapter 11 debtor (through its existing management) typically continues to operate its business as a "debtor in possession".[286] It enjoys the exclusive right to propose a Chapter 11 plan for the first 120 days of the case, which exclusive right may be extended to no more than eighteen months, after which other parties having an interest may file their own plan.[287]

US Bankruptcy Courts preside over insolvencies and reorganisations conducted under the US Bankruptcy Code.[288] US law imposes no absolute obligation on a board of directors to commence reorganisation proceedings.[289]

Thus the procedure established by Chapter 11 of the US Bankruptcy Code is not one which can be described as cautious. As set out above, all that is required for protection to be established is a filing of the requisite Chapter 11 notice with the US Bankruptcy Court. It is simply that filing which triggers the protection, which unless lifted, is called "stay litigation" (moratorium on all claims).[290] The stay "will last until the time the bankruptcy case is closed, or the case is dismissed or a discharge granted or derived".[291] There is no exercise of any discretion nor any investigation as to eligibility requirements (at least not at the early stages). A debtor company wishing to obtain protection from litigation by creditors may do so when solvent.[292] There is a general requirement of good faith and

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283. Section 301 of the US Bankruptcy Code. Also see Ferriell and Janger *Understanding Bankruptcy* (2013) 166.
284. Section 521 of the US Bankruptcy Code.
285. Section 362 of the US Bankruptcy Code.
286. Section 1107(a) and 1108 of the US Bankruptcy Code.
287. Section 1121(a), (b), (c) and (d) of the US Bankruptcy Code. See Kornberg and Tobler *Restructuring and Insolvency* (US Chapter) (2013) 518. Also see Ferriell and Janger *Understanding Bankruptcy* (2013) 739–741.
288. US Bankruptcy Courts have their own rules and procedures as governed by the Federal Rules of Bankruptcy Procedure and in sections set out in the Federal Judicial Code – 28 USC section 1334 (2000).
289. Ibid.
290. Section 362 of the US Bankruptcy Code.
291. Rajak and Henning "Business Rescue for South Africa"(1999) *SALJ* 274. See Sections 362(c) and 1141 of the US Bankruptcy Code.
292. Under US bankruptcy law, insolvency is *not* a requirement for a voluntary filing. Failure to pay debts as they fall due is required in the case of an involuntary filing. Thus, an application for Chapter 11 protection under the US Bankruptcy Code does not set down insolvency as a requirement. See Burdette "Legislative Framework for the Facilitation of Turnarounds" in Harvey (ed) *Turnaround Management and Corporate Renewal – a South African Perspective* (2011) 135.

much of the "stay litigation" consists of creditors requesting the stay to be lifted on the grounds that there is no genuine possibility of a realistic plan acceptable to the creditors under which the debtor can be restructured. If there is a lack of good faith on the part of the debtor company, the court may lift the stay. Thus, although the US entry into the restructuring process, on the face of it, looks reckless, there are control mechanisms in place and the stay cannot go on indefinitely and without good reason.[293]

In Canada, the CCAA[294] provides a mechanism through which a company could attempt to negotiate an arrangement with its creditors. This legislation has a full protective moratorium on all claims which can be initiated by the debtor company alone by the filing of a notice of the intention to make a proposal to repay creditors. Other parties may also initiate the moratorium.[295] Unlike Chapter 11 proceedings in the US, the debtor's insolvency is a precondition to the initiation of this protection. The Canadian system requires strict monitoring by the court in the protective period (unlike the US).[296]

A decision to commence restructuring proceedings is not taken lightly in Canada.[297] Restructuring proceedings under the CCAA are commenced through an application to court for an initial order. In most cases, it is the debtor company that initiates the proceedings, and usually on an ex parte basis.[298] Alternatively, if the Canadian BIA is used, there is no need to have the court intervene in order to commence the proceedings.[299]

Generally, entry into a rescue procedure by way of a court application is expensive and time consuming. Automatic entry into the process by filing notices might be preferable and less costly but one needs to balance this approach to one where there is a greater degree of

293. Ibid. A critical difference in respect of the grounds from entry into a protective regime, would be a question of onus. In the UK and South Africa, the onus is on the creditors to establish a lack of good faith on the part of the debtor company which might result in the company not being eligible for rescue or insolvency procedures or for the moratorium on claims being lifted. Also see Ferriell and Janger *Understanding Bankruptcy* (2013) 231–234 for the scope of the stay.

294. The CCAA must be read together with Section 50.4 of the Canadian Bankruptcy and Insolvency Act, 1992.

295. Section 11.02(1) and (2) of the CCAA. See discussion on stay in Wood *Restructuring & Insolvency Law* (2009) 333–346.

296. Rajak and Henning "Business Rescue for South Africa" (1999) *SALJ* 276.

297. Wood *Bankruptcy and Insolvency Law* (2009) 326.

298. Ibid 331. The ex parte option is useful if there is a real prospect that creditors will attempt to exercise their enforcement remedies against the debtor's assets before the court hears the matter. The stay of proceedings provided for in the initial order cannot exceed thirty days. The applicant will therefore have to bring a subsequent application before the court for a stay of proceedings for a longer duration. This permits parties affected by the initial order to have an opportunity to express their views concerning the eligibility of the debtor or the appropriateness of the order.

299. Section 11.02(1) of CCAA and section 50(2) of the BIA. Ibid 331. There are two routes for commencement. The first route is simplest. If the debtor has already developed a commercial proposal the restructuring proceedings can be initiated by filing such proposal with a licensed trustee. The trustee then files the proposal together with a cash-flow statement and associated documents with the official receiver. The second route is used more frequently and where the debtor company requires time to negotiate with its creditors. In this instance, the debtor initiates proceedings by filing a notice of intention to make a proposal with the official receiver.

court intervention and control, particularly when claims against the debtor company are substantial.[300]

If the jurisdiction prefers initiation of the process to be driven by the exercise of a judicial discretion, then this supports the contention that all stakeholders have faith in the judicial system in contributing to a successful outcome. If courts are to be avoided in the process of initiating the protective regime, then they should also be avoided in the period past commencement of the process.[301]

It is submitted that ultimately the best procedure for restructuring needs to deliver a quick entry into a protective restructuring regime which effectively places the control of the company and its affairs into the hands of an effective, experienced supervisor who can deliver a suitable and acceptable outcome for all stakeholders in as short a time frame as possible.[302]

The appropriate mechanism for entry into a rescue process will differ from jurisdiction to jurisdiction. The balance of power between creditors, management, directors, employees and shareholders in each different country will differ and will be strongly linked to cultural pressures present in each jurisdiction.

In order for a debtor company to be placed in a position to benefit from a protective regime, one would need to determine the level of entry requirements (burden of proof) that needs to be established. The burden of proof is an essential element which would have to be considered by the court determining the debtor company's change of status. Wherever the debtor company files for rescue, it would have to persuade the relevant authorities and/or the court that it is indeed a suitable candidate for a rescue process, and not for liquidation.

The term "rescue" includes cases where the debtor's recovery must be completed, that is to say that the debtor company emerges from the protective period on a solvent basis, with

300. UNCITRAL *Legislative Guide on Insolvency Law* Part 1 (2005) 12.

301. Rajak and Henning "Business Rescue for South Africa" 1999 *SALJ* 276.

302. It is submitted that the model to be adopted by each country must not be taken lightly. Court-driven processes should provide opportunity for serious consideration of the merits and which culminates in a court order. Automatic filing for rescue is the direct opposite. The US, Australia and Canada have implemented cheap and fast procedures while court permission is still required in countries such as France, Germany, the UK and South Africa.

the business intact and capable of being continued successfully from the point where the protection began. All creditors will have been or will be paid in full.[303]

The term "rescue" also has a second possible outcome to it; that is, the possibility of situations where the debtor company's recovery is partial, but where the overall result is one of greater benefit to the various stakeholders than would have occurred on liquidation of the debtor company.[304] Rajak and Henning describe the consequences of recovery as follows:

> "Rescue" thus includes the case where the debtor emerges from the protective period solvent and capable of carrying on without protection, but where this will have been due to some surgery conducted during the protective period. The result of this surgery might be all or any one or more of the following: (i) a slimmer business, (ii) with fewer employees, (iii) with certain activities reduced or eliminated, (iv) with the agreement of the creditors as a body to accept a particular percentage of their claims, with or without agreement that the balance be paid over an agreed period.[305]

Thus, as long as the debtor company (or the creditor seeking to place the debtor company into such protective regime) can establish the probability of one of the two above outcomes, there is a strong likelihood that the debtor company will be in a position to enter into the rescue regime, with all of the benefits of the moratorium on claims. Debtor companies will always seek the protection of a limited moratorium when they can potentially survive a temporary liquidity crisis.[306] The survival prospects of debtors in temporary protection will span a wide range of possibilities. Any successful business rescue regime would want to ensure that all debtors with genuine recovery prospects should receive the protection of a formal regime with the benefits of a moratorium; however, hopeless debtors should not. Thus there is no guarantee that all debtor companies that enter the protection regime will survive and meet the expectations of successful recue.[307]

Modern "corporate rescue" seeks to take advantage of the reality that in many cases an enterprise not only has substantial value as a going concern, but that its going-concern value exceeds its liquidation value. Through judicial bankruptcy procedures, reorganisation

303. Rajak and Henning "Business Rescue for South Africa" 1999 *SALJ* 277.
304. Ibid.
305. Ibid.
306. Ibid.
307. Ibid 278.

seeks to maximise, preserve and possible enhance the value of a debtor's business enterprise. This process maximises payment to the creditors of the distressed debtor.[308]

In terms of a restructuring process, the business can be rescued in many ways and the process can result in the –

- Sale of the enterprise as a whole, as a going concern for cash and/or securities (by way of a debt for equity swop);
- Restructuring or forgiveness of certain debt;
- Splitting off and sale of divisions or subsidiaries of the business while either continuing to operate the remainder, or liquidate units.[309]

In most countries corporate rescue is simply an alternative to liquidation and is used when more value can be achieved for creditors than in the event of a liquidation.[310]

The reorganisation/restructuring objectives of rescue regimes aim to provide a framework for the evaluation of the continuing feasibility of the enterprise and, where desirable, to reorganise the debtor with a new capital structure and allocation of interest in it to resume operations and terminate the formal proceedings. In certain jurisdictions, such as the US, reorganisation is seen as the "preferred" forum of bankruptcy proceedings, with liquidation being a last resort.[311]

In the US, a bankruptcy reorganisation seeks to enable financially troubled companies to capture and preserve their "going-concern value". In doing so, reorganisation benefits everyone involved with the business. Creditors obtain a greater distribution for their claims, employees keep their jobs, suppliers keep their customers and the owners/shareholders may even preserve their investment.[312]

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308. Smits "Corporate Administration: A Proposed Model" (1999) 32 *De Jure* 83. See UNCITRAL *Legislative Guide on Insolvency Law* Part 1 (2005) 83.
309. UNCITRAL *Legislative Guide on Insolvency Law* Part 1 (2005) 83.
310. Ibid.
311. Ibid 84.
312. Ferriell and Janger *Understanding Bankruptcy* (2013) 709. For the statutory grounds required for a Chapter 11 filing see Section 1112 of the US Bankruptcy Code. Also see Epstein and Nickles *Principles of Bankruptcy Law* (2007) 45–48.

As opposed to liquidation, in a reorganisation, in order for the debtor to be eligible for the protection of a Chapter 11 reorganisation process, the debtor must be able to prove that if the business continues to operate, income generated from such operations can be used to repay its creditors. The goal of a Chapter 11 is centred around maintaining the enterprise's going-concern value.[313]

As a result, Chapter 11 debtors usually find it necessary to obtain immediate court approval in order to continue to operate their business in terms of a formal Chapter 11 process. The burden of proof required for a successful petition will depend on the nature of the company's businesses, the extent of prepetition debt and the prospects of success of a successful Chapter 11 filing.[314]

In its petition, the prospective Chapter 11 debtor must show that relief is required to ensure that existing obligations can be restructured. The voluntary petition filed by the debtor must meet certain requirements, including publication of standard information such as the location of the debtor company's principal assets, the debtor's plan or intention to file a plan and a request for relief under the appropriate Chapter of the US Bankruptcy Code.[315] The bankruptcy Chapter 11 case commences when it is filed with the US Bankruptcy Court. A case filed under Chapter 11 of the US Bankruptcy Code is frequently referred to as a "reorganisation" bankruptcy.[316]

In Canada, the initial application to court will usually require an order that declares the debtor company to be one to which the CCAA applies. This court is requested to authorise the debtor company to continue to operate its business operations and continue in possession of its property. It will include a request for a stay of proceedings against the debtor company.[317] A monitor is appointed to administer the debtor company throughout its CCAA proceedings.[318] The application will include a request to authorise the debtor company to obtain interim debtor-in-possession ("DIP") financing and to indemnify

313. Ferriell and Janger *Understanding Bankruptcy*(2013) 711.

314. Ibid 732. Also see Wessels and De Weijs *International Contributions to the Reform of Chapter 11 U.S. Bankruptcy Code* (2015) at 22–24 and 28–31 on the treatment of post-petition financing, as well as at 24–25 on the position on the timing of section 363 sales.

315. Section 301 of the US Bankruptcy Code. Involuntary petitions by creditors can be brought under Chapter 11 and creditors would have to prove that the debtor is not paying its debts as they become due – section 303(h) of the US Bankruptcy Code.

316. Section 301 of the US Bankruptcy Code. See United States Courts "Chapter 11 – Bankruptcy Basics" available at http://www.uscourts.gov/services-forms/bankruptcy/bankruptcybasics/chapter-11-bankruptcy-basics.

317. Section 11.02(2) of the CCAA and section 69.1(1) of the BIA.

318. Appointed in terms of section 11.7(1) of the CCAA.

directors of the debtor company against liability that might be incurred following the date of the initial order.[319] It will also deal with the effect of charges against property to secure administrative expenses, interim financing and allowing the debtor company to file a plan of arrangement.[320]

In the UK, the entry routes into administration are by administration order of the court, by direct appointment by the holder of a floating charge or by direct appointment by the company or its directors.[321] The court must be satisfied that the company is, or is likely to become, unable to pay its debts and that the administration order is reasonably likely to achieve the purpose of administration.[322]

As to the first of these tests, if it is not demonstrable that a company is currently unable to pay its debts, then there must be evidence to show that the company is "likely" to become unable to do so. It has been held that the test of the "likelihood" of the company becoming unable to pay its debts is a relatively exacting one, requiring the applicant to demonstrate on a balance of probabilities that "it is more probable than not" that this criteria will be fulfilled.[323] In the case of the second criterion, that the administration order is "reasonably likely" to achieve the purpose of administration, the court must be satisfied that there is a "reasonable prospect" that the statutory purpose will be achieved. Even where the UK court is satisfied that the two requirements are met, the use of the word "may" indicates that the court's exercise of its jurisdiction is a matter for its discretion.[324]

In Australia, Part 5.3A of the voluntary administration legislation is the mechanism used for facilitating the survival or restructure of distressed Australian companies.[325] The Australian administration system is driven by the execution of a DOCA. The fundamental objective is to rescue viable companies from being wound up where the threat of

319. See discussion in Wood *Bankruptcy and Insolvency Law* (2009) 355–359.

320. Ibid 331.

321. See para 3 of Sch. B1 to the UK Insolvency Act, 1986.

322. Para 2 of Sch. B1 of the UK Insolvency Act. See Fletcher *The Law of Insolvency* (2009) 529–530. Also see Rajak *Company Rescue and Liquidation* (2013) 83–86.

323. Fletcher *The Law of Insolvency* (2009) 530.

324. Ibid.

325. A DOCA has the effect of bringing about a voluntary administration and is essentially a statute directed procedure that sees the company making compromises or arrangements that are binding on creditors – see section 444A(5) of the Australian Corporations Act. Australia has never had a separate insolvency statute with its corporate insolvency legislation incorporated within Chapter 5 of its general legislation: the Corporations Act, 2001. See Blazic *In Search of a Corporate Rescue Culture: A Review of the Australian Part 5.3A Regulation* (2 October 2010) available at http://ro.uow.edu.au/cgi/viewcontent.cgi?article=1007&context=sbshdr 4. Recent reforms were effected under the restructuring legislation found under the Corporations Amendment (Insolvency) Act 2007.

insolvency would otherwise result in steps being taken by creditors to place the company into liquidation.[326]

Voluntary administration in Australia can be commenced by the company director, by a liquidator who appoints an administrator to proceed with the voluntary administration, or by major secured creditors or the sole secured creditor. The application in support of the voluntary administration process must support the fact that the distressed company's state of affairs can be reorganised by way of a DOCA whereby creditors come to an arrangement relevant to the company's state of affairs in the near future. The DOCA will need to be approved by the court.[327]

It is relatively simple to enter the procedure in Australia and the burden of proof is placed on one of the abovementioned persons to show that the company is insolvent or about to become insolvent. This enables directors to enter into the administration process in a swift and effective manner. [328]

It is submitted that there must be a burden of proof threshold in place which financially distressed companies can assess in order to establish whether they can meet the entry requirements. Not every financially distressed company is a candidate for rescue or restructuring. Many of these companies might, from the outset, realise that there is no reasonable prospect of being rescued or restructured successfully. These companies should then be placed into liquidation as soon as possible. Not to do so could result in diminished liquidation dividends for creditors after having gone through a painful attempt of a rescue or restructuring that turned out to be unsuccessful.

5.5.2 MORATORIUM: THE STAY OF CLAIMS

A fundamental theme which is common to all modern rescue regimes worldwide is the concept of a "stay" or moratorium on claims. This is an essential requirement to protect the value of the company against its determination by actions taken by creditors, as the UNCITRAL guidelines state:

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326. Ibid. Also see Symes and Duns *Australian Insolvency Law* (2012) 264–295.

327. Wong "Corporate Rescue in Australia and the US: A Comparative Study" (2009) *Norton Journal of Bankruptcy Law and Practice* 3. Also see Symes and Duns *Australian Insolvency Law* (2012) 296–311.

328. Section 436A(1). A director appoints an administrator without going to court. This is by far the most commonly used manner to commence administration in Australia. See Anderson "Viewing the Proposed Business Rescue Provisions from an Australian Perspective" (2008) 1 (4) *PER* 7.

> An insolvency law should preserve the estate and prevent premature dismemberment of the debtor's assets by individual creditor actions to collect individual debts. Such activity often reduces the total value of the pool of assets available to settle all claims against the debtor and may preclude reorganisation or the sale of the business as a going concern. A stay of creditor action provides a breathing space for debtors, enabling a proper examination of its financial situation and facilitating both maximization of the value of the estate and equitable treatment of creditors. Some mechanism may be required to ensure that the stay does not affect the rights of secured creditors.[329]

The preservation of assets is thus effected with the interests of creditors in mind.[330]

No debtor company can effectively be restructured without having the benefit of a breathing space which would occur upon the freezing of or lock down on all claims that can be brought by creditors (and shareholders) of the company once the restructuring process has commenced. This would include a stay on any applications/motions to court, the issue of actions/summons, the launch of winding-up or liquidation proceedings and the prohibition on continued service and execution of writs of execution against the debtor company. Rajak and Henning state as follows:

> Almost all modern industrial nations have statutorily created regimes which provide protection for insolvent debtors. Generally, such "business-rescue" regimes will be invoked where the insolvency is believed to be temporary and where the debtor is believed capable, with assistance, of returning to commercial life as an active and successful entrepreneur. Although not entirely without criticism, business-rescue provision is widely supported as a means of saving jobs, of enabling work in progress to be satisfactorily completed, of ensuring that debts are paid in full (or at least to a greater extent than if the debtor were permanently removed from commercial life) and of protecting investment.[331]

According to Smits, the "protection" mechanism referred to above is an essential requirement for successful restructuring of a company in financial distress:

> The stay is critical to the reorganisation effort. It immediately gives the debtor and its business a breathing space. Very often the filing of the application will be triggered

329. UNCITRAL *Legislative Guide on Insolvency Law* Part 1 (2005) 12 and Part 2 (2005) 83.

330. Ibid 83: "With regard to creditors, one of the fundamental principles of insolvency law is that insolvency proceedings are collective proceedings, which require the interests of all creditors to be protected against individual action by one of them. Many insolvency laws include a mechanism to protect the value of the insolvent estate that not only prevents creditors from commencing actions to enforce their rights through legal remedies during some or all of the period of the liquidation or reorganisation proceedings, but also suspends actions already under way against the debtor. Such a mechanism is variously termed a 'moratorium', 'suspension' or 'stay', depending on the effect of the mechanism. For the purposes of the Legislative Guide, the term 'stay' is used in a broad sense to refer to both suspension of existing actions and a moratorium of the commencement of new actions."

331. Rajak and Henning "Business Rescue for South Africa"(1999) *SALJ* 262. South Africa's business rescue model was clearly overdue and particularly as a result of the failure of judicial management. The protection of the investment and value in the company would be assisted by the moratorium which was now automatic.

> following a breakdown in negotiations between the debtor and one or more of its creditors. The stay, coupled with the appointment of an administrator, will force both parties to step back and reassess the whole situation given that the debtor is not in bankruptcy.[332]

The commencement of a restructuring/rescue process should also disallow creditors from cancelling contracts which have not yet been cancelled prior to the commencement.[333]

Of course, exceptional circumstances may warrant court intervention in order to protect the rights of a creditor even before all creditors have the opportunity to vote on the plan. This would arise where a creditor's rights could be irreparably prejudiced by virtue of the delay caused by the stay or moratorium.[334]

Without the moratorium on claims, the effective restructuring of a distressed company would be difficult to achieve. Some guidance is set out in the UNCITRAL Guidelines:

> In reorganisation proceedings, the application of a stay facilitates the continued operation of the business and allows the debtor a breathing space to organise its affairs, provide time for preparation and approval of a reorganisation plan and for other steps such as shedding unprofitable activities and onerous contracts, where appropriate. As in liquidation, it also provides an opportunity to consider actions pending against the debtor. Given the goals in reorganisation, the impact of the stay is greater and therefore more crucial than in liquidation and can provide an important incentive to encourage debtors to initiate reorganisation proceedings. At the same time, the commencement of proceedings and the imposition of the stay give notice to all those who do business with the debtor that the future of the business is uncertain. This can cause a crisis of confidence and uncertainty as to how the insolvency proceedings will affect suppliers, customers and employees of the debtor's business. The immediate benefits that accrue to the debtor by having a stay quickly imposed to limit the actions of creditors will need to be balanced against the longer-term benefits that are derived from limiting the degree to which the stay interferes with contractual relations between debtors and creditors, especially secured creditors.[335]

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332. Smits "Corporate Administration: A Proposed Model" (1999) 32 *De Jure* 99. Also see Burdette "Legislative Framework for the Facilitation of Turnarounds" in Harvey (ed) *Turnaround Management and Corporate Renewal – a South African Perspective* (2011) 135–136.

333. Smits "Corporate Administration: A Proposed Model" (1999) 32 *De Jure* 99. Application of the stay would allow the supervisor to consider the need for the contract and its prejudice to the prospects of the company being restructured. Some argue that clauses in contracts which purport to accelerate the agreement on insolvency or commencement of rescue should be held null and void. Effectively, once the automatic stay is in effect, creditors cannot unilaterally cancel their contracts with the company, provided that the company remains current in performing its post-commencement obligations.

334. Ibid.

335. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 84.

The extent of the stay might be very wide, applying to various remedies and proceedings that might potentially affect the assets and ongoing business of the company.[336] The most important reason for a stay is to place all litigation against the company on hold.[337]

There are of course opportunities to ensure that certain exclusions apply to the stay. These might include employee actions, government claims, claims involving public interest, environmental claims or activities detrimental to public health and safety. What is required is a detailed identification of those actions that are specifically excluded from the scope of the stay. This would enable the effective prosecution of claims that can be continued while the company is being restructured.[338]

Actions by secured creditors must also be dealt with by the relevant insolvency legislation applicable in the jurisdiction. Certain jurisdictions would allow secured creditors to freely enforce their rights against encumbered assets. This can frustrate and prejudice the objectives of the reorganisation. In certain instances, actions by secured creditors are included within the scope of the stay, but subject to certain protections.[339]

It is important to ensure that the legislation addresses the issue as to the exact time at which the stay will become effective to ensure protection of the company. In some jurisdictions, the stay becomes effective as at the date of the court's decision to commence proceedings; in others, when the decision to commence becomes publicly available.[340]

It is further important for the legislation to address the status of a stay between the date of the application for restructuring proceedings and the actual commencement date of the reorganisation proceedings. If the application is opposed, the company will be caught in a

336. Ibid 85. Examples would include the commencement and continuation of actions or proceedings (including arbitration proceedings) against the debtor or in relation to its assets, against enforcement proceedings, execution of judgments and actions to perfect security interests, recovery of property, payment or provision of further security interests in respect of debts incurred prior to the commencement date, the transfer, encumbrance or other disposal of any assets of the debtor and the termination of a contract with a counter party.

337. Ibid.

338. Ibid 87.

339. Ibid 88.

340. Ibid 89. In other jurisdictions, the stay becomes effective retrospectively from the date when the commencement order is made, as opposed to the date upon which the application for commencement of proceedings is made. What is clear, is that the legislation should be clear on the date and time of the commencement of the stay.

hiatus which makes the process difficult to administer. The introduction of "provisional measures" should address this issue.[341]

In the US, a Chapter 11 process is always accompanied by an automatic stay (moratorium on claims).[342] The US version of an automatic stay provides a period of time in which all judgments, collection activities, foreclosures and repossessions of property are suspended and may not be pursued by the creditors on any debtor claim that arose before the filing of the bankruptcy petition. As with cases under other Chapters of the US Bankruptcy Code, a stay of creditors' actions against the Chapter 11 debtor automatically comes into effect when the bankruptcy petition is filed.[343] The stay provides a breathing space for the debtor during which negotiations can take place to try to resolve the difficulties in the debtor's financial position.[344]

Under specific circumstances, a secured creditor can obtain an order from the court granting relief from the automatic stay.[345] For example, when the debtor has no equity in the secured property and that property is not necessary for an effective reorganisation, the secured creditor can seek an order of the court lifting the stay to permit the creditor to foreclose on the property, sell it, and apply the proceeds of the debt.[346]

According to Ferriell and Janger, the automatic stay remains an essential feature of the Chapter 11 process:

> The automatic stay is one of the most significant features of the Bankruptcy Code – as soon as a bankruptcy petition is filed, virtually all civil actions involving the debtor, the debtor's property, or property of the estate, and nearly all informal actions undertaken by creditors in their efforts to collect must stop dead in their tracks. Many individuals who file bankruptcy petitions do so to stop an imminent mortgage foreclosure sale, to put an end to a wage garnishment, or to stop the barrage of

341. Ibid. 91. Provisional measures could include the appointment of an interim supervisor to protect the debtor's assets, a prohibition on the debtor from the disposing of assets, suspension on secured creditors of enforcing security rights against the debtor, a stay of actions by creditors and preventing the commencement or continuation of individual actions by creditors to enforce claims.

342. Section 362 of the US Bankruptcy Code.

343. See Ferriell and Janger *Understanding Bankruptcy* (2013) 231–234. Also see Public Information Series *Reorganisation Under the Bankruptcy Code – Chapter 11* Public Information Series of the Bankruptcy Judges Division (December 1998) available at http://www. ctb.uscourts. gov/doc/chap11.html 3. Note that the filing of a petition does not operate as a stay for certain types of actions listed under 11 U.S.C. – Section 362(b).

344. Ferriell and Janger *Understanding Bankruptcy* (2013) 231–269. Also see Epstein and Nickles *Principles of Bankruptcy Law* (2007) 15–17; Howard *Bankruptcy Overview: Issues, Law and Policy* (2002) 27–28.

345. Section 105(a) of the US Bankruptcy Code.

346. Ferriell and Janger *Understanding Bankruptcy* (2013) 231. See 11 U.S.C. Section 362(d). Also see McCormack *Corporate Rescue Law: An Anglo American Perspective – Corporations, Globalisation and the Law* (2008) Chapter 5 – The automatic stay: barring individual creditor enforcement actions 156–175.

> dunning letters and phone calls from their creditors' collection agencies. Businesses file to prevent creditors from levying on bank accounts, repossessing equipment and inventory, or terminating leases. The benefits of the automatic stay are thus a key incentive for debtors to file a bankruptcy petition.[347]

In the UK the provisions of the Insolvency Act 2000, section 1A enable directors of an "eligible company" to take steps to obtain a moratorium for the company where they intend to make a proposal for a voluntary arrangement.[348]

A moratorium in the UK voluntary administration process can only be obtained following a professional validation by an accountable person who is either a qualified insolvency practitioner or a person specifically authorised to act as a nominee or supervisor of a voluntary arrangement. These threshold requirements are exacting, given the extent of the opportunities that could otherwise be exploited by those in charge of the company to use the moratorium as a delaying tactic when the company is in reality doomed to fail.[349]

The UK moratorium commences when the documents are filed with the court, and ends at the end of the day on which the meetings of the company and its creditors are first held, unless an extension is granted. During the UK moratorium period in a voluntary commencement process, creditors are, *inter alia*, prohibited from presenting a petition for the winding-up of the company or a resolution for such winding-up and no administration application may be made in respect of the company.[350]

In the UK administration procedure, a protective moratorium on claims applies from the inception of the process until its conclusion.[351] The UK administration moratorium provisions are divided up into two distinct phases. The first phase subsists from the initiation of the process for placing the company into administration until the company commences formal administration and the second phase from the period after the commencement of formal administration until the cessation of such administration process.[352]

347. Ferriell and Janger *Understanding Bankruptcy* (2013) 231. For a full exposé of the US-style automatic stay, see 231–274.
348. Eligibility is determined by the size of the company in terms of a threshold test on turnover as well as the nature of the company's business. See Fletcher *The Law of Insolvency* (2009) 206–507; Rajak *Company Rescue and Liquidation* (2013) 83–85.
349. Fletcher *The Law of Insolvency* (2009) 509. Also see Rajak *Company Rescue and Liquidation* (2013) 70–73.
350. Fletcher *The Law of Insolvency* (2009) 509–510.
351. Sch. B1: Insolvency Act, 1986.
352. Sch. B1, para 44. For the two phase moratorium procedure, see Fletcher *The Law of Insolvency* (2009) 539; Rajak *Company Rescue and Liquidation* (2013) 70–73.

The effect of a moratorium during the administration process includes, *inter alia*, a prohibition on the company passing a resolution for its winding-up, no landlord to whom rent is payable may exercise any right of forfeiture in relation to the premises except with the consent of the administrator or permission of the court, and no step can be taken to enforce security or to repossess goods in the company's possession, unless with the consent of the administrator or leave of court. Fundamentally the moratorium prohibits any legal process (including legal proceedings and execution), from being launched against the company or its property without the consent of the administrator or leave of court.[353]

Secured creditors can be granted leave to allow a secured creditor to enforce its security, or to enable an owner to repossess goods in the possession of the company during the period when an administration order is in force. The UK courts, when considering such an application, generally attempt to balance the interests of the secured creditor, as against those of the other creditors and in the light of what the administrator proposes, and any progress made towards their implementation.[354]

The purpose of the moratorium is to give the administrator time to formulate proposals and lay them before the creditors, and then implement any proposals approved by creditors.[355]

In Australia, the appointment of the administrator in terms of a voluntary administration results in a stay of action and proceedings against the company and its property.[356] The moratorium extends to lessors of property used or occupied by the company, as well as secured creditors and suppliers of goods who have dealt with the company on a retention of title basis. The moratorium is designed to preserve the business and assets of the

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353. Paras 42, 43 and 44 of Sch. B1 of the UK Insolvency Act. Fletcher *The Law of Insolvency* (2009) 542. For an exposé of judicial approaches to the UK moratorium provisions see pp. 542–543.

354. Ibid 543. For an analysis of the basis for a lifting of the stay, see 543–546, sections 70, 71 and 72 of Sch. B1 for the basis of a lifting of the stay/moratorium in the UK Insolvency Act.

355. Para 47 of Sch. B1. See *Olympia v York Canary Wharf Limited* (1003) B.C.C. 154. In this case, the court held as follows:

> [The moratorium provisions] are intended to impose a moratorium upon the creditors of the company in order to assist the administrator in his attempts to achieve the statutory purpose for which he was appointed. They are couched in procedural terms and are designed to prevent creditors from depriving the administrator of the possession of property which may be required by him for the purpose of the administration.

Also see Lightman and Moss *The Law of Administrations and Receivers of Companies* (2011) 256–260.

356. Corporate Reform Act, 1992, Pt 5.3A, Section 440D(1) (Australia). See Anderson "Viewing the Proposed Business Rescue Provisions from an Australian Perspective" (2008) 1 (4) *PER* 13. Anderson states "in any corporate rescue system there needs to be a circuit breaker that provides a breathing space whilst a consideration is given to the prospect of saving the company". See Symes and Duns *Australian Insolvency Law* (2012) 286–291; Murray and Harris *Keay's Insolvency* (2014) 642–648 (including exceptions to the moratorium).

company as the procedure unfolds through its successive stages.[357] The moratorium applicable in Australia is for a limited time period. The standard procedure is a 28-day period and this is rarely extended to any significant degree.[358] As a result the Australian moratorium represents less interference with ex-ante contractual rights than most comparable systems.[359]

Secured creditors have a right to avoid being bound by the moratorium if the charge (security) is over the whole or substantially the whole of the property of the company.[360] A secured creditor is generally in a relatively good position to influence any outcome provided their property is necessary for the ongoing successful operation of the business. These factors have meant that there has been relatively widespread support for the Pt 5.3A provisions as they are seen as preferable to alternative systems that interfere more in creditor interests.[361]

In Canada, a major difference between the stay of proceedings under the CCAA and the stay of proceedings under the BIA is that the former is derived from a court order while the latter arises automatically upon the commencement of the proceedings. The stay provided by a court order will have the effect of restraining further proceedings in any other action, suit or proceeding against the company. The stay is effective against secured and unsecured creditors and can be very broad in its scope.[362] The stay of proceedings created by the initial court order has a maximum duration of thirty days. In order to extend the stay, a subsequent application must be brought. In both, the applicant must satisfy the court that circumstances exist that make such an order appropriate.[363]

Thus it becomes clear that the stay/moratorium on claims is a universal principle aimed at allowing companies to achieve a successful restructuring. Without it, management of the

357. Pt 5.3A is dedicated to achieving a moratorium on claims against the company and to allow the administrators to conduct investigations and meetings to determine the company's future. See Symes and Duns *Australian Insolvency Law* (2012) 286–291 and Harmer "Comparison of Trends in National Law: The Pacific Rim" (1997) 23 *Brooklyn Journal of International Law* 153.

358. Anderson and Morrison "The Australian corporate rescue provisions: how do they compare?" in Omar (ed) *International Insolvency Law: Reforms and Challenges* 246.

359. Ibid 246. Note that it is feature of the Australian provisions that they represent a minimalist interference in the rights of creditors.

360. Section 441E of the Australian Corporations Act.

361. Ibid 246. The Harmer Report argued, *inter alia*, that the moratorium was justified in that it promoted an orderly dealing with the company's affairs, recognised the debtor's interests in the assets that are subject to the security and further recognised that the particular asset that is subject to the security may be necessary for the reorganisation to be successful. See Anderson "Viewing the Proposed Business Rescue Provisions from an Australian Perspective" (2008) 1 (4) *PER* 14.

362. Section 11.02(1) and (2) of CCAA and section 69.1(1) of the BIA.

363. Section 11.02(1) and (2) of CCAA and section 69.1(1) of the BIA. See Wood *Bankruptcy & Insolvency Law* (2009) 333–334. For a full analysis of the extent of the stay of proceedings in a BIA or CCAA proceeding, see pp. 330–340.

debtor company and/or its supervisor will not be able to focus on and provide proper attention to the restructuring process, while fighting off claims from numerous creditors (secured and unsecured). The stay provides the necessary breathing space for a financially distressed company to be restructured within the framework of applicable legislation.

5.5.3 MANAGEMENT OF THE COMPANY IN THE RESCUE PROCESS

5.5.3.1 THE SUPERVISOR

The role of the supervisor[364] in the restructuring process is critical. The supervisor's job is to oversee and direct the reorganisation of the company during the restructuring process. The supervisor must interact and negotiate with directors, management, creditors, employees and shareholders. The objective is to work towards the common goal of alleviating the company's financial problems through effective decision making.[365]

The supervisor plays an essential role in the effective and efficient implementation of a restructuring process with certain powers over the debtor company, its assets and the general wellbeing of the company in his attempt to reorganise the company. He or she has a duty to protect the assets of the company and their value as well as the interests of the creditors and employees. He or she should be independent and act impartially. Most of all, the supervisor should be appropriately qualified and possess sufficient knowledge, experience and personal qualities that will ensure not only the effective and efficient conduct of the proceedings but also add confidence to the reorganisation process.[366]

The qualifications of the supervisor may vary depending on the design of a particular jurisdiction's insolvency/restructuring regime and the degree or level of supervision

364. The supervisor can include insolvency representatives, administrators, trustees, receivers, curators, judicial managers and practitioners (including business rescue practitioners). Generally a supervisor would be an individual and not a corporation, although in certain jurisdictions the latter may be appointed as a supervisor.

365. For an analysis of the role of effective decision making in a turnaround process see Pretorius and Holtzhauzen "Business Rescue Decisions Making Through Verifier Determinants: Ask the Specialists" (2013) 5(16) *SAJEMS* 468–485.

366. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 174. See specifically Part 2 III B which deals *inter alia* with aspects of qualifications, selection and appointment, oversight, duties and functions, confidentiality and remuneration. Also see World Bank *Principles for Effective Insolvency and Creditor/Debtor Regimes* (Principles D7 and D8) dealing with the role of regulatory or supervisory bodies and insolvency representatives, including expectations of fairness, impartiality, transparency and accountability. See http://sitesources.worldbank.org/INTGILD/…/ICRPrinciples-Jan2011.pdf.

required. A balance should be struck between the appointment of a highly qualified person and requirements that are too low to guarantee the quality of service provided.[367]

What is regarded as appropriate qualification will differ from jurisdiction to jurisdiction. Certain professional qualifications and examinations, licensing by a government authority, specialised training courses and certification examinations, and a minimum requirement for certain levels of expertise might become applicable. Ongoing professional education to ensure familiarity with current developments in relevant areas of law and restructuring practice could be an additional feature to ensure the maintenance of the required degree of competence.[368]

Conflicts of interest should be avoided. Independence from vested interests, whether of an economic, financial or other nature is necessary, and the presence of conflicting interests should disqualify the supervisor from appointment. The legislation should impose an obligation to disclose existing or potential conflicts of interest whether prior to or during the supervisor's appointment.[369]

The selection of a practitioner will become all important in the successful outcome of a restructuring. Generally, practitioners are selected from a pool of different candidates. Some are appointed from the ranks of the business community, from employees of a specialised governmental agency or from a private panel of qualified persons (often lawyers, accountants or other professionals).[370]

Alternatively, creditors can play a role in recommending and selecting the practitioner to be appointed, provided that the recommended person meets the required qualifications for serving the particular case. If the debtor appoints the practitioner, the prospective practitioner would usually have had a prior opportunity to become acquainted with the

367. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 174–175. Factors such as the cost of the proceedings and restructuring the pool of professionals considered to be appropriately qualified must be considered. Where there is a lack of appropriately qualified professionals, the role given to the court in the appointment and supervision of the practitioner may be an important factor in achieving the required balance.

368. Ibid 175–176.

369. Ibid 176. Conflicts of interest could arise from a number of existing relationships with the debtor company such as prior ownership of the debtor company, a prior or existing business relationship with the debtor (including being a creditor or a debtor of the company), a relationship with a creditor or debtor, a prior engagement as to representative or offeror of the company, a prior engagement as an auditor of the debtor and a relationship with a competitor of the debtor. The legislature should specify the degree of relationships that would preclude a supervisor from taking an appointment.

370. Ibid 177–178. Selection of the practitioner might be made from a list of appropriately qualified professionals at the discretion of the court, it may be made by reference to roster or rotation system (usually by an independent appointing authority) or by the recommendation of creditors or by appointment by the board of the debtor company.

prospective debtor company and its business. Thereafter, if the debtor believes such practitioner is best suited for the appointment, it can proceed to appoint such practitioner. Questions of independence as a result of this pre-assessment phase might be raised by creditors. If this becomes an issue, an alternative practitioner can be appointed.[371]

Once appointed, certain jurisdictions require a degree of oversight over the practitioner during the reorganisation process. The question of who has "management control" over the rescue process becomes an important factor in the prospects of achieving a successful rescue. The appointment of the supervisor might be effected by the creditors or by the courts. Certain decisions might require court and/or creditor approval. Reports might have to be provided to creditors on an ongoing basis. Courts might have to intervene in disputes arising in the proceedings.[372]

In addition to the reimbursement of the proper expenses incurred in the conduct of the administration of the company while it is being reorganised, the practitioner will be entitled to be remunerated for his or her services. The extent of remuneration will differ from jurisdiction to jurisdiction. Fees could be determined by statutory tariff, determined by the general body of creditors, the court or a professional body. Remuneration may be based on a time-based or commission-based system. Most importantly, remuneration must achieve a balance between risk and reward in order to attract appropriately qualified professionals.[373]

The standard of care to be employed by the practitioner is important to the efficient conduct of and confidence in the restructuring proceedings. Failure to adhere to levels of acceptable conduct could result in the personal liability of the practitioner. A balance must be achieved between a standard that will ensure competent performance of the practitioner's required duties and one that is so stringent that it invites law suits and litigation against the practitioner. This would have a significant impact on the costs of the

371. Ibid 178.

372. Ibid 178–179. The role of the supervisor in a restructuring is varied and he or she must have the powers to perform his or her duties and functions efficiently and effectively. See comments on the role of the Supervisor (Administrators and Monitors) in Wessels and De Weijs *International Contributions to the Reform of Chapter 11 U.S. Bankruptcy Code* (2015) 42.

373. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 181. For a full exposé of the different remuneration models see 181–183.

proceedings. The practitioner must be subject to the standards of conduct imposed by his or her professional body and the relevant standards set by such organisation.[374]

Another issue of liability for the practitioner will be that of personal liability for obligations incurred in the course of running the company's business while the restructuring is taking place. Personal liability of the practitioner might be a check to the incurring of debt and obligations that cannot be realistically achieved. At the same time, it might operate as an disincentive if the risk of personal liability far exceeds the fees that may be earned.[375]

He or she might require assistance from accountants, attorneys, appraisers and other professionals in the conduct of his or her duties, and/or creditor approval might be required.[376]

A supervisor/practitioner might need to be removed from the proceedings for a variety of reasons. The supervisor might have violated or failed to comply with legal duties, demonstrated gross incompetence or gross negligence, failed to disclose a conflict of interest, engaged in illegal conduct or failed to display a level of competence required from such an individual. Removal would generally have to be effected by the court at the request of the complainant, generally the creditors. Once removed, provision must be made for a successor to replace the practitioner. Legislation might have to consider the issue of the validity of the acts undertaken in the conduct of the proceedings prior to the practitioner's removal.[377]

His or her skill set is markedly different from that of a liquidator. The latter is obligated to take control of the assets of the company and realise them "at best" in order to distribute a liquidation dividend/distribution to creditors (secured and unsecured). The role of the supervisor in a restructuring scenario is one which is akin to that of director in that he or

374. Ibid 183–184. Falling short of required standards could invite civil actions for damages (in the main brought by creditors). Certain jurisdictions might require the supervisor to put up a bond of security to cover the loss of assets to the company or possible damages payable as a result of a breach of his or her duties. Insurance cover for personal indemnity liability might also be required. One must be weary of the "deep pocket syndrome": that is, the more indemnity cover available to the practitioner, the more likely he or she is to be sued.

375. Ibid 184. A practitioner might also be held personally liable for the wrongful acts of the debtor while he or she is in control and supervising the reorganisation. The extent of such liability may depend upon the level of control the practitioner exercises over the debtor's activities.

376. Ibid 185.

377. Ibid 187.

she must run the company or at least ensure that it (or portions of it) remains intact pending its final reorganisation. The skill set of such an individual is crucial and very different in each scenario.[378]

Another crucial aspect is the level of confidence stakeholders have in the supervisor and his or her ability to manage the process. If a creditor feels confident that the monitoring of the business during the moratorium period will protect creditors as well as the debtor company, such creditor will be far more comfortable and reassured in allowing the protective moratorium to come into existence.[379] Thus appropriate monitoring during the protective regime, with meaningful interaction with all stakeholders, will contribute towards a successful outcome.[380]

The supervisor's role is made much easier if there is a transparent and predictable regime in place that has incentives for gathering and dispensing meaningful information to all stakeholders. The level and degree of monitoring is dictated by decisions on certain questions to be determined in each jurisdiction, such as how long the benefits of protection should last.[381]

Generally, the moratorium and the protective regime start automatically on the filing of an application/petition or upon an order of court. Once the process has commenced, there must be a finite time frame within which the company must be restructured and exit from the process. The shorter the time period, the more intensive the monitoring. The length of time that is required for a restructuring to be completed will, in each case, be determined by the size of the company, the complexity of its business and the number of tasks/steps that are required to be undertaken by the supervisor in administering the restructuring of the company.[382]

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378. Ibid.
379. Rajak and Henning "Business Rescue for South Africa" (1999) *SALJ* 276.
380. UNCITRAL *Legislative Guide on Insolvency Law* Part 1 (2005) 13.
381. Ibid.
382. Rajak and Henning "Business Rescue for South Africa" (1999) *SALJ* 279. In the US, for example, the debtor company has the exclusive right to file a plan for the first 120 days following the coming into operation of the moratorium, whereafter anyone interested may do so. In the UK on the other hand, the administrator must, within three months of the administration order, send to all creditors a statement of the proposals for achieving the purpose or purposes for which the order was granted (see Section 23 of the UK Insolvency Act).

Further questions that should be considered when determining these time scales are as follows:[383]

- The extent and nature of the documents and other financial information that should be produced by the management of the debtor company; for example, list of employees, the terms of contracts, executory contracts etc.);

- The extent and detail required in reporting back to all stakeholders as to the progress being made and the company's chances of survival;

- The extent and nature of information that is required to be collected as to the causes of the financial distress and insolvency with a view to possibly excluding certain directors and management from further entrepreneurial activity on account of their reckless, negligent and/or fraudulent conduct.

All of these issues will ultimately determine the length of time required to complete what can become a difficult and arduous exercise and which unfortunately might still end up in the demise of the company. The supervisor is obligated to obtain as much information as possible once he or she is appointed. The time frame within which the supervisor has to effect a reorganisation of a company in financial distress is often limited, with pressure being brought to bear by aggressive creditors.

To enable the supervisor to draw up a restructuring plan in as short a time frame as possible, he or she must have immediate access to information relevant to the pertinent activities of the debtor company. The supervisor will need to assess the company's immediate liquidity needs so as to establish the need for post-commencement funding, the prospects for long-term survival of the business and whether management should remain in possession of the company, and if so, the extent and nature of such possession.[384]

383. Rajak and Henning "Business Rescue for South Africa" (1999) *SALJ* 279.

384. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 168. Detailed information required by the supervisor will include, *inter alia*, details of assets and liabilities, income and expenses, customer lists, projections of profit and loss, details of cash flow, marketing information, industry trends, the causes of the financial distress, disclosure of past transactions, outstanding contracts and ongoing court and arbitration proceedings. A fundamental aspect required by the practitioner will be the list of creditors against which claims can be verified. These lists might have to be updated during the restructuring process as claims are identified on an ongoing basis. Information provided, should of necessity be up-to-date, complete, accurate and reliable and should be provided as soon as possible after commencement of proceedings. If the debtor can meet the obligation within a short time frame, it will serve to enhance the confidence of the supervisor and creditors in the ability of the debtor to continue to manage the business while it is being restructured.

The manner in which this information is elicited from the company will be central to the ultimate usefulness of the information provided. Financial managers may not wish to provide true financial figures or might be willing to provide full and frank disclosure of the financial position of the company. Management might be concerned about publicising self-incriminatory evidence.[385] If information is being withheld by the debtor, the legislation should provide a mechanism to compel the provision of relevant information such as an enquiry or public examination procedure. Failure to provide such information should result in criminal sanction.[386]

In the US, the appointment of a case trustee (supervisor) is a rarity in a Chapter 11 case. A party can request the appointment of a case trustee at any time prior to confirmation in a Chapter 11 case. Appointments by the court will occur for several causes, including fraud, dishonesty, incompetence or gross mismanagement in the affairs of the company. A case trustee will be appointed if it is in the interest of creditors, equity holders or other parties with interests in the estate.[387]

The case trustee is responsible for management of the property of the estate, operation of the debtor's business and, if appropriate, the filing of a plan of reorganisation.[388] The court, after notice and hearing, may at any time before confirmation, upon the request of a party in interest or the US trustee, terminate the trustee's appointment and restore the debtor to possession and management of the property of the estate and the operation of the debtor's business.[389]

Alternatively, an examiner might be appointed to oversee the debtor in Chapter 11.[390] Again, this is a rarity. The role of an examiner is generally more limited than that of a trustee. The examiner is authorised to perform the investigating functions of the trustee and

385. Ibid 169

386. Ibid 170–171.

387. 11 U.S.C. Section 1104(a). See http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics; Ferriell and Janger *Understanding Bankruptcy* (2013) 718–720; Howard *Bankruptcy Overview: Issues, Law and Policy* (2002) 78–79. Also see Epstein and Nickles *Principles of Bankruptcy Law* (2007) 87–88.

388. Section 1104(a)(1)–(2) and section 704 of the US Bankruptcy Code. See http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics. Section 1106 of the Code requires the trustee to file a plan as soon as is practicable or alternatively to file a report explaining that the case be converted to another Chapter or be dismissed.

389. Section 1106(a)(3) and (4) of the US Bankruptcy Code. Section 363 of the US Bankruptcy Code outlines a trustee or debtor-in-possession's rights to use, sell or lease property of the estate. It allows companies to sell assets in order to get an influx of capital to fund reorganisation plans or allow them to continue to operate their business whilst strapped of capital. For an analysis of the section 363(b) process, see Goren "Chip away at the stone: The validity of pre-bankruptcy clauses contracting around section 363 of the Bankruptcy Code" (2006–2007) *New York School Law Review Volume 15*, 1078–1104.

390. Section 1104(c) of the US Bankruptcy Code.

is required to file a statement of any investigation conducted. The court has authority to determine the duties of an examiner in each particular case.[391]

In addition to the case trustee or examiner, the US trustee plays a major role in the monitoring of the progress of a Chapter 11 case and in supervising its administration. The US trustee is responsible for monitoring the debtor in possession's operation of the business and the submission of operating reports and fees.[392]

In a US Chapter 11 case, supervision is generally left to the debtor in possession.[393] However, common practice allows a creditors' committee to play a major role in a Chapter 11 case.[394] The US trustee appoints the committee, which ordinarily consists of unsecured creditors. The committee may consult with the debtor in possession on the administration of the case, investigate the conduct of the debtor and the operation of the business and participate in the formulation of a plan. A creditors' committee can be an important safeguard to the proper management of the business by the debtor in possession.[395]

In the UK, an administrator is generally appointed by the company, its directors or by the holder of a qualifying floating charge[396] by way of an "out of court" appointment". This is a fast-track, direct appointment and allows the company to enter into administration on a "user-friendly" basis. This process is less costly than an appointment by way of the preparation and presentation of an administrator order application.[397] Once appointed, the administrator's objective is to submit proposals to creditors for the purpose of the administration, as soon as is reasonably practicable after the company enters

391. Section 1104(c)(1) and (2) of the US Bankruptcy Code. For an analysis of the role of trustees and examiners, see Ferriell and Janger *Understanding Bankruptcy* (2013) 718–721.

392. See http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics.

393. See Ferriell and Janger *Understanding Bankruptcy* (2013) 712–713. Also see Howard *Bankruptcy Overview: Issues, Law and Policy* (2002) 78–82; Epstein and Nickles *Principles of Bankruptcy Law* (2007) 87–88.

394. Section 1106(a)(4) of the US Bankruptcy Code.

395. Section 1104(c) and 1106(a)(3) of the US Bankruptcy Code. See http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics. See 11 U.S.C. section 1102. For an analysis of the appointment of creditors' committees see Ferriell and Janger *Understanding Bankruptcy*(2013) 713.

396. Section 22–34 of Sch. B1 of the UK Insolvency Act. See Rajak *Company Rescue and Liquidation* (2013) 103–107. Additionally in the UK, the holder of a floating charge has the right to appoint the administrator (section 250 of the Enterprise Act, 2002, from 15 September 2003). The floating charge itself confers substantial protection on its holder, both by way of security for the debt, and in the measure of control conferred in relation to future funding. For the impact of the Enterprise Act, 2002 (as read with Schedule B1, para 70 of the UK Insolvency Act) on the appointment of administrators, see Rajak *Company Rescue and Liquidation* (2013) 100–103.

397. Fletcher *The Law of Insolvency* (2009) 536.

administration. The proposals are considered at creditors' meetings and voted on in terms of the regulations provided in para 53 of the UK Insolvency Act.[398]

Once appointed, administrators take control of the debtor company's property and proceed to further manage the affairs, business and property of the company.[399] To be eligible to be appointed administrator of a company the person in question must be qualified to act as an insolvency practitioner in relation to the company.[400] The administrator is obligated to discharge his or her duties in terms of the proposal approved, and in terms of any revisions to such proposals. The administrator must also comply with any directives which may at any time be given by the court in connection with any aspect of the management of the company's affairs, business or property. The administrator will carry out a review of all the company's contractual commitments, including the size of the workforce, as part of the process of devising a strategy for the rescue of the company, or the orderly disposal of its assets, including its businesses.[401]

The administrator's appointment terminates automatically after a period of one year. The appointment can be extended by the court on the administrator's application.[402]

In Australia, the administrator has control of the company, acts as its agent and exercises all the powers of its affairs.[403] The administrator's job is to investigate the affairs of the company and determine which one of the following three options would be in the creditors' best interest[404] –

- a deed of company arrangement;
- a termination of the administration; or

398. Para 3 and para 49 of Sch. B1 of the UK Insolvency Act. The creditors meeting is convened in terms of para 51 of Sch. B1 of the UK Insolvency Act. A creditors committee is established in terms of para 57 of Sch. B1. Fletcher *The Law of Insolvency* (2009) 550–565. Also see Rajak *Company Rescue and Liquidation* (2013) 113–122.

399. Para 68 of Sch. B1 of the UK Insolvency Act. Paras 70 and 71 of Sch. B1 confer important powers on the administrator in relation to the property of the company. Fletcher *The Law of Insolvency* (2009) 578. For an analysis of the powers of the UK Administrator see pp. 570–578.

400. Sch B1, para 6. For the statutory requirements attaching to qualification to practice as an insolvency practitioner see SS/388–398 of the UK Insolvency Act. See Fletcher *The Law of Insolvency* (2009) 565.

401. See para 49(1) of Sch. B1 as read with r 2.33(2) of the Insolvency Rules (para 49(2) of Sch. B1). A detailed list of matters must be dealt with by the administrator in his proposals. Fletcher *The Law of Insolvency* (2009) 578–579. See also Rajak *Company Rescue and Liquidation* (2013) 115–119.

402. Para 76 of Sch. B1. Fletcher *The Law of Insolvency* (2009) 589. See also Rajak *Company Rescue and Liquidation* (2013) 119–122. In the UK, insolvency practitioners are licensed by the Insolvency Practitioners Association (IPA), a membership body recognised for the purposes of licensing insolvency practitioners in terms of the Insolvency Act, 1986. See http://www.insolvency-practitioners.org.uk.

403. Section 437A of the Australian Corporations Act.

404. Section 438A(b) of the Australian Corporations Act. See Symes and Duns *Australian Insolvency Law* (2012) 270–271

- a winding up of the company.

If the administrator is of the view that a DOCA is a proposal that should be seriously considered by the creditors, then all creditors must be notified of the details of the deed of arrangement.[405] The administrator must place the deed of arrangement before creditors and obtain their agreement to its implementation. If the creditors agree to a deed of company arrangement, the resulting deed binds all creditors, the company and its officers.[406] The administrator thereafter proceeds to implement the terms of the deed of arrangement.[407] The voluntary administration process in Australia is run by the administrator independently of the courts. The court has a general jurisdiction to give directions and make relevant orders, although only upon application by the administrator or by other persons affected by the administration procedure.[408]

The Australian voluntary administration system places much responsibility on the administrator, and requires the administrator to act independently of the company and its management.[409] It is not a debtor-in-possession process. The administrator must manage the interests of competing stakeholders as well as the process itself. The fact that there is almost always a loss to be borne by some stakeholders creates the pressure upon the administrator as the responsible officer of the company to deal with these issues in a responsible manner which reflects the objectives of the Australian legislation and the contractual rights of the various groups.[410]

Since directors can initially appoint an administrator, the Australian legislation seeks to encourage directors to deal with the insolvency in a fast and efficient manner.[411] The

405. Section 444 of the Australian Corporations Act. See Harmer "An Overview of Recent Developments and Future Prospects in Australia" in Ziegel (ed) *Current Developments in International and Comparative Corporate Insolvency Law* (1994) 44.

406. Section 444D of the Australian Corporations Act.

407. Section 437A of the Australian Corporations Act.

408. Section 447E of the Australian Corporations Act.

409. Section 437A of the Australian Corporations Act sets out the powers of the administrator.

410. See Symes and Duns *Australian Insolvency Law* (2012) 302–311. Anderson and Morrison "The Australian corporate rescue provisions: how do they compare?" in Omar (ed) *International Insolvency Law: Reforms and Challenges* 240. See also Symes and Duns *Australian Insolvency Law* (2012) 271–272; Murray and Harris *Keay's Insolvency* (2014) 633–634.

411. Section 436A(1) of the Australian Corporations Act.

administrator must strive to achieve an outcome which enables the company to continue or maximise the returns to creditors in a speedy and low-cost manner.[412]

In Australia, the administrator has effective total control over the company. Anderson points out that a critical factor in the success of the administration process is to have confidence in the administrator:

> The role of the administrator is critical to the success or failure of the rescue regime in Australia. The administrator must have the confidence of both the creditors and the debtor company. The debtor will not use the procedure if the administrator does not have their confidence and a major point of the procedure – encouraging early dealing with the insolvency – will be lost. On the other hand the creditors must have confidence in the administrator in terms of any proposal to rescue the company, otherwise they will reject any plan proposed. Having an administrator with very wide powers of control overcomes some of the criticism of the American model of rescue where the debtor remains in possession as a general rule.[413]

In Canada, the monitor under the CCAA proceedings and a trustee under the BIA restructuring proceedings fulfil a similar, though not identical role. The monitor is under a statutory obligation to monitor the business and financial affairs of the company.[414] The trustee is under a statutory obligation to make an appraisal and investigation of the affairs and property of the debtor so as to enable him or her to estimate with reasonable accuracy the financial situation of the debtor and the cause of the debtor's financial difficulties or insolvency, and report the result of the investigation to the creditors.[415]

The monitor and the trustee are given a right of access to and examination of the debtor's property, including premises, books, records and other financial documents for the purpose of monitoring the debtor's business and financial affairs. Ultimately the monitor must advise the court on the fairness or reasonableness of any proposed plan or alternatively advise the court immediately if the monitor is of the opinion that bankruptcy proceedings would be more beneficial to the company. Courts have further provided monitors with the power of management over the business or the power to sell the business as a going concern. Courts are sometimes reluctant to provide such powers to the monitor because

412. Section 437A of the Australian Corporations Act. See Anderson and Morrison "The Australian corporate rescue provisions: how do they compare?" in Omar (ed) *International Insolvency Law: Reforms and Challenges* 246. Supervision of the administration is conducted by the Australian Securities and Investments Commission (ASIC).

413. Anderson "Viewing the Proposed Business Rescue Provisions from an Australian Perspective" (2008) 1 (4) *PER* 17.

414. Section 11.7(1) and section 23(1) of the CCAA sets out specific statutory duties of the Monitor and the trustee's duties under a BIA are set out in section 50(5).

415. Section 23(1) of the CCAA and section 50(5) of the BIA. Wood *Bankruptcy and Insolvency Law* (2009) 388–392.

when the monitor becomes involved in the making of business decisions that have a differential impact on the various stakeholders, there may be a perception that the monitor has entered the fray and can no longer carry out an objective and impartial analysis.[416]

It is clear that the level of competence and skill set of the nominated supervisor is of critical importance to any successful restructuring. Such supervisor will be appointed (with or without the benefits of a pre-assessment) to quickly take control of a business which might have complex group structures, multiple subsidiaries and high levels of turnover. In addition, such a supervisor will have to get acquainted with the financial position of the company, the continued need for employees, identify prejudicial contracts, consider offers from third parties and attend to numerous other functions expected of him or her in the restructuring process.

One may well ask whether this is a task for one person or rather for a team? After all, the supervisor cannot transpose his abilities overnight into a company and hope that all goes well. The concept of debtor in possession and the need to appoint an independent supervisor give rise to difficult questions which must be taken very seriously by any rescue system.

5.5.3.2 DEBTOR

A major issue in the conduct of a restructuring process is how and by whom the business of the company should be administered during the protection period. Any jurisdiction considering a system for reorganisation will have to consider who should take charge of the company during the protected period and what powers should be exercisable by the debtor company during the period when it is under the protection of the moratorium.[417]

The question needs to be asked: does one need a supervisor at all? Can the reorganisation not be left to the management of the debtor company?

416. Ibid 390–391.
417. Rajak and Henning "Business Rescue for South Africa" 1999 *SALJ* 282.

Different jurisdictions adopt different approaches to the role of the debtor in a reorganisation proceeding. Where the business is being reorganised, there is a clear need for the debtor to remain involved in the management of the company.[418]

Management of the debtor company will also have an important role to play in assisting the supervisor to enable him or her to perform their duties in respect of the restructuring process. The provision of financial and other pertinent information will in the main be provided by management to the practitioner on an ongoing basis throughout the reorganisation, as stated in the UNCITRAL Guidelines:[419]

> In reorganisation proceedings, there is no agreed approach on the extent to which displacement of the debtor is the most appropriate course of action and, where some level of displacement does occur, on the ongoing role that the debtor may perform and the manner in which that role is balanced with the roles of other participants. That ongoing role may depend in large part upon the debtor acting in good faith during the reorganisation proceedings; where it does not, its continuing role may be of questionable value. It may also depend upon the existence of a strong, independent governance regime that can address incompetent or self-serving behaviour.[420]

There are a number of potential advantages in allowing the debtor to have an ongoing role in management, namely: [421]

- In many cases, the debtor's management will have immediate and intimate knowledge of the debtor's business and the industry within which it operates;

- Knowledge of the debtors company's business by management will be invaluable in assisting the practitioner in making short-term day-to-day management decisions;

- The debtor's involvement will assist the practitioner with a more immediate and complete understanding of the operation of the debtor's business. This assists in the drafting of the reorganisation plan;

- Total displacement of the debtor's management, notwithstanding their role in the financial difficulties of the business, may eliminate an incentive for the continuation

418. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 161.

419. Ibid.

420. Ibid 162. The advantages of a continuing role in management by a supervisor will also depend on who commenced the proceedings. If it was commenced by creditors, the debtor might be uncooperative or hostile. The decision to displace management in favour of a supervisor will depend to a large extent on the local corporate culture and the level of effectiveness of the applicable insolvency regime.

421. Ibid 162–163.

of the company's entrepreneurial activities, the incentive for risk taking in general and for debtors to commence reorganisation procedures at an early stage. This would all serve to undermine the prospects of success of the reorganisation.

The disadvantages of allowing the debtor and its management to have an ongoing role are as follows:[422]

- Creditors have a lack of confidence in the management of the debtor on account of the financial difficulties of the business and the role that such persons may have played in causing those difficulties. As a result, there is a need for confidence building if the reorganisation is to be successful;

- Permitting the debtor to continue to operate the business with insufficient control over its powers may not only accelerate the breakdown of confidence, but may also antagonise creditors further. The status and confidence in the jurisdiction's corporate governance regime and the responsiveness of the debtor to such regime will be a factor in supporting the debtor's continued involvement. Where there is no effective governance regime, creditors may prefer an appointed insolvency representative to displace the debtor or to insist on significant supervisory powers over the debtor;

- A system which is perceived to be pro-debtor may result in creditors being apathetic about the reorganisation proceedings and unwilling to participate. This may lead to an adversarial clash between creditors and the debtor, with the supervisor caught up between these two factions;

- A debtor may have its own agenda that clashes with the objectives of the insolvency regime and in particular with the maximisation of returns for creditors. This might manifest itself in the debtor's overriding goal of ensuring that it does not lose control of the business rather than be concerned about looking after the interests of creditors.

422. Ibid 163. A related factor that should be considered is whether the proceedings were commenced on application of the debtor or of creditors (in which latter case, the debtor may be hostile to creditors).

Whether a debtor should remain in control of a failing and distressed business remains an ongoing debate around the world. Views vary between support for displacing the debtor and appointing a practitioner at the one end of the scale, and allowing the debtor to remain in control of the business with minimum supervision at the other. A hybrid or intermediate approach is to provide for a supervisor/practitioner to be appointed to exercise some level of supervisory function as well as for retention of existing management. The choice between these options has implications for the structure of the restructuring regime and in particular for the balance to be achieved between the various participants and stakeholders. What is required is a system of "checks and balances", whether provided by the legislation, the court or creditors.[423]

Total displacement of the debtor and its management may cause disruption to the business and cause repercussions detrimental to its continuing operation at a critical point in its survival.[424]

Intermediate approaches establish different levels of control between the debtor and the practitioner. Some broad supervision by the practitioner is required, including approval of significant transactions, while the existing management continues to operate the business and take decisions on a day-to-day basis. Precise rules are required so that management and the practitioner are clear on their respective responsibilities and certainty is created in the reorganisation process.[425]

The alternative approach is to allow full control by the debtor and its management. This is what is known as a "debtor in possession" or "DIP" process. Where this occurs, legislation must stipulate the functions of the practitioner in such a process. In certain circumstances, this approach may enhance the chances of a successful reorganisation by building on the debtor's familiarity with the business provided. Such a regime can be relied upon if

423. Ibid 164.

424. Ibid. The attrition of senior management and in particular CEOs of companies operating in reorganisations has been considered. In the US, studies have shown that the level of CEO turnover remains consistent (from 2001) whether a firm operates inside or outside of a Chapter 11 process. See Bernstein "All's Fair in Love, War and Bankruptcy? Corporate Governance Implications of CEO Turnover in Financial Distress" (2006) 11 *Stanford Journal of Law, Business and Finance* 1.

425. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 164. Some jurisdictions specify that certain transactions, such as entering new debt structures, transferring or pledging assets and granting rights to the use of property of the company can be undertaken without the consent of the practitioner or the court provided they are undertaken in the ordinary course of business. If not, consent is a requirement. Where management fails to observe these restrictions, the legislation will need to deal with the validity of such transactions and provide appropriate sanction for the debtor's behaviour.

business is continued in an honest and transparent manner and where creditors continue to have trust in existing management.[426]

The disadvantages to this approach would be where assets continue to be diminished by management who care about their own interests and not those of the creditors or the company. The debtor may act irresponsibly and even fraudulently while the company remains under its control. This undermines the reorganisation process as well as the confidence of creditors. These difficulties can be mitigated by requiring regular reports from the debtor, appointing a supervisor to monitor the process, or giving creditors a significant role in supervising or overseeing the debtor.[427]

"Debtor in possession" does not always mean that original or existing management remains in control. Existing management can be replaced during the reorganisation with new, more competent management who are able to competently assist the development and implementation of the reorganisation plan.[428]

If debtor management is replaced, legislation must provide for an obligation on the part of the debtor to cooperate and assist the supervisor in the performance of his or her duties. The supervisor must be allowed to take effective control of the assets, business records and books of account. This would enable the practitioner to be in a position to properly understand the nature of the company's business, the extent of its creditors as well as an identification of its assets, debtors books, level of employee obligations and a general ability to analyse the prospects of the business and reorganisation.[429]

In the US, debtor in possession applies.[430] The system implies no change in the administration of the debtor company while it is being restructured. The existing board of directors remains as much in control as it was before the commencement of the

426. Ibid 166.
427. Ibid.
428. Ibid.
429. Ibid 168. The debtor must have a continuing obligation to provide detailed information regarding the company's business and financial affairs over the historical period as well as in the period following the commencement of the restructuring proceedings. The quality of this information will enable the supervisor to assess the extent of the debtor's involvement and whether management is qualified to continue to lead the business in the process.
430. In most cases, it is the debtor that initiates the case by filing a bankruptcy petition (creditors would file an involuntary petition) – see section 6.01(A) for a voluntary commencement and section 6.01(B) for an involuntary commencement.

moratorium. Management continues to run the debtor company's business. This is indeed a radical approach.[431]

The US Bankruptcy Code makes it clear where an estate is managed by a debtor in possession or "DIP", the DIP has all the statutory powers of the trustee in bankruptcy.[432]

In the US the term "debtor" rather than "the bankrupt" is used to avoid the stigma of a business debtor being labelled "bankrupt". Thus the term "debtor in possession" implies that the management of the debtor remains in possession.[433]

A new entity, the DIP, is created whenever a debtor files a case under Chapter 11. The debtor (and its management) becomes a debtor in possession because there is normally no case trustee appointed to administer the debtor's estate. Literally, the debtor's management remains "in possession" of the estate's property and remains responsible for managing the estate's financial affairs while the case is pending.[434]

The DIP is a primary participant in the reorganisation and has many of the powers and functions of the trustee and conducts whatever negotiations precede the filing of a plan of reorganisation. The DIP is responsible for deploying the estate's assets for the benefit of its creditors, including taking action against officers, directors, shareholders and other insiders of a corporate debtor who might have received preferential transfers before the Chapter 11 case commenced.[435]

The DIP is placed in a position of a fiduciary and the DIP's duties are specific, including accounting for property, examining and objecting to claims and filing information reports as required by the court and the US trustee (including monthly operating reports). The DIP has the right, with the court's approval, to employ attorneys, accountants, appraisers,

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431. Rajak and Henning "Business Rescue for South Africa" (1999) *SALJ* 282. See Salerno, Hansen and Meyer *Advanced Chapter 11 Bankruptcy Practice* Volume 1 (1996) 260. Under Chapter 11, there is a presumption that the debtor remains in possession. As such, the debtor is known as the debtor in possession (DIP) and as an entity legally distinct from the debtor.

432. Ferriell and Janger *Understanding Bankruptcy* (2013) 120–121. See section 1107 of the US Bankruptcy Code.

433. Ferriell and Janger *Understanding Bankruptcy* (2013) 121. Also see Howard *Bankruptcy Overview: Issues, Law and Policy* (2002) 78–79; Epstein and Nickles *Principles of Bankruptcy Law* (2007) 87–88; Salerno, Hansen and Meyer *Advanced Chapter 11 Bankruptcy Practice* Volume 1 (1996) 260. The DIP is the entity that is initially in charge of the administration of a Chapter 11 case and is the authorised representative of the estate. In a corporate restructuring, the DIP is the management (officers, directors) existing as of the date the petition is filed.

434. Ferriell and Janger *Understanding Bankruptcy* (2013) 122.

435. Section 541(a)1 of the US Bankruptcy Code deals with the specific administration of the company once the bankruptcy case is filed. See Ferriell and Janger *Understanding Bankruptcy* (2013) 123. Also see Salerno, Hansen and Meyer *Advanced Chapter 11 Bankruptcy Practice* Volume 1 (1996) 260–261.

auctioneers or other professional persons to assist the debtor during its Chapter 11 filing. The US trustee is responsible for monitoring the compliance of the debtor in possession with its reporting requirements.[436]

The Chapter 11 concept of debtor in possession has been criticised over the last few years:

> Chapter 11 itself has become controversial in recent years. In the view of some commentators, Congress went much too far in giving control of the Chapter 11 debtor to the debtor in possession, and indeed of the whole Chapter 11 process to the debtor's pre-bankruptcy management. The debtor's managers may be unduly optimistic about the prospects of reorganisation. Worse still is the problem of "moral hazard". This phrase refers to the effects that protection against loss has on risk-taking. The owners and managers of a debtor will have neither equity nor jobs if the debtor is liquidated; if it is reorganized, they may salvage both. Given the fact that the company is probably insolvent, they have nothing to lose and much to gain; the managers at least may keep their salaries a little longer if the company's demise can be postponed. In this situation, management is tempted to take wild chances in the hope that some miracle might yet save the company. This problem arises even before bankruptcy but may be exacerbated by it.[437]

Giving creditors too much power and control in a distressed debt situation is open to controversy. In the US, there is a perception that the Chapter 11 concept of debtor in possession provides too much leeway to the company being reorganised. Herbert was of the view that the legislature recognised that a Chapter 11 filing would place a management team already familiar with the company's business into a position where it would be more likely to reorganise a troubled firm successfully than would a newly appointed trustee.[438]

> This presumption favouring management's continued control, when combined with other provisions of Chapter 11 … effectively gave managers powerful incentives to pursue bankruptcy reorganisation. Managers are more likely to keep their jobs by

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436. See http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics. Also see Salerno, Hansen and Meyer *Advanced Chapter 11 Bankruptcy Practice* Volume 1 (1996) 260–261. Gross *Failure and Forgiveness: Rebalancing the Bankruptcy System* (1997) 31–32 has the following to say on this issue:

> One of the most significant features of a Chapter 11 case, which distinguishes this chapter from most other chapters of the Code, is that a debtor's management is entitled to remain in place and continue to run the business. Except for situations involving fraud or misconduct, a trustee or examiner is not appointed. The Chapter 11 debtor is termed a debtor-in-possession, or DIP (more than one joke has been made about the appropriateness of the acronym). Many people are startled by the notion that the Code permits the very folks who got the debtor into financial trouble to lead the charge to get it out of trouble. There are several reasons for allowing management to remain in control. First, a debtor's existing management knows a great deal about the business. The debtor remains under the watchful eye of the court, creditors, and the United States Trustee, which is the arm of the Justice Department charged with overseeing the administrative aspects of the bankruptcy process. Keeping existing management in place is efficient, as it would take time and money to educate someone else about the debtor's business. Although numerous critics have charged that Chapter 11 serves only to keep existing management entrenched to the detriment of creditors, managers of large financially troubled companies are frequently replaced just before or during a large case. Bringing in new management is generally well received by creditors because it demonstrates a visible effort to right a sinking ship.

Also see Granfield, O'Neal and Mehok *International Insolvency and Bankruptcy* (2008) 2913–2915.

437. Herbert *Understanding Bankruptcy* (1996) 304.

438. Ibid 305 (quoting Bradley and Rosenzweig "The Untenable Case for Chapter 11" (1992) 101 *Yale LJ* 1043).

> reorganizing rather than liquidating their firm, and during reorganization they can operate without the constraints ordinarily imposed by creditors.[439]

Critics of the Chapter 11 process vary in their approaches. Some call for minor reform that proposes that greater power should move away from the debtor to both creditors and the court.[440] Levin and Klee state as follows:

> In the reform debate in the United States, there is little serious questioning of the self-administration (debtor in possession) model. First, the original reason for adopting the self-administration models still applies today. Management is less willing to commence a reorganization case if it knows that it will lose its employment immediately upon doing so, especially in small, closely-held corporations where there is an identity between owners and managers. Admittedly, there are many other reasons that deter management from opening a reorganization case, such as denial and terminal optimism. Still, removing one impediment is useful in encouraging management to confront financial problems and seek the protection that insolvency proceedings can provide.[441]

In the US, business failure is very often thought of as a result of misfortune rather than wrongdoing. The US is, after all, a pioneering country where the taking of risks is thought to be a good thing and creditors, often unfairly, are perceived as being greedy. This philosophy differs from that existing in other jurisdictions.[442]

In the US, the legislature left management in charge through a Chapter 11 reorganisation; even though a trustee or examiner can be appointed, this does not often happen.[443] Secured creditors (unlike in the UK) do not receive much sympathy from the public or the courts and are often seen as the oppressor of the enterprising debtor. Focus remains on the rescue of the corporation and its business. Preservation of the corporate entity is the aim.[444]

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439. Ibid 305–306.

440. Ibid 306.

441. Levin and Klee *Rethinking Chapter 11* (International Insolvency Institute, 12th Annual International Insolvency Conference, Paris, France, 21–22 June 2012) 3. The authors were of the view that self-administration does not necessarily leave management that was responsible for failure in place. In recent major filings for Chapter 11, such as Enron, Worldcom and Lehman Brothers, senior management were replaced soon after the commencement of the process. In certain cases where fraud had taken place, it was necessary to place experienced turnaround managers in control, who had little choice but to assume the role of CEO or Chief Restructuring Officer.

442. Moss "Chapter 11 – An English Lawyer's Critique" (1998) 11(3) *Insolvency Intelligence* 2.

443. In a Chapter 11 case, a trustee would rarely be appointed. If there is "fraud, dishonesty, incompetence or gross mismanagement" of the debtor or its assets, and the court determines that the appointment of a trustee is "in the interests of creditors", such a trustee will be appointed – section 1104(a) and section 19.03(D) of the US Bankruptcy Code. Also see Ferriell and Janger *Understanding Bankruptcy* (2013) 126–129.

444. Moss "Chapter 11 – An English Lawyer's Critique" (1998) 11(3) *Insolvency Intelligence* 2–3. Also See Salerno, Hansen and Meyer *Advanced Chapter 11 Bankruptcy Practice* Volume 1 (1996) 270–271 for an analysis of the general principles regarding governance of an entity in a Chapter 11 case.

The US Chapter 11 system has, as its biggest criticism, the concept of "debtor in possession" – it has been said that it is like leaving alcoholics in charge of the pub.[445] Commentators on the Chapter 11 process have, however, suggested that this concept is not that peculiar. In most cases, management will already have changed from the directors who may have acted improperly or unwisely in the management of the company. Management may very well change during Chapter 11 proceedings as a result of creditor pressure. In reality, in Chapter 11 proceedings the same directors are not left in charge of the ailing company in many instances.[446]

The debtor in possession (the management of the company) continues to operate the company's business during the course of its reorganisation. The debtor in possession becomes an officer of the court in this process and has a fiduciary duty to protect and preserve the assets of the estate and to administer them in the best interests of its creditors.[447]

The US Trustee's Office would monitor the debtor's activities during its reorganisation. The United States Trustee should be distinguished from the case trustee appointed in a Chapter 11 case. The former is an agent of the US government and is part of the US Department of Justice. The latter serves an administrative function in individual bankruptcy cases.[448]

If a case is made out, the court may also appoint a trustee for cause, including fraud, dishonesty, incompetence or gross mismanagement.[449] The court generally does not involve itself with the day-to-day management of the debtor's affairs, and when court approval is required, the court generally defers to the debtor's business judgement.[450]

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445. Moss "Chapter 11 – An English Lawyer's Critique" (1998) 11(3) *Insolvency Intelligence* 3.

446. See sections 1107, 1203 and 1303 of the US Bankruptcy Code. For a full analysis of the role of existing management in a Chapter 11, see Herbert *Understanding Bankruptcy* (1996) 307-308. Another important criticism is that of the overt role of shareholders in a Chapter 11. In reality, there is nothing really left for shareholders: Chapter 11 proceedings allow shareholders to use blocking tactics so as to extract value from the distressed company, from which, on an equitable basis, they should in fact receive no benefit. For a discussion on shareholder/equity holder's role in a Chapter 11, see Herbert *Understanding Bankruptcy* (1996) 310–311. The ability of shareholders to extract money or assets in a Chapter 11 proceeding arises from the complicated and bureaucratic system of classes of creditors. See Moss "Chapter 11 – An English Lawyer's Critique" (1998) 11(3) *Insolvency Intelligence* 3–4; Wessels and De Weijs *International Contributions to the Reform of Chapter 11 U.S. Bankruptcy Code* (2015).

447. See sections 1107, 1203 and 1303 of the US Bankruptcy Code. Leonard *Restructuring and Insolvency – Getting the Deal Through* (2013) 518 at para 12.

448. Ferriell and Janger *Understanding Bankruptcy* (2013) 128.

449. Section 1107 of the US Bankruptcy Code.

450. Leonard *Restructuring and Insolvency – Getting the Deal Through* (2013) 519. See Ferriell and Janger *Understanding Bankruptcy* (2013) 126–128.

The automatic stay in the US is broad in scope and applies to all types of creditors' actions against the debtor company, its property and estate.[451] Under certain circumstances, a creditor can apply to a court for relief from the automatic stay.[452] Debtor-in-possession financing ("DIP financing") is available on a post petition basis.[453] This can be obtained by the company without court approval. Lenders might obtain a "superpriority" claim for such DIP finance which has priority over all other administrative priority and unsecured claims. The US Bankruptcy Court may appoint an examiner to oversee the operations of the debtor and this waters down the notion that the board always continues to run the company under Chapter 11 proceedings.[454] An examiner's role is to investigate "fraud, dishonesty, incompetence, misconduct, mismanagement or irregularity".[455]

The reorganisation model requires a shift in the balance of power from company management to a supervisor, with or without continued court intervention. Business reorganisations in the US typically leave the debtor in control of the distressed company for good reason. Management is best suited to repair its business and work out a new payment schedule with creditors.[456]

The basic approach encouraged by the US Bankruptcy Code is the same as that found in preventative medicine: companies, like people, fare better if their maladies are treated sooner rather than later. The principle is that while there is still meat on the bone, a number of advantages remain available[457] –

- Honest management would not have to give up control of the business;[458]

- The company could get specialised assistance to solve its problems; consultants can be effective more quickly because management knows more about the business than would a trustee;

451. Section 362 of the US Bankruptcy Code.
452. See Ferriell and Janger *Understanding Bankruptcy* (2013) 238–249.
453. Section 364 of the US Bankruptcy Code. See Ferriell and Janger *Understanding Bankruptcy* (2013) 732.
454. Section 68 of the US Bankruptcy Code. See Leonard *Restructuring and Insolvency – Getting the Deal Through* (2013) 519.
455. Sections 1104(c) and 11046(a)(3) of the US Bankruptcy Code. See Ferriell and Janger *Understanding Bankruptcy* 718–720.
456. Rochelle "Lowering the Penalties for Failure: Using the Insolvency Law as a Tool for Spurring Economic Growth: The American Experience, and Possible Uses for South Africa" (1996) *TSAR* 326.
457. Rochelle "Lowering the Penalties for Failure: Using the Insolvency Law as a Tool for Spurring Economic Growth: The American Experience, and Possible Uses for South Africa" (1996) *TSAR* 326–327.
458. In the US, Chapter 11 US C 1104(a) requires that a debtor in possession will be replaced by a trustee only for cause, including fraud, dishonesty, incompliance or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or if such appointment is in the interests of creditors.

- The company would get relief from creditor harassment, allowing management to dedicate its time to fixing its business while remaining in possession;

- Truly successful reorganisations can solve problems and leave ownership intact undiminished by creditors' claims;

- Even in situations where reorganisation takes the form of selling off assets, having that process led by management and owners, rather than liquidators, is an emotionally more satisfying way of ending things, giving a sense of closure and duty done.

Additionally, the debtor in possession approach recognises that a company's problems are not always that of the debtor or the debtor's fault. Reasons for financial distress range from markets shifting too rapidly for a timely response, interest rates moving too rapidly and new competitors changing a whole industry's economics.[459]

The US Bankruptcy Code and case law mention that in principle, the debtor must become a trustee of itself, for the benefit of its creditors. It has all the same duties with respect to creditors as the trustee, including the duties of disclosure. If a debtor in possession is faced with a choice between taking an action which will benefit itself only, and one which will benefit its creditors only, it will be obliged to choose the course which benefits its creditors. Clearly, being a debtor in possession is not an easy position, and debtors often find it unnatural to prefer their creditors' interests over their own.[460] Such, however, is the bargain which the debtor makes when it files for Chapter 11 protection. An early start in the Chapter 11 process is essential. This assists in obtaining early court protection before it becomes too late to save the company and its business. However, the early start needs to be weighed up against the undesirable length of the proceedings.[461] An early commencement often contributes to the incentive of becoming a debtor in possession. In the US, there is no

459. Rochelle "Lowering the Penalties for Failure: Using the Insolvency Law as a Tool for Spurring Economic Growth: The American Experience, and Possible Uses for South Africa" (1996) *TSAR* 327.

460. Ibid. In the UK the Courts see such a failure as a breach of fiduciary duties on the part of a director and sanctions against such behaviour are stringent. For an excellent comparison between the US Chapter 11 process and the UK administration procedure, see Westbrook "A Comparison of Bankruptcy Reorganisation in the US With the Administration Procedure in the UK" in Leonard and Besant (eds) (1994) *Current issues in Cross-Border Insolvency and Reorganisations* 33-40.

461. Ibid.

real effective sanction against management for wrongful trading and disqualification proceedings if management leaves the commencement date too late.[462]

The debtor-in-possession model in the US is unlikely to change anytime soon:

> The self-administration model is likely to survive, and the restrictions on a debtor in possession are likely to continue to come from the private sector, rather than from a government-appointed fiduciary. However, the roles are likely to be rebalanced to take account of the appropriate interests of each class of creditors in protecting their own positions while respecting the rights of other classes. The re-balancing will be a delicate operation. As in the past, it will undoubtedly require further re-balancing as experienced practitioners gain and exercise a better understanding of the leverage that their positions give them.[463]

The situation is quite different in the UK, where a licensed insolvency practitioner is appointed. Here, the insolvency practitioner takes complete control of the debtor to the exclusion of the directors of the company.[464]

In practice, the contrast is not as stark. It is common in the UK for the insolvency practitioner to seek the assistance of the debtor where appropriate and where such assistance can be relied upon.[465]

In the UK the administrator acts as the company's agent and may do anything that is necessary or expedient for the management of the affairs, business and property of the company.[466] Administrators will usually look to continue the company's business at least for a limited period of time. In doing so, the administrator may elect to dispose of assets subject to floating or fixed charge security or to engage in purchase, retention of title or leasing agreements.[467]

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462. Ibid.

463. Levin and Klee *Rethinking Chapter 11* (International Insolvency Institute, 12th Annual International Insolvency Conference, Paris, France, 21–22 June 2012) 6.

464. Powers of an administrator are set out in para 59, Sch. B1 to the UK Insolvency Act. Smits "Corporate Administration: A Proposed Model" (1999) 32 *De Jure* 89. Also see Fletcher *The Law of Insolvency* (2009) 549. Although the directors are not automatically dismissed from office as a consequence of the company going into administration, the corollary to the transfer of all managerial power to the administrator is that the powers of the directors are suspended for the duration of the administration. The administrator also has the power to remove any director of the company and to appoint any person to be a director of the company. The composition of the board will depend upon the administrator's personal judgement regarding the company's needs and the best way to achieve the purpose of the administration. For a full analysis of the administrator's conduct of the administration in the UK to exclusion of the debtor's management, see pp. 578–589.

465. See Fletcher *The Law of Insolvency* (2009) 549–550.

466. Keay and Walton *Insolvency Law: Corporate and Personal* (2003) 116. See Schedule 1 of the UK Insolvency Act.

467. See paras 70 and 71 of Sch. B1 of the UK Insolvency Act which deals with the power to deal with charged property subject to any floating charge or other security. Keay and Walton *Insolvency Law: Corporate and Personal* (2003) 117.

However, any statute administrator pursuing a rescue strategy will need to involve the company in his or her thinking. In considering whether to trade, administrators should consider their duty to the company's creditors as a whole.[468] In administration, the administrator acting as the party in control, has a duty not to harm the interests of unsecured creditors unnecessarily. In administration, the benefit to the creditors as a whole or the avoidance of unnecessary risk to creditors may on occasion justify trading even though a break-up sale is ultimately expected. The important notion is that the decision to trade lies with the administrator to the exclusion of the management of the company. The administrator must evaluate the risks and rewards of such a strategy.[469]

In the UK there is a parallel regime to administration. This is the CVA[470] and it is available for less contentious debtor restructuring. Here the directors of the company remain in control of the debtor company. The CVA allows the appointment of a licensed insolvency practitioner to act as a supervisor rather than as a chief executive.[471]

Similar to the UK regime, the voluntary administration process in Australia is left to the administrator. The debtor company does not take over the process like in the US. As agent of the company, the administrator has general control of the company's business, affairs and property and can perform any function that the company would perform if it were not under administration.[472] If a DOCA is concluded, the administrator exercises a supervisory role while such DOCA is being negotiated. Once the DOCA is implemented, the administrator will attend to the implementation of the debt restructuring in terms of such DOCA.[473]

The Australian legislation (Pt 5.3A of the Corporations Act, 2001) places all control in the hands of the qualified insolvency practitioner (administrator) to the exclusion of the debtor and its management.[474]

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468. Lightman and Moss *The Law of Administrations and Receivers of Companies* (2011) 177.
469. Ibid.
470. Section 1–7 of the UK Insolvency Act. See Ferriell and Janger *Understanding Bankruptcy* (2013) 469–510.
471. The appointment of a "nominee" – section 1(2) of the UK Insolvency Act. Lightman and Moss *The Law of Administrations and Receivers of Companies* (2011) 177. Also see Rajak *Company Rescue and Liquidation* (2013) 3–74.
472. Sections 436A and 436B of the Australian Corporations Act.
473. Section 437A of the Australian Corporations Act. Murray and Harris *Keay's Insolvency* (2014) 677–685. Also Symes and Duns *Australian Insolvency Law* (2012) 296–311.
474. Section 436A(1) of the Australian Corporations Act. Harmer "Comparison of Trends in National Law: The Pacific Rim" (1997) 23 *Brooklyn Journal of International Law* 152, states the following:

The Australian administrator's role is critical and much responsibility is placed on him or her to achieve a successful reorganisation. However, the lack of debtor involvement in this process has been criticised:

> While creditor participation is important, it is also worthwhile to consider directors' participation in corporate rescue. It is beneficial to a financially distressed company if the voluntary administrator actively communicates with the directors in order to facilitate information flow. Often the directors of a distressed company are the most appropriate people to provide details on the company's true financial position (despite the fact that they may be personally liable for causing such financial distress). It is a positive outcome for the VA if the voluntary administrator can draw on the directors' expertise on the company's day-to-day operations and true financial position.[475]

In Canada, in a CCAA or BIA proceeding, the assets of the debtor remain under the control of the debtor, but the curator or trustee obtains control over the management of the business.[476] Thus restructuring proceedings in Canada diverge from other models in that the debtor retains ownership and control of the business assets. The debtor thus has the ability to operate the business while the restructuring proceedings are under way.[477]

The CCAA expressly gives the court the power to direct a monitor to advise the debtor company in the development of its plan and in respect of its negotiation with creditors. In a BIA, the trustee is expressly given the power to advise the debtor and participate in the preparation of the proposal, including negotiations with creditors.[478]

The monitor or trustee therefore is given two essential functions. The first is to provide an independent assessment of the business and financial affairs of the debtor that can be relied upon by the court and by the creditors. The second is to assist the debtor in navigating through the complexities of restructuring proceedings. The monitor or trustee must attempt

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The Intervention of a Qualified Licensed Administrator. This functionary (considered to be important in the Australian environment) is appointed by the directors to take control of the company and its property. The administrator becomes the pivotal force of the procedure. The administrator is required to carry out an investigation into the financial position and affairs of the company and, ultimately, to make a recommendation about the future of the company. This would normally involve a recommendation that either the company be liquidated or that terms of an arrangement between the company and its creditors be considered and possibly adopted by the creditors. The "management" of the company is suspended from ultimate control of the affairs of the company, though it may remain in office and continue to operate the business of the company under the control of the administrator. Both management and equity holders may seek to influence the terms of a possible arrangement for the company, but they do not control the forum for that purpose.

475. Wong "Corporate Rescue in Australia and the US: A Comparative Study" (2009) *Norton Journal of Bankruptcy Law and Practice* 547.

476. Section 23(1) of the CCAA and section 50 of the BIA. See Wood *Bankruptcy and Insolvency Law* (2009) 377–380 on the sale of assets.

477. Ibid 315–316 and 392–393.

478. The difference between the CCAA and the BIA is that the former has a much higher degree of court involvement and a greater degree of judicial discretion or "flexibility" – the BIA is more rule driven and less adaptable to large and complex restructurings – See Wood *Bankruptcy and Insolvency Law* (2009) 394–399. Also see Yamauchi "Evolution, Revolution or Nothing at All? Recent Reforms to Canadian Bankruptcy and Insolvency Legislation" (2006) 15 *International Insolvency Review* 179.

to guide the debtor through the process without becoming an advocate or mouthpiece for the debtor.[479]

Particularly where a debtor is a closely held corporation, the trustee or monitor will need to work closely with management. Management often possesses firm specific knowledge and expertise, which makes it necessary to retain them as participants in the restructured business. The debtor does not lose control over the management of its business during the period in which the restructuring proceedings are ongoing. However, the initiation of restructuring proceedings undeniably changes the environment within which the debtor manages its business.[480] The debtor and its management must therefore work closely with the monitor, insolvency professionals and expert legal advisors and must engage in a series of negotiations with claimants in order to develop an acceptable plan.[481]

In Canada, legislation allows the debtor to remain in possession, but appoints a trustee to keep a watchful eye over its operations. The same applies in Germany and France.[482]

In summary, it is widely believed that some form of external monitoring is required in a restructuring process. The opportunity for a restructuring managed by a third party practitioner together with directors who are able to continue to operate an insolvent business might have positive benefits for companies in distress.[483]

Furthermore, there is no real benefit in completely shutting out the existing management of the company during the moratorium. By doing so, one reduces the benefit of obtaining experienced management who can assist the practitioner in the restructuring of the company.[484]

Advocates for a debtor in possession regime would argue strongly for a regime where directors and management are aware that once a restructuring/rescue regime commences, they will not be cut out or cast aside. Certain debtors will no doubt be reluctant to seek the assistance of a practitioner when it may result in a regime from which they will be

479. Section 23(1) of the CCAA and section 50 of the BIA. See Wood *Bankruptcy and Insolvency Law* (2009) 392–393.
480. See section 23(1) of the CCAA and section 50 of the BIA.
481. Wood *Bankruptcy and Insolvency Law* (2009) 393.
482. Smits "Corporate Administration: A Proposed Model" (1999) 32 *De Jure* 89.
483. Rajak and Henning "Business Rescue for South Africa"(1999) *SALJ* 283.
484. Ibid 284.

excluded and through which they may lose everything.[485] The incentive of remaining in control may be a strong driver for directors of financially distressed companies to seek out the assistance of a protective regime, rather than applying for the direct route into liquidation.[486]

When a company enters into a restructuring process it must be permitted all the powers it had when solvent, but subject to outside monitoring. The question in a debtor in possession scenario is how these powers should be split between the debtor company and its directors on the one hand, and the supervisor on the other. In the words of Rajak:

> The reply [to such a question] must be debated in good faith by the various apparently conflicting interests, each being aware that to press for too great an advantage will jeopardise a scheme which is designed to break a log jam that is detrimental to all.[487]

The concept of wrongful trading encourages directors to file for a rescue process as early as possible. Certain jurisdictions encourage directors of companies to seek bankruptcy protection within a certain time period of learning of the insolvency or imminent insolvency of the company.[488] This will encourage early filing and acts as a deterrent against officers allowing corporate assets to be dissipated through continued operating losses.[489]

Those directors who have filed late or conducted the business of the company while insolvent could possibly be held personally liable for wrongful negligent or reckless trading. These directors will find it difficult to assist the supervisor in continued trading of the business where there is every chance that such director will be facing claims for losses or damages.[490] Some would argue that, on the contrary, directors would have every incentive to cooperate and assist the supervisor in every way possible in order to ensure that creditors maximise their recovery to the greatest extent possible, thus minimising the potential of personal claims.[491]

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485. Ibid.
486. Ibid.
487. Ibid 285.
488. Smits "Corporate Administration: A Proposed Model" (1999) 32 *De Jure* 97. Australia, Germany and France have a mandatory set period in which directors must file.
489. Ibid.
490. Ibid. For a full expose of director's obligations in the period approaching insolvency see UNCITRAL *Legislative Guide on Insolvency Law* Part 4 (2013).
491. Smits "Corporate Administration: A Proposed Model" (1999) 32 *De Jure* 97.

Those countries opting for the continuation of management in the restructuring regime base their decision to do so on encouraging management and directors to seek relief early enough to provide a realistic chance of recue. Their reasoning is based on the notion that if management is automatically divested of control, they will most likely resist a system that immediately causes them to lose their job and increases the possibility of a loss of their investments.[492]

On the other hand, supporters of complete control (or partial control) are deeply suspicious of the debtor and its management and of abuses that would follow if they carried on operating the company with no supervision. The danger of course is that when management knows if they place the company into a financial restructuring process, they will in time be ousted from control, they may continue to avoid any proceeding until left with no alternative but to file for bankruptcy or liquidation. At that stage, there is no longer any prospect of rescuing the company.[493]

Certain jurisdictions, like South Africa, the UK and Australia, through the concept of "wrongful trading" or "trading in insolvent circumstances", effectively force management to seek bankruptcy protection once the corporation is technically or commercially insolvent by imposing on the directors (and management) personal liability for the debt of the company incurred thereafter.[494]

It is submitted that the debtor-in-possession principle will always be a function of the level of corporate sophistication prevalent in a particular industry or jurisdiction. Whether or not there is room for a hybrid approach, that is having a supervisor working in conjunction with the board of directors, remains open to question. The need to appoint a trustee, supervisor or practitioner will depend on whether corporate management is sufficiently experienced to continue to run the company while it is being restructured or whether companies require the intervention of a third party or officer who steps into the shoes of the company's management. The skill set and level of competence of existing management as well as the appointed supervisor is thus of crucial importance.

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492. Ibid 89.
493. Ibid.
494. Ibid. See sections 424 of the 1973 Companies Act as read with section 22 of the 2008 Companies Act. Canada, Australia and Germany also impose liability on directors for "wrongful trading or "trading in insolvent circumstances". The threat of personal liability serves to ensure that management will seek the winding-up of the company upon learning its insolvency. This is in direct contrast to the US, where no such liability exists.

5.5.3.3 COURTS

The role of the courts in the ongoing development and practical implementation of a restructuring process can become controversial. Delay and cost of court procedure can serve to undermine the effectiveness of the rescue process and can, if substantially delayed, result in the liquidation of the company.

As dealt with above, many jurisdictions require the initiation of the reorganisation process and protective regime to be by way of court order. Thereafter, the manner in which the control of the process by the court should occur, is up for debate.[495]

In the US, a high degree of court participation over the rehabilitation process occurs, with the danger of court process serving to delay the effective outcome of the reorganisation. If the court is going to have a major role to play, then it makes sense to have separate court systems to deal with rescue matters so that the normal court system does not get bogged down. In the US bankruptcy proceedings are regulated by a specialised branch of the national court system.[496]

In a US Chapter 11 case, the DIP administers and controls the operation of the business under the control of the incumbent management. However, there may come a time when the Chapter 11 debtor realises that their hopes for successful reorganisation are unrealistic. This would result in a conversion on a voluntary basis to a Chapter 7 bankruptcy case. If there is no attempt at a voluntary conversion, a debtor's Chapter 11 case may be converted or dismissed involuntarily by the US Bankruptcy Court.[497] The court plays a very important role in the conversion or the termination of the Chapter 11 proceeding.[498]

The US Bankruptcy Court can intervene at numerous points in the Chapter 11 proceeding itself and would view motions based on an inability of the debtor to reorganise, a failure to

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495. UNCITRAL *Legislative Guide on Insolvency Law* Part 1 (2005) 205–206.

496. The US and Canada have specialised courts to deal with Bankruptcy cases. See Smits "Corporate Administration: A Proposed Model" (1999) 32 *De Jure* 88.

497. Ferriell and Janger *Understanding Bankruptcy*(2013) 723–724; Section 1112(b)(4) of the US Bankruptcy Code.

498. Ferriell and Janger *Understanding Bankruptcy*(2013) 724. Section 1112(b)(4)) provides a long but not exclusive list of circumstances that require the court to convert or dismiss a Chapter 11 case. The court will only convert or dismiss if it is in the best interests of creditors and the estate to do so.

comply with code requirements, bad faith filings and other failures to adhere to the provisions of the code.[499]

Criticism of court intervention in a Chapter 11 is the inordinate amount of time and expense, with attendant court hearings, involved in "structured bargaining" between the various classes in order to ensure the necessary majorities are obtained for a plan of reorganisation. This could result in the danger of different classes fighting over a "useless corpse".[500]

The expense involved in respect of lawyers and advisory fees in the conduct of a Chapter 11 is prohibitive, particularly in medium- to smaller-sized enterprises. The larger corporates that are reorganised in this process generally are able to cope with the cost of this remuneration, with the smaller- to medium-sized companies struggling to cope with the prohibitive costs involved in the process.[501]

A further issue in the conduct of a Chapter 11 is the speed of the process. The heightened publicity revolving around the insolvency of the company and the Chapter 11 proceedings tend to shake the confidence of lenders, suppliers and investors. This slows the process down as there is a need for heightened and efficient negotiation in the conduct of the Chapter 11 proceedings. In this static process, competitors will attempt to lure customers away, and if possible destroy the business of the company.[502] Speed is therefore often of the essence. The delay and bureaucratic elements of a Chapter 11 proceeding, mostly due to court intervention, makes the successful disposal and the saving of businesses and jobs very difficult. It is important to note, however, that the allocated bankruptcy judge can exercise strong control over what happens and this may speed up the process.[503]

Having a separate system of specialised courts also allows for the establishment of a bench and bar which become experts in the specialised field of bankruptcy. Judges and

499. Ibid 725–729. For example, see the ability of the US Court to convert a Chapter 11 process to liquidation, if the debtor fails to file a plan timeously or obtain confirmation of a plan within the time limits imposed – section 1112(b(4)(J) of the US Bankruptcy Code.
500. Moss "Chapter 11 – An English Lawyer's Critique" (1998) 11(3) *Insolvency Intelligence* 3–4.
501. Ibid 3.
502. Ibid 4.
503. Ibid.

practitioners accordingly become very astute at dealing with bankruptcy issues and do so in an efficient manner.[504]

In the US the autonomous office of the Bankruptcy Court is highly efficient and is a system to be admired. The Bankruptcy Court is a largely autonomous adjunct of the Federal District Court. It has its own judges, court rooms, clerks and dockets. Bankruptcy judges are appointed by the judges of the relevant Federal Court of Appeals for terms of 14 years. These appointments can be, and often are, reviewed.[505] Rules of procedure are contained in the Federal Rules of Bankruptcy Procedure and in various sections of the Federal Judicial Circle.[506]

In the UK, a company may enter administration by court order and in terms of a formal application to court. The administrator would send regular reports to creditors and the registrar of companies. Once appointed, there is very little ongoing court involvement. At any time during the administration of the company, the administrator can apply to court for an order ending the administration. The out-of-court route into administration offers a quick and flexible option for companies in financial difficulties which is very cost-effective, due to low levels of court involvement.[507]

A UK court would however become involved where a creditor or member of a company wishes to apply for the removal of an administrator from office. Such applications would be brought based on complaints relating to the administrator's conduct and where there are allegations of unfair harm to the interests of the applicant, or undue delay or inefficiency on the part of the administrator. The court will generally require convincing evidence of the matters alleged as reasons for the removal of the administrator and will take into account the wider interests potentially affected by the disruption of the rescue process that was to have been pursued via administration, as well as the costs consequent upon the administrator's removal.[508]

504. Smits "Corporate Administration: A Proposed Model" (1999) 32 *De Jure* 88.
505. Ferriell and Janger *Understanding Bankruptcy* (2013) 130–131.
506. Ibid 133.
507. Fletcher *The Law of Insolvency* (2009) 529–531. Also see Rajak *Company Rescue and Liquidation* (2013) 90–91.
508. See para 74 of Sch. B1 to the UK Insolvency Act. Fletcher *The Law of Insolvency* (2009) 538–539.

The UK courts will further entertain applications for the lifting of the moratorium (relief against stay),[509] where there is a need to intervene to protect a secured or preferential creditor's interest,[510] challenges made to the administrative conduct of the company in its administration process,[511] and where there are allegations of misfeasance actions such as a breach by the administrator of his common-law duties to unsecured creditors.[512]

The UK court would further entertain applications made by the administrator for the termination of the administration by order of court. Such an order would generally be granted if the court believes that the purpose of the administration cannot be achieved in relation to the company.[513] An application for termination of the administration can also be made by applications brought by the creditors of the company. Such an order will only be granted where a creditor can show an improper motive on the part of the person by whom the administration was initiated.[514]

In Australia, voluntary administration allows a compromise agreement (DOCA) between the company and its creditors and provides such agreement statutory force.[515] Like in the UK, there is very little court involvement. An administrator is appointed by the company itself, if the board of directors has resolved that the company is insolvent or is likely to become insolvent in the future. The process of voluntary administration requires no reference to the court. However, the court is given a wide range of powers to prevent abuse of the administration process, including the power to make orders to end or extend the administration period, authorise the transfer of shares and protect the interests of the creditors.[516]

The voluntary administration process in Australia avoids the need for constant application to and supervision by the court. However, the court has a general jurisdiction to give directions and make relevant orders, although only upon the application by the

509. Paras 70, 71 and 72 of Sch. B1 empowers the lifting of the stay in certain circumstances. See Fletcher *The Law of Insolvency* (2009) 543.
510. Para 73 of Sch. B1. Fletcher *The Law of Insolvency* (2009) 561.
511. Para 74 of Sch. B1. Fletcher *The Law of Insolvency* (2009) 562.
512. Para 75 of Sch. B1. Fletcher *The Law of Insolvency* (2009) 564.
513. Para 79 of Sch. B1. Fletcher *The Law of Insolvency* (2009) 590.
514. Para 81 of Sch. B1. Fletcher *The Law of Insolvency* (2009) 591. Also see Rajak *Company Rescue and Liquidation* (2013) 90–91; 99–100; 123–127.
515. Section 444G of the Australian Corporations Act.
516. Symes and Duns *Australian Insolvency Law* (2012) 270. Also see Murray and Harris *Keay's Insolvency* (2014) 606–608. An example of court involvement would be in terms of section 439A(6) – to extend the convening period to convene the second creditors meeting by way of court application. See Symes and Duns *Australian Insolvency Law* (2012) 291. See other examples, ibid 291–292.

administrator or by other persons who might be affected by the administration procedure.[517]

As a result of the absence of court involvement, the costs of an Australian administration are greatly reduced. Time is saved and there is less formality. The court will generally only play a facilitating and supervisory role in the administration.[518] Thus the role of the court in Australian voluntary administrations is very much secondary to the process. Anderson and Morrison confirmed that the Australian court plays a very limited and indirect role in the administration process. However, if an application in terms of the Pt 5.3A procedure is made, it will play an active role in ensuring that its provisions are carefully followed.[519]

In Canada, the CCAA attempts to reach a compromise restructuring of the debtor's obligations to its creditors. A monitor is appointed by way of a debtor or creditor applying to court for the right to commence CCAA proceedings. The debtor remains in control of its assets and the monitor is appointed to oversee and work with the debtor. The monitor will report to the court if the debtor engages in transactions out of the ordinary course of business or otherwise does not comply with any restrictions on its business that the court has imposed on it as part of the proceedings. Where the creditors and court approve the proposal, the debtor emerges from the proceedings freed from any debts that have been dealt with in the proposal, subject to the debtor's obligations to make payments under the proposal. Once the proceedings have been concluded and the plan implemented, the debtor can resume its normal business operations.[520]

The CCAA is a mere court-focused procedure but has a greater degree of flexibility. The BIA process is more rule-driven and is more suitable for smaller restructurings.[521]

In summary, it is submitted that minimal court involvement supports an effective rescue system as time frames in any restructuring need to be kept as short as possible. The window of opportunity to properly effect a restructuring within the confines of financial

517. Harmer "An Overview of Recent Developments and Future Prospects in Australia" as published in Ziegel *Current Developments in International and Comparative Corporate Insolvency Law* (1994) 46.

518. Harmer "Comparison of Trends in National Law: The Pacific Rim" (1997) 23 *Brooklyn Journal of International Law* 152.

519. Anderson and Morrison "Part 5.3A: The Impact of Changes to the Australian Corporate Rescue Regime" (2007) 15 *INSOL Law Journal* 248.

520. Wood *Bankruptcy and Insolvency Law* (2009) 327–351. Also see Houlden, Morawetz and Sarra *The 2013–2014 Annotated Bankruptcy and Insolvency Act* (2013) 1174.

521. For the extent of court involvement in both procedures, see Wood *Bankruptcy and Insolvency Law* (2009) 394–399.

distress is small. To allow a rescue system to become bogged down in arduous and costly court procedures will limit the opportunity and prospects of success for a company to be rescued.

A highly court-regulated rescue system is unnecessary and the administration of a rescue or restructuring should rather be left to the practitioner or supervisor. Of course, if there is a need for court intervention then the court should become involved, at the very least to resolve deadlock, to rule on interpretation of the legislation and if necessary to sanction a plan of reorganisation.

5.5.4 **TREATMENT OF CREDITORS, CONTRACTS AND EMPLOYEES**

5.5.4.1 CREDITORS

In a restructuring process, equitable treatment of creditors in an insolvency regime is an imperative. The objective of equitable treatment is to ensure that creditors with similar legal rights should be treated fairly and should receive a distribution on their claim in accordance with their relative ranking and interests. All creditors do not need to be treated identically, but in a manner that reflects the different bargains they have concluded with the debtor. Even though the principle of equitable treatment is affected by social policy on priorities, it retains its significance by ensuring that the priority accorded to the claims of a similar class affects all members of the class in the same manner.[522]

Creditors will have varied interests in a rescue scenario. Creditors' claims will be divided into several categories: secured claims, preference (or priority) claims and unsecured claims. Generally, secured claims are treated as priority as all secured claims are secured by "security" or "collateral". That is, a secured claim is usually accompanied by an ownership interest in a specific property (movable or immovable). By contrast, an unsecured claim is simply a debt, such as a claim arising in contract or delict (tort). Preferent claims generally arise as a result of statute, where such claims are afforded a "priority" in the company being restructured.[523]

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522. UNCITRAL *Legislative Guide on Insolvency Law* Part 1 (2005) 11–12.

523. Ferriell and Janger *Understanding Bankruptcy* (2013) 309–311. Also see Epstein and Nickles *Principles of Bankruptcy Law* (2007) 12–13; Howard *Bankruptcy Overview: Issues, Law and Policy* (2002) 29–33.

Certain creditors' claims might be subordinated; that is, their priority is lowered so that the claim is not paid until both secured, preferent (priority) and unsecured claims have been paid in full. Generally, creditors would subordinate their claims by agreement.[524]

In any restructuring scenario, claims will be dealt with in accordance with the legislation applicable in such jurisdiction.[525] Various jurisdictions will deal with the rights of different classes of creditors in a particular manner, some providing certain creditors (mainly secured) with priority positions in the restructuring, while others will not.

The principle of ensuring existing creditor rights and the establishment of clear rules for the ranking of priority claims is a further essential element in balancing the rights of creditors (amongst themselves) as well as against the rights of other stakeholders. This is stated as follows in the UNCITRAL Guidelines:

> Recognition and enforcement in insolvency proceedings of the differing rights that creditors had with respect to the debtor and its assets before the commencement of insolvency proceedings will create uncertainty in the market and facilitate the provision of credit, in particular with respect to the rights and priorities of secured creditors. Clear rules for the ranking of priorities of both existing and post-commencement creditor claims are important to provide predictability to lenders and to ensure consistent application of the rules, confidence in proceedings and that all participants are able to adopt appropriate measures to manage risk. To the greatest extent possible, those priorities should be based upon commercial bargains and not reflect social and political concerns that have the potential to distort the outcome of insolvency. According priority to claims that are not based on commercial bargains therefore should be minimized.[526]

Clarity on the ranking of claims in a reorganisation process is a critical element of ensuring confidence in the effectiveness of the system. In particular, the recognition of secured creditors is important in any attempted reorganisation.

Under the Chapter 11 procedure in the US, the rights of secured creditors are recognised even to the point where secured creditors may approach the courts for relief from the

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524. Ferriell and Janger *Understanding Bankruptcy*(2013) 309–310. Claims might also be ranked or recognised as "contingent" (a claim would be contingent if it does not become an obligation until the occurrence of a future event) or "unliquidated" (a claim would be unliquidated if the amount of liability depends on a future determination). If the claim is liquidated, it would be determinable by reference to an agreement, promissory note, a contract that specifies a fixed liability or through simple calculation. A judgment debt would be a liquidated (liquid) claim. See 314–315.

525. For the treatment of claims in a US Chapter 11 filing, see Ferriell and Janger *Understanding Bankruptcy* (2013) 309–370, with secured creditor claims dealt with from 331–341. For the treatment of claims in a UK administration, see Rajak *Company Rescue and Liquidation* (2013) 75–127 at paras 2-01–2-157. For the treatment of claims in an Australian Deed of Company Arrangement (DOCA), see Symes and Duns *Australian Insolvency Law* (2012) 296–309. For the treatment of claims in a Canadian CCAA procedure, see Wood *Bankruptcy and Insolvency Law* (2009) 12–23.

526. UNCITRAL *Legislative Guide on Insolvency Law* Part 1 (2005) 13.

automatic stay (moratorium).[527] Chapter 11 generally treats secured creditors' claims very favourably. The rights of most secured creditors remain intact throughout the proceedings and after the plan is confirmed. The holder of a secured claim is in a relatively powerful position. Many plans contain provisions that secured creditors' claims be paid in the full value of their claim. Most secured claims are recognised in its own class, partly for the sake of convenience, but primarily because it is unusual for a secured claim to be sufficiently similar to other secured claims to warrant combining them in the same class.[528] As far as the ranking of claims is concerned, administrative claims are paid first, followed by secured creditors, prepetition unsecured creditors, subordinated debt and equity holders.[529]

In the UK, the rights of secured creditors are also recognised, while charge holders have special rights that can be enforced.[530] The ranking of claims under the UK system follows a similar pattern, namely secured creditors, administration expenses, preference holders, employees, unsecured creditors, subordinated debt and equity holders.[531]

In Canada, the restructuring plan will determine recoveries for secured creditors. The priority status of secured claims is governed by the ordinary rules and principles that establish the validity and priority of security interests in real and personal property. A failure to perfect does not result in a loss of priority in restructuring proceedings. Although a failure to perfect a security interest will not result in its subordination, it may cause a loss of priority in respect of a claimant who asserts an interest in the collateral.[532]

In Australia, a deed of company arrangement will consider the rankings of priority creditors (such as secured creditors). Administration costs and expenses rank ahead of the secured parties. The Corporations Amendment (Insolvency) Act, 2007 requires a DOCA to

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527. See section 1129 of the US Bankruptcy Code.

528. See section 1129 of the US Bankruptcy Code and discussion in Ferriell and Janger *Understanding Bankruptcy* (2013) 755–757 and 782.

529. Section 1123(a)(2) of the US Bankruptcy Code. See discussion in Ferriell and Janger *Understanding Bankruptcy* (2013) 744–745. Burdette "Legislative Framework for the Facilitation of Turnarounds" in Harvey (ed) *Turnaround Management and Corporate Renewal – a South African Perspective* (2011) 136–137. See the position of secured creditors in the US - McCormack *Corporate Rescue Law: An Anglo American Perspective – Corporations, Globalisation and the Law* (2008) Chapter 9 – Conclusion, 296–298.

530. Para 73 of Sch. B1 of the UK Insolvency Act.

531. Para 65(2) of Sch. B1 causes the distributional principles applied in company liquidations under section 175 of the UK Insolvency Act to be applicable in relation to distributions by an administrator. See Fletcher *The Law of Insolvency* (2009) 597–599. Also see Walters "Statutory erosion of secured creditor's rights: Some insights from the United Kingdom" *University of Illinois Law Review Volume 2015* 543–570. See the position of secured creditors in the US – McCormack *Corporate Rescue Law: An Anglo American Perspective – Corporations, Globalisation and the Law* (2008) Chapter 9 – Conclusion, 296–298.

532. Wood *Bankruptcy and Insolvency Law* (2009) 410–411.

preserve creditors priorities (as in liquidation) unless employee creditors vote to waive those rights.[533]

The moratorium sees security interests rendered unenforceable unless the administrator gives written consent or the court grants leave. During the administration, property that is the subject of security interest can be sold in the ordinary course of business and any other disposal will need the secured party's consent or leave of the court.[534]

The ranking of claims in a restructuring scenario (and thereafter in a liquidation) will heavily influence the peculiar stance taken up by creditors (in the main, financial institutions) as to whether "debtors" should be given a fresh start and where creditors are willing to accept the concept of a debt compromise.

5.5.4.2 CONTRACTS (EMPLOYEES)

A major asset of any business is its contracts. The value and sustainability of a company's contracts will determine the company's sustainability in its restructuring process. As a result, the treatment of contracts is of critical importance in a restructuring scenario.

The difficulty is that contracts are generally tied up to liabilities and claims of counterparties to such contracts. The supervisor might have to perform or make payment in order to enjoy the benefits to the rights flowing from such contracts and which are potentially valuable assets. A supervisor must therefore be in a position to deal effectively with existing contracts so as to realise the most value for the company in its reorganisation process.[535] Contracts will generally include contracts for the sale or supply of goods or securities; short-term or long-term leases of lend or property; franchise, distribution and licence agreements; construction agreements; loan or facility agreements and employment contracts.[536]

In a reorganisation, the supervisor's objective is to ensure that the debtor company continues to trade, thus enabling the company to continue its affairs to the maximum extent possible and in an uninterrupted manner. A supervisor/practitioner must attempt to take

533. See Section 556(1)–Pt 5.3A of the Corporations Act, 2001; Symes and Duns *Australian Insolvency Law* (2012) 299.
534. Symes and Duns *Australian Insolvency Law* (2012) 289.
535. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 120.
536. Ibid.

advantage of those contracts that are beneficial and which contribute value to the estate. Those contracts which are prejudicial or burdensome and where the ongoing cost of performance exceed the benefit to the company should be terminated or at least varied or amended to the advantage of the company. Unprofitable agreements should be terminated as they will continue to have a detrimental effect on the debtor's ability to continue to trade the company on a solvent basis into the future.[537]

Most insolvency laws allow the administrator or supervisor to elect to continue or repudiate contracts based on a cost-benefit analysis of what is in the best interest of creditors. Good bargains are to be accepted and bad ones rejected. The prospects of success in a rehabilitation may often depend on the ability to enforce contracts notwithstanding a right of cancellation in the event of insolvency to cancel contracts (including employment contracts) to enable the company to downsize its workforce to an acceptable level, or to avoid burdensome contracts.[538]

Decisions are made almost entirely based on the interests of creditors and preserving value in the company that is being restructured.[539]

Interference with the sanctity of contracts thus becomes an issue. Upholding the particular jurisdiction's contract law must be weighed against enabling the distressed company's chances of survival. Competing interests need to be weighed to ensure an appropriate balance is struck between the goals of reorganisation and the predictability of commercial relations in the market place. All of these considerations will also have to be assessed against the cost and availability of credit as well as the ability to affect the performance of contracts in a rescue situation,[540] stated as follows in the UNCITRAL Guidelines:

> In reorganisation, where the objective of the proceedings is to enable the debtor to survive and continue its affairs to the best extent possible, the continuation of contracts that are beneficial or essential to the debtor's business and contribute value to the estate may be crucial to the success of the proceedings. These may include contracts for the supply of essential goods and services or contracts concerning the use of property crucial to the continued operation of the business, including property owned by third parties. Similarly, the prospects of success may be enhanced by

537. Ibid.

538. Westbrook, Booth, Paulus and Rajak (eds) *A Global View of Business Insolvency Systems* (2010) available at https://www.openknowledge.worldbank.org/bitstream/handle/10986/13522/68423.pdf?sequence=1 91–92.

539. Ibid 92.

540. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 121.

> allowing the insolvency representative to reject burdensome contracts, such as those contracts where the cost of performance is higher than the benefits to be received or, in the case for example, of an unexpired lease, the contract rate exceeds the market rate. In liquidation, the desirability of contracts continuing after commencement of proceedings is likely to be less important than in reorganisation, except where the contract may add value to the debtor's business or to a particular asset or promote the sale of the business as a going concern. A lease agreement, for example, where the rental is below market price and the remaining term is substantial, may prove central to any proposed sale of the business or may be sold to produce value for creditors.[541]

Identification of the types of contracts that can be affected in a rescue or reorganisation process can be dealt with by legislation. The ability to reject labour or employment contracts might be limited. Other contracts that might require special treatment may include financial contracts and contracts for loans and insurance. Certain contracts would typically include a clause that defines events of default giving the counterparty an unconditional right to terminate the contract. These events of default commonly include the making of an application for commencement or actual commencement of an insolvency proceeding, including a business rescue or restructuring procedure.[542]

There are various schools of thought in respect of the validity of these clauses. There are those that believe that such clauses must be upheld. They are motivated by the desirability of respecting commercial bargains, the need to prevent the debtor from selectively performing contracts that are profitable and rejecting others, the belief that since an insolvent business will generally be unable to pay and delaying the termination of contracts potentially only increases existing levels of debt.[543]

A counterview to this is that the legislation (insolvency law) overrides these event of default clauses, making them unenforceable. The approach of overriding these clauses can be regarded as interfering with general principles of contract law. However, such interference may be crucial to the success of the restructuring proceedings. In a reorganisation, a critical lease of property, for example, might be an essential to the continued ability of the company to trade while it is being restructured. The aim must be to

541. Ibid. Also see Westbrook, Booth, Paulus and Rajak (eds) *A Global View of Business Insolvency Systems* (2010) available at https://www.openknowledge.worldbank.org/bitstream/handle/10986/13522/68423.pdf?sequence=1 92. The "insolvency clauses" (also known as "ipso facto" clauses) cancel contracts or permit the cancellation of contracts in the event of the insolvency of one of the parties. If these clauses are enforced in an insolvency proceeding, they will lessen or eliminate the power of the administrator to maximise the value of the estate by accepting good bargains and rejecting or disclaiming bad ones (pp. 91–92).

542. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 122. See discussion on "pacta sunt servanda" in Chapter 5, para 5.4.

543. Ibid.

capture the value of the debtor's contracts for the benefit of all creditors and thereby assist in the rescue of the company.[544]

Thus, the ability to override these clauses is crucial in the restructuring of companies. Any negative impact can be counterbalanced by the provision of compensation to creditors who can demonstrate that they have suffered damage or loss as a result of the contract continuing to be performed after commencement of the proceedings. Of course, a creditor can always pre-empt the overriding effect of the legislation by terminating early and before the application for the proceedings has been made, assuming a default by the debtor other than the one triggered by the commencement of the proceedings.[545]

Any decision to terminate a contract will result in a claim for damages by the counterparty to the contract. Damages are awarded and equate to either a liquidation dividend or a pay-out on a plan. The counterparty's claim for damages arises as a result of breach of contract, a risk with any contract, greatly worsened by insolvency.[546]

If a contract is accepted, the counterparty is merely held to its bargain with the debtor. Even if the counterparty had concluded a bad bargain, it would nonetheless be required to perform. The good bargain is preserved for the benefit of the creditors.[547] The risk to a counterparty who must continue with the contract is that of non-payment. Some systems react to these risks by requiring the administrator to provide some sort of guarantee of payment or performance to the other party (by bank guarantee or a letter of credit) even though the original contract did not have such a provision. In other systems, the administrator assumes personal liability for such contracts, so the counterparty has a solvent defendant in case of breach.[548]

Most systems have a time limit within which the administrator must decide to continue or not continue with a pre-insolvency contract. If the administrator does not make elect to cancel the contract within such time frame, the contract continues on its original terms.[549]

544. Ibid 123.
545. Ibid.
546. Westbrook, Booth, Paulus and Rajak (eds) *A Global View of Business Insolvency Systems* (2010) available at https://www.openknowledge.worldbank.org/bitstream/handle/10986/13522/68423.pdf?sequence=1 94.
547. Ibid 94–95.
548. Ibid 97.
549. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 100.

A further issue is the ability of the practitioner to alter the terms and conditions of those contracts. The ability to amend will either be granted by the relevant statute or alternatively would have to be effected by way of negotiation.[550]

An essential type of contract which should be specifically considered is the employment contract. Such contracts are particularly important in a reorganisation.[551] The business of the company can only continue with the continued participation of employees, albeit sometimes at a reduced number. Consideration must be given to whether or not onerous labour contracts should be terminated in order to achieve cost savings by the reduction of the work force of the debtor. Other laws have an impact on such an action, such as applicable labour legislation and particularly laws relating to unfair dismissal, minimum rates of pay, paid leave, maternity leave, equal treatment and non-discrimination. The practitioner's right to offer retrenchment packages will also have to be considered.[552] Certain jurisdictions will specifically choose to regulate the manner in which practitioners will have to deal with employment contracts as well as the protection of employee claims in insolvency regimes. In certain instances, the law goes so far as to provide that employees are to follow the business as a going concern in both a reorganisation and a liquidation of the debtor company.[553]

A further category of contracts that need to be considered are those that are required to be concluded after the commencement of proceedings. In a reorganisation there is often a need to conclude contracts (both in the ordinary course of business and otherwise) to maintain the business as a going concern and to enable it to continue earning for the ultimate benefit of creditors. These contracts are generally regarded as post-commencement obligations of the company, and costs and expenses incurred in their performance would generally be paid as a cost of the restructuring administration.[554]

In the US, the US Bankruptcy Code seeks to respect property rights, but discharges contractual claims against the debtor. When a debtor and a counterparty exchange

550. Ibid 128.

551. See comments in McCormack *Corporate Rescue Law: An Anglo American Perspective – Corporations, Globalisation and the Law* (2008) Chapter 7 – The role of employees, 209–250.

552. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 131.

553. Ibid.

554. Ibid.

executory promises, they do so with an expectation that they will both be better off once the promises are performed. This remains true even in bankruptcy.[555]

Sometimes the debtor is right, and completing performance is advantageous. Other times the debtor is wrong, and performance would be burdensome to the estate. Section 365 of the US Bankruptcy Code allows the debtor to make a choice whether to breach or perform its obligations under a contract. The section's intention is to preserve value for the debtor's estate. It does this by providing the estate's representative (the trustee or a DIP) with several options in connection with the handling of certain types of contracts to which the debtor is a party. A debtor may reject the contract (breach it), assume the contract and perform it according to its terms; or assume the contract and assign it to a third party to perform.[556]

The purpose of permitting assumption or rejection of these contracts in the US is to permit the trustee or DIP to realise the value of transactions that are valuable to the estate and to treat the breach of claims in burdensome transactions as prepetition claims against the estate. Once appointed, the trustee or DIP makes an inventory of the debtor's executory contracts and determines which ones would be beneficial to adhere to, and which ones would be beneficial to reject.[557]

In general, US employment contracts are treated the same as other executory contracts. An employer has the right to reject any long-term employment contract with its employees. The employee will then have a prepetition claim for damages.[558]

In Canadian restructuring proceedings, both the CCAA and BIA have provisions respecting the disclaimer of contracts.[559] Under the CCAA, the stay of proceedings granted by the court was used to prevent counterparties from terminating their agreements with the

555. See section 365 of the US Bankruptcy Code. Also see Ferriell and Janger *Understanding Bankruptcy* (2013) 371–373. For the meaning and approach to executory contracts and leases see 373–399.

556. Ibid 394–399.

557. Ibid 385–387.

558. Section 502(b)(7) of the US Bankruptcy Code provides employees with the right to submit pre-petition claims. These claims are entitled to priority under section 507(a)(4). See Ferriell and Janger *Understanding Bankruptcy* (2013) 384–385. Also see Chapter 23.03 of Ferriell (869) regarding employee claims.

559. See sections 32(9) and 11.3(1) of CCAA and sections 65.11(10) and 84.1(3) of the BIA.

debtor. The BIA has express statutory provisions limiting a counterparty's ability to terminate a contract or exercise other contractual remedies for breach.[560]

As in other jurisdictions, contracts entered into by the debtor prior to the commencement of restructuring proceedings would sometimes contain a contractual clause that gave the counterparty the right to terminate the contract if the debtor were insolvent or subject to insolvency proceedings.[561]

Both the BIA and the CCAA contain provisions which limit the effectiveness of such clauses by preventing a party from terminating, amending or calling for accelerated payment or forfeiture of the term under an agreement by reason only that the debtor is insolvent or has commenced restructuring proceedings.[562]

The retention of key employees in a Canadian restructuring process is critical to the successful reorganisation of the company. The creditors and other stakeholders might look askance at the prospect of alternative compensation packages being given to a managerial team that they view as responsible for the business failure.[563]

In the UK, the appointment of an administrator does not in itself terminate existing contracts with the company, although many contracts will expressly state that such an appointment brings the contract to an end.[564] As agent of the company, the administrator is entitled to continue contracts on behalf of the company. This may involve continued occupation of land held under a lease, hire-purchase, leasing or title contracts. If the administrator decides not to pay out under the existing contracts, the moratorium prevents the creditors from enforcing their rights against the company by forfeiture or repossession without obtaining the permission of the court. It is usual for the administrator to pay such creditors, at least for the use of the assets during the administration.[565]

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560. Sections 34(1) of the CCAA and 65.1(1) of the BIA. Wood *Bankruptcy and Insolvency Law* (2009) 367–369.
561. Ibid 368. These are called "ipso facto" clauses in the US. See Ferriell and Janger *Understanding Bankruptcy* (2013) 389.
562. Sections 34(1) of the CCAA and 65.1(1) of the BIA. For an analysis of the procedure used for termination of contracts in Canada see pp. 368–374. For the analysis of executory contracts see Yamauchi "Evolution, Revolution or Nothing at All? Recent Reforms to Canadian Bankruptcy and Insolvency Legislation" (2006) 15 *International Insolvency Review* 171 –176.
563 Wood *Bankruptcy and Insolvency Law* (2009) 387–388.
564. See administrator's powers set out in para 68 of Sch. B1. See extent of powers in the administration of the company in Fletcher *The Law of Insolvency* (2009) 578–581. See also Keay and Walton *Insolvency Law, Corporate and Personal* (2003) 120.
565. Ibid. Also see section 234 of the UK Insolvency Act.

An administrator bears no personal liability under an adopted employment contract. If a contract of employment is adopted by the administrator, the employees' entitlements are paid out ahead of the administrator's own remuneration and expenses (a superpriority claim).[566]

Once appointed, the UK administrator will carry out a review of all the company's contractual commitments (including the size of its workforce) as part of the process of devising his or her strategy for the rescue of the company or for the orderly disposal of its assets, including its business. Of course, employees whose continued engagement is seen as essential to any plan for the survival of the business as a going concern will require some reassurance as to their status of their expected remuneration if the plan does not succeed.[567]

In Australia, the administrator has a duty to consider contracts with the company under administration. These are not automatically terminated. The appointment of an administrator does not support the company's intention to repudiate any existing contracts nor does it mean that the company will be breaking or repudiating contracts already in existence. An administrator, if carrying on the business of the company, will adopt many of the existing contracts with the company. Section 443A of the Australian Corporations Act establishes liability upon the administrator for the debts for services rendered and goods supplied to the company. An administrator can approach a court for orders that a contracting party not terminate a particular contract and the court will make such orders provided the interests of the contracting party are protected.[568]

In addition, the administrator must consider *ipso facto* clauses in contracts as a priority once appointed. An *ipso facto* clause is one which stipulates the consequences of the insolvency of a party to the agreement. The significance of *ipso facto* clauses as a common provision in most contracts in Australia derives from the corresponding right of the counterparty to terminate a contract in the event that a company becomes insolvent. This has the potential to have a very disruptive effect on the attempts of the administrator who

566. Keay and Walton *Insolvency Law, Corporate and Personal* (2003) 121. See *Powdrill v Watson* 1995 (2) AC 394 (House of Lords). See para 99 of Sch. B1 to the UK Insolvency Act.

567. There are legislative provisions (para 99 of Sch. B1) relating to the position of employees who continue to work during the course of the administration, placing them in a protected position at the conclusion of administration in respect of any unpaid claims for wages and salary. See Fletcher *The Law of Insolvency* (2009) 579–585. Also see Rajak *Company Rescue and Liquidation* (2013) 148–153.

568. See Symes and Duns *Australian Insolvency Law* (2012) 283.

seeks to restructure the company.[569] The administration order of the company will often provide grounds for termination,[570] as stated by Blazic:

> The absence under current Australian restructuring legislation of provisions preventing a "a supplier or a customer of the company from cancelling contracts of supply on the basis solely of insolvency (as opposed to non-performance or repudiation)" … often corresponds to a crippling and immediate cessation of a company's operations and any possibility of restructure. This lack of protection under Australian legislation relating to the enforcement of this type of ipso facto clause and the absence of a moratorium on such enforcement, will often strike at any company's ongoing ability to trade and destroy its major assets; its customer base.[571]

In Australia, the need to protect employees in insolvent business has been a sensitive and political issue for some time. Historically, the pervasive view has been that employees have much to gain from the continued existence of a company or at least the business of the company and hence there is likely to be support for the DOCA in most cases. The Corporations Amendment (Insolvency) Act, 2007 had the effect of ensuring that all DOCA arrangements must reflect the priority afforded to unsecured debts relating to employees. This covers wages, superannuation contributions along with amounts owing for leave and retrenchment payments. Under section 444DA(1), the DOCA must contain a provision that the employee creditors will receive a priority at least equal to their statutory entitlements.[572]

It is submitted that any company that is financially distressed must have the ability to consider the viability of prejudicial contracts having already been concluded by the company prior to the commencement of its restructuring. The ongoing viability of the company would seriously be placed in jeopardy if the company did not have such a choice.

It is further submitted that in any restructuring, there will always be a need to retain key employees, managers, specialists and core staff that support the operational requirements of the company. It would be disastrous for the future prospects of the company if the

569. Ibid. Also see Murray and Harris *Keay's Insolvency* (2014) 616–617.

570. Blazic *In Search of a Corporate Rescue Culture: A Review of the Australian Part 5.3A Regulation* (2 October 2010) available at http://ro.uow.edu.au/cgi/viewcontent.cgi?article=1007&context=sbshdr 7.

571. Ibid. The absence of protection from *ipso facto* clauses is one of the key criticisms of the Australian system. This often contributes to the future of any restructuring prospects. The result is that contracts that are essential to the company's survival are often discarded at an early stage in the process.

572. Section 444DA(1) was promulgated in the Australian Corporations Act in December 2007 and confirms that a DOCA must provide "eligible employee creditors" a vote on their priority status of their employee entitlements. See Symes and Duns *Australian Insolvency Law* (2012) 299; Anderson and Morrison "Part 5.3A: The Impact of Changes to the Australian Corporate Rescue Regime" (2007) 15 *INSOL Law Journal* 249–251.

contributions of such employees were terminated at the very time in the company's history where "good people" are needed to steady the ship! Thus, the ability to retain staff/employees and incentivise them to continue to work for the company in its restructuring period is a fundamental aspect of a successful restructuring of the debtor company.

5.5.5 FINANCING THE RESCUE

Once a company is in the throes of a restructuring process, ongoing expenses must be paid in the ordinary course of the debtor company's business. This is referred to as debtor-in-possession financing ("DIP finance") or post-commencement financing ("PCF"). The importance of post-petition finance is emphasised by Vriesendorp and Gramatikov:

> One of the important requirements for recovering businesses is the access to finance. Successful restructuring is dependent on two factors – meeting the liquidity needs and obtainment of post-petition financing. Metaphorically Westbrook and Gottlieb put the relationship between access to financial facilities and restructuring as: "Liquidity is the lifeblood of reorganization." The major purpose of reorganization is to protect viable but distressed companies and thus to realize the interests of the concerned parties through healing of the business entity. In order to continue its business operations and pay debts as they come due, a company in restructuring often needs to secure substantial amounts of additional liquidity and capital. In times of financial crisis and credit crunch the difficult goal to convince the lenders in the viability of the distressed company becomes even harder if not impossible.[573]

The ability to reorganise successfully requires continued operation of the debtor's business in order to preserve ongoing concern value. Many proceedings can rely on the ongoing operations to generate funding for the company. This is only effective if the proceedings are limited to a short time frame. However, where the rescue proceedings last for long periods of time and where operating losses continue in the short term, the rescue proceedings must provide for post-petition financing.[574]

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573. Vriesendorp and Gramatikov "Impact of the Financial Crisis" (2010) *INSOL International Survey* 8. Also see Westbrook and Gottlieb "Reorganisations, Exemption of Financial Assets" (2009) 27 *American Bankruptcy Institute Journal* 10; Stapleton *Bankruptcy and Restructuring Chapter 11 Strategies 2009: Top Lawyers on Trends and Key Strategies for the Upcoming Year. What does the Current Financial Crisis Portend for Bankruptcy Reorganization?* WL 531544 Aspatore 1 (2009).

574. Smits "Corporate Administration – A Proposed Model" (1999) *De Jure* 92. Also see UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 113. Also see Loubser "Post Commencement Financing and the Ranking of Claims: A South African Perspective" in Parry (ed) *European Insolvency Law: Current Issues and Prospects for Reform* (2014) 30.

The ability to raise new cash or loan capital and also to incur new debt in the post-petition period is critical to the success of the restructuring process.[575]

A failure to address mechanisms for the provision of post-commencement finance will create uncertainty. For example, in certain jurisdictions new money can only be provided on the basis of a security interest. Where there are no unencumbered assets or no excess value in already encumbered assets, the debtor company will have limited options to obtain post-commencement financing. New money in such an instance might have to be provided on risk without security in place.[576]

Legislation must recognise the need for post-commencement finance, provide authorisation for it and to create priority or security for repayment to the lender. The documents that can be provided to a potential offeror of post-commencement finance must be clear, which ultimately has the effect of encouraging its provision. One needs to be careful in balancing the need for post-commencement finance and its impact on the rights of existing secured creditors or those holding an interest in assets that were established at an earlier period in time. Interference with the pre-existing rights and priorities of creditors can result in a backlash which might prejudice the success of a reorganisation.[577] Further, one must consider the impact on unsecured creditors who might see the remaining unencumbered assets disappear to secure new lending, leaving nothing available for distribution, especially if the restructuring were to fail. This risk must be balanced against the prospect that preservation of going-concern value by continued operation of the business will benefit those creditors.[578]

Sources of post-commencement funding are very important to identity. Such financing can come from various sources. The first is pre-insolvency lenders or vendors of goods who have an ongoing relation with the debtor company and its business. These lenders may advance funds or provide trade credit in order to enhance the likelihood of recovering their

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575. Smits "Corporate Administration – A Proposed Model" (1999) *De Jure* 92. See UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 114. To ensure the continuity of the business where this is the object of the proceedings, it is highly desirable that a determination on the need for new finance be made at an early stage, in some cases even in the period between the time the application is made and commencement of proceedings. The availability of new finance will also be important in reorganisation proceedings between commencement of the proceedings and approval of the plan; obtaining finance in the period after approval of the plan should generally be addressed in the plan, especially in those jurisdictions which prohibit new borrowing unless the need for it is identified in the plan. Also see McCormack *Corporate Rescue Law: An Anglo American Perspective – Corporations, Globalisation and the Law* (2008) Chapter 6 – Financing the Debtor, 176–208.

576. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 114.

577. Ibid 115.

578. Ibid.

existing claims and perhaps growing additional value through the higher rate charged for the new lending.[579]

An alternative lender would be a lender that has no prior connection to the business of the debtor. Such a lender would be motivated by the possibility of achieving higher returns by lending to the distressed company. The inducement for both types of lenders is the required certainty that special treatment will be accorded to post-commencement finance. For existing lenders, there is the additional inducement of the ongoing relationships with the debtor and its business, the assurance that the terms of their post-commencement lending will not be altered and, in certain jurisdictions, the possibility that if they do not provide post-commencement finance, their priority may be displaced by the lender who does provide such finance.[580] The establishment of priority remains the most fundamental aspect of the provision of post-commencement finance. It must be clearly defined by the applicable legislation whether post-commencement finance ranks ahead of secured creditors, or whether it is dealt with as an administrative priority expense, ranking ahead of ordinary unsecured creditors, other statutory priorities such as taxes or social security.[581]

Suppliers of goods and services during the restructuring process are also viewed as providers of post-commencement finance. Such suppliers would only be prepared to continue to supply such goods and services on credit, if they have a reasonable expectation of payment ahead of pre-commencement unsecured creditors. In certain jurisdictions, a priority is afforded on the basis that the new credit or lending is extended to the supervisor, rather than to the debtor company. As a result, post-commencement finance becomes an expense of the company under administration or reorganisation.[582]

Other jurisdictions require borrowings or credit to be approved by the court or by creditors. Some provide a "super" administrative priority if credit or finance is not available, where it is ranked at the same level as the supervisor's fees. Such superpriority might rank ahead of administrative creditors. In most cases, any new financing is afforded priority over old debt in the event that the corporation is eventually liquidated. This is essential to encourage new

579. Ibid.
580. Ibid.
581. Ibid.
582. Ibid 116.

lending or financing into a company while it is being restructured. Lenders would otherwise be unwilling to take the risk of lending to the corporation.[583]

A more novel approach is taken in Australia. It makes the administrator personally liable for any new debts incurred, but gives him or her an indemnity payable from the assets of the corporation. The administrator would be covered so long as the business has value remaining in unencumbered assets.[584]

In the US, the US Bankruptcy Code offers the company a number of mechanisms through DIP financing.[585] It provides current or new lenders the first priority claim on the finances (i.e. a right of repayment priority) through the acquisition of financing and loans on favourable terms for the company. Access to DIP financing may be obtained during the ordinary course of business transactions without court approval. If there is a requirement for court approval, it would be where the DIP financing required is not in the ordinary course of business. In this instance, the court would authorise a debtor company to incur unsecured post-petition debt as a first priority administration expense or secured debt over unencumbered assets or remaining portions of unencumbered assets.[586]

In effect, DIP financing would pay the expenses necessary to cover the day-to-day operations of the business while under the Chapter 11 process.[587]

583. Smits “Corporate Administration – A Proposed Model” (1999) *De Jure* 93.

584. Ibid. Also see Granfield, O’Neal and Mehok *International Insolvency & Bankruptcy* (2008) 29–32; Symes and Duns *Australian Insolvency Law* (2012) 272–273; Murray and Harris *Keay’s Insolvency* (2014) 638–641.

585. Section 364(a) of the US Bankruptcy Code provides that the debtor can “obtain unsecured credit and incur unsecured debt in the ordinary course of business” without the need for prior court approval. Creditors’ claims for such advances are entitled to administrative priority under section 503(b)(1) of the US Bankruptcy Code. See Ferriell and Janger *Understanding Bankruptcy* (2013) 732.

586. Ibid 732–734; Epstein and Nickles *Principles of Bankruptcy Law* (2007) 92–94; Howard *Bankruptcy Overview: Issues, Law and Policy* (2002) 79–82; Du Preez “The Status of Post-Commencement Finance for Business rescue in South Africa” (2012) *Gordon Institute of Business Science* 26. See Sections 364(a) of the US Bankruptcy Code. Companies under Chapter 11 may negotiate favourable terms for DIP finance, such as loans from financial institutions on an unsecured basis and with favourable interest rates. This has been seen as a major success in the US in respect of obtaining DIP finance. See sections 364(a), (b), (c) and (d) of the US Bankruptcy Code. Under the U.S. Code, the company in business rescue can, in terms of 11 U.S.C.§ 364(a), obtain unsecured credit outside the ordinary course of business after notice and a hearing. The company in business rescue in the USA can seek to obtain credit as an “administrative expense” and if such financing is not obtainable, the company loan can be given “superpriority” over other administrative expenses, secured against any unencumbered property, or secured by a junior lien on property that is already encumbered, in terms of 11. U.S.C. § 364(b) and (c). If the company is unable to obtain financing on these terms, it can grant the creditor a senior or equal lien on encumbered property of the estate so long as there is “adequate protection”. This is pursuant to 11 U.S.C. § 364(d). What has been found is that as a practical matter, loans of companies in business rescue in the USA often offer attractive interest rates at relatively low risk, and the company creditor often has substantial control over the bankruptcy process. See Mongalo “Two Steps Forward and One Step Back is better than One Step Forward and Two Steps Back: A Limited Comparative Analysis of Business Rescue in South Africa” Opening address for *Business Rescue – First three years* University of Pretoria (7 October 2014) 6.

587. Du Preez “The Status of Post Commencement Finance for Business rescue in South Africa” (2012) *Gordon Institute of Business Science* 26.

As lenders are reluctant to extend credit to financially troubled companies, the rules relating to the order in which claims are paid are favourable to lenders who provide DIP financing. Section 364(d) of the US Bankruptcy Code provides superpriority status on prepetition assets to new lenders if they can prove that no other financing is available to the company.[588] Superpriority or DIP financing claims rank after secured claims in a Chapter 11 filing.[589]

DIP financing in the US has been criticised for "operating as a lever of control over management as well as transferring value to 'privileged' creditors at the expense of ordinary creditors and shareholders".[590]

Few Chapter 11 companies are capable of continuing in business without obtaining some additional financing. Debtors under Chapter 11 require additional infusions of cash to finance adjustments that they must make to restore their profitability.[591]

Many prospective lenders will not be confident of the debtor's ability to propose, confirm and consummate a reorganisation plan. Thus, the debtor company may not be able to find lenders who are willing to provide further extensions of credit on an unsecured basis. Accordingly, section 363(c) of the US Bankruptcy Code also permits the court to allow the debtor company to obtain funding and permits the court to grant the post-petition creditor either a superpriority claim or a security interest in the debtor's assets.[592]

Moreover, if existing secured creditors can be adequately protected, the court may authorise the debtor to provide a new lender with a senior lien on already encumbered assets.[593]

588. Ibid.

589. Ibid 27. For a listing of the ranking of claims in a Chapter 11 filing, see Gilson "Investing in Distressed Situations: A Market Survey" (1995) 51 (6) *Financial Analysts Journal* 8–27. Also see Ferriell and Janger *Understanding Bankruptcy* (2013) 732–738. The priority afforded under Section 503(6)(1) combined with Chapter 11's requirement that the debtor's plan provides for full payment of all priority claims, provides post-petition creditors with a substantial assurance of eventual payment.

590. Du Preez "The Status of Post-Commencement Finance for Business rescue in South Africa" (2012) *Gordon Institute of Business Science* 27. Also see Gaur "Post-Petition Financing in Corporate Insolvency Proceedings" (2012) *Taxmans SEBI Corporate Law Journal* 17–26.

591. Ferriell and Janger *Understanding Bankruptcy* (2013) 732. Also see Levin and Klee *Rethinking Chapter 11* (International Insolvency Institute, 12th Annual International Insolvency Conference, Paris, France, 21–22 June 2012) 6–7. Section 363 of the US Bankruptcy Code allows secured lenders to hedge against the diminution in value of their collateral by opting for quick sales of all of the debtor's assets rather than go through a prolonged Chapter 11 case. See pp. 7–8.

592. Ferriell and Janger *Understanding Bankruptcy*(2013) 732–734. See section 363(c) of the US Bankruptcy Code. Also see Goren "Chip away at the stone: The validity of pre-bankruptcy clauses contracting around section 363 of the Bankruptcy Code" (2006–2007) *New York School Law Review Volume 15*, 1078–1104.

593. Ferriell and Janger *Understanding Bankruptcy* (2013) 732–734.

The UK does not have the concept of a superpriority DIP financing arrangement, as is the case in the US. Any additional liquidity requirements must be met by funding from existing creditors.[594] The UK government embarked on a national consultation to encourage rescue and equivalent DIP financing in 2009. Responses to the proposal indicated a negative interest from the UK financing community and therefore no further action was taken.[595]

Although the concept of post-commencement finance is not expressly mentioned in the UK Enterprise Act, 2002, as set out above, the legislation does allow the administrator the ability to exercise the management powers of borrowing money and granting security on the company's behalf. The ranking would place "loan obligations" as a superpriority in repayments in an administration process.[596]

Administration expenses in the UK rank ahead of all preferential debts. This "golden rule" of insolvency, whereby the expenses of the procedure take priority over all other claims (except for those secured by means of a fiscal change) is embodied in the legislation.[597] Immediately upon appointment, the administrator will need to consider the funds available to finance trading. If the company has not granted security, the focus will be on the liquidity of the company's assets to meet the cost of trading. In the more usual circumstances, when the company has granted debenture security, the administrator's access to assets for trading expenses will be restricted to the pool of floating charge assets.[598]

In practice, the administrator would approach the existing banks for adequate working capital to assist in the carrying on of the business during the company's administration.[599] Application of the London Rules (applicable since 1990), would ensure that banks and, where appropriate, creditors, work together to reach a collective view on whether and how

594. Para 59 of Sch. B1 of the UK Insolvency Act provides the administrator with extensive powers. One of such powers is "the power to raise or borrow money and grant security over the property of the company". No further specific section deals with the ability of the administrator to raise financing.

595. Du Preez "The Status of Post-Commencement Finance for Business Rescue in South Africa" (2012) *Gordon Institute of Business Science* 29.

596. Ibid. Para 65(d) of Sch. B1 provides that the administrator can rank and distribute proceeds to creditors in terms of the distributional provisions set out in section 175 of the UK Insolvency Act. This would include the ability to recognise the preferential status of lenders in the administration. See Fletcher *The Law of Insolvency* (2009) 597–607.

597. Section 175 of the UK Insolvency Act. Fletcher *The Law of Insolvency* (2009) 599. See para 99 of Sch. B1 to the UK Insolvency Act. Also see Rajak *Company Rescue and Liquidation* (2013) 116–119.

598. Lightman and Moss *The Law of Administrations and Receivers of Companies* (2011) 177. Also see para 70(1) of Sch. B1.

599. Goode *Principles of Corporate Insolvency Law* (2011) 315.

the company should be given financial support during the course of its administration. The pain (of funding) is shared on an equitable basis and with a view to maximising value for creditors:[600]

> In England, it is usual for companies to raise a good portion of their capital by resort to bank loans secured by floating charges. This is consistent with English judicial and legislative policy which encourages financing through secured loans at interest rates that are reduced by giving secured creditors high levels of protection.[601]

In Canada, neither the CCAA nor the BIA originally addressed the issue of DIP financing. The gap was filled by the Canadian courts which began to grant orders authorising the debtor to obtain interim financing. The courts also began to grant charges against the assets of the debtor to secure the interim financing. Courts have also made orders creating superpriority for a DIP lender under the BIA on the basis of their inherent jurisdiction.[602]

In determining whether it is appropriate to give a DIP lender priority over existing secured creditors, courts have considered the extent to which the secured creditors would be adversely affected. There must be "cogent evidence that the benefit of DIP financing clearly outweighs the potential prejudice to the lenders whose security is being subordinated". To make this assessment, courts wait upon being given information as to the value of the collateral and the amount of the secured obligation.[603]

In some cases, the DIP lender is a new lender that has had no past dealings with the debtor. In other cases, the DIP loan is obtained from an existing creditor. A pre-filing lender may extend funds to the debtor in order to enhance its recovery on its pre-filing claim or to gain a greater ability to influence the direction of the restructuring.[604]

The 2005/2007 amendments to the Canadian legislation specifically addressed interim funding in both the CCAA and BIA restructuring. The amendments specifically allow a court (on good grounds) to make an order declaring that all or part of the debtor's property

600. Ibid 338–339.

601. Finch *Corporate Insolvency Law: Perspectives and Principles* (2002) 9.

602. At first these orders simply gave the interim lender priority over the existing unsecured creditors. However, this was not sufficient to induce an interim lender to advance funds to an insolvent debtor who was given a security interest in all of its present and future assets to an earlier lender. Courts then began to make orders that gave the charge priority over existing secured creditors. When this order is made, the DIP charge is said to "prime" the other secured loans. See Wood *Bankruptcy and Insolvency Law* (2009) 356.

603. Ibid.

604. Ibid. Under certain circumstances courts have been willing to extend the scope of the DIP charge, so that it covers pre-existing obligations that are unconnected to the DIP loan.

becomes subject to a security or a charge in an amount that the court considers appropriate.[605]

Thus the CCAA and BIA in Canada now utilise the concept of DIP financing. This provides a superpriority charge in favour of a lender. There must be persuasive evidence that the benefits of such financing clearly outweigh the prejudice to lenders whose security becomes subordinated to such financing.[606]

In the case of CCAA, the provision and structure of DIP financing generally reaches court approval unchallenged as the process to agree on the terms of DIP financing is resolved through intense negotiations amongst strategic stakeholders prior to the commencement of CCAA proceedings. The Canadian courts do not tend to intervene in DIP financing proceedings unless the terms are controversial, for example where the DIP lender is provided with superpriority security against the objections of existing creditors. Generally PPF is required upfront due to the fact that as soon as the company makes a CCAA filing, existing lenders and creditors tend to terminate financing facilities or change the terms of their payments. It would also contribute towards confidence levels of existing creditors in boosting the prospects of success of the distressed company. The authorisation of new financing would be considered by the Canadian courts on a “balance of prejudices” test. Several enumerated criteria would have to be met for the court to grant such new financing.[607] In CCAA proceedings, it is generally the responsibility of the courts to determine the relative ranking of charges in such process.[608]

In Australia little mention is made in the legislation relating to the financing of businesses which have filed for bankruptcy. As a result, any additional liquidity requirements would be met by funding from existing lenders and creditors. Australian banks are usually more forthcoming with further financing if the company in question is in distress, rather than insolvent.[609] Thus, whether a company is in the voluntary administration stage or being liquidated will make a significant difference on the willingness of banks to participate in

605. Section 11.2(1) of the CCAA and section 50.6(1) of the BIA. See Symes and Duns *Australian Insolvency Law* (2012) 358–359.

606. Du Preez “The Status of Post-Commencement Finance for Business Rescue in South Africa” (2012) *Gordon Institute of Business Science* 30.

607. Ibid 31.

608. Ibid.

609. Ibid 33. Also see Wong “Corporate Rescue in Australia and the US: A Comparative Study” (2009) *Norton Journal of Bankruptcy Law and Practice* 16.

further interim funding and its level of participation in supporting the corporate rescue. Generally, Australian banks are accepting of the need to provide finance to companies in financial distress, thus making it easier to assist corporate rescue practice in Australia.[610]

The problems associated with the raising of post-commencement finance are generally experienced in most jurisdictions. In January 2010 the INSOL International Academics' Group published the results of a survey done among its members on the impact of the financial crisis on accessing post-commencement finance by companies in business rescue.[611] The report indicated that the vast majority of members (84,7 per cent to be precise) in all jurisdictions, and irrespective of the legal system or, surprisingly, of how creditor-friendly the system is, strongly agreed or agreed that access to financial facilities, which had never been easy, was now severely restricted as a result of the global financial crisis. Many banks were in trouble themselves and were generally more cautious and thus very aware of the exposure to the severe risks associated with business rescues.[612]

Interestingly enough, however, a report published by INSOL International a few months later, in June 2010, of a survey done among insolvency practitioners on how they had found the market during the past two or three years indicated that only 8 per cent regarded the problems faced and solutions employed during this period as unique to the recession, although 68 per cent believed that "financial stakeholders" distinguished between viable businesses that were worthy of rescue and those that were not. This suggests that although the banks were more cautious than ever, the problem of obtaining post-commencement finance was not a new one and not limited to periods of financial strain.[613]

A major spin-off of considering the availability of post-commencement funding is the practice of investing in distressed funds, popularly known as "vulture" investing. Investors who are adept at managing these risks generally understand the risks of corporate

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610. Du Preez "The Status of Post-Commencement Finance for Business Rescue in South Africa" (2012) *Gordon Institute of Business Science* 33.

611. Loubser "Post-Commencement Insolvency and the Ranking of Claims – A South African Perspective" in Parry (ed) *European Insolvency Law: Current Issues and Prospects for Reform* (2014) 30–31.

612. Ibid.

613. Ibid. Also see Vriesendorp and Gramatikov "Impact of the Financial Crisis" (2010) *INSOL International Survey*.

bankruptcy and are skilled at identifying or creating value in a distressed debt situation. Such investors aim to achieve consistently high returns as a result of such investment.[614]

A distressed debt investor would identify a company that is financially distressed and look to introduce funds into such company on a post-commencement finance basis or alternatively in an effort to buy either the shares or assets of the company. Over the last ten years, distressed debt acquisition and investments have increased substantially, particularly in jurisdictions such as the US and Australia.[615]

As a result of increased bankruptcy filings and debt restructurings in the US, a strong secondary market for trading in the financial claims of distressed companies has emerged.[616] The strategies that are used are diverse, as to the claims targeted and the companies that have been targeted. Some investors prefer to acquire the debt claims of a company while it tries to reorganise under Chapter 11 so that they can position themselves to influence the terms of the reorganisation or wait until the company's debt is converted into a major equity stake that can be used to influence company policy. Some investors prefer to purchase senior claims, others junior claims and still others spread their purchases throughout the entire capital structure.[617]

In the US there is a market for virtually every kind of distressed claim, ranging from bank loans, debentures, trade payables, private placements, real estate damages and claims for legal damages and lease contracts.[618]

Investing in distressed situations involves purchasing the financial claims of firms that have filed for legal bankruptcy protection or alternatively are trying to negotiate an out-of-court restructuring with creditors. The US Bankruptcy Code does not specifically regulate

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614. Gilson "Investing in Distressed Situations: A Market Survey" (1995) *Financial Analysis Journal* 8. Distressed debt investing first took hold in the US. It began as a small niche market primarily used by hedge funds that often were called "Vulture Investors". The nickname refers to these investors' perceived practice of scavenging company carcasses for value. Distressed debt investing has since developed into an investment strategy independent of Chapter 11 that focuses on a much broader pool of troubled companies and distressed debt instruments. It also has extended beyond the US borders to the UK and Australia. See Harner "The Corporate Governance and Public Policy Implications of Activist Distressed Debt Investing" (2008) *Fordham Law Review* 21.

615. See Levenstein "Opportunities Arising from the New Business Rescue Provisions of the South African Companies Act, 2008" (November 2013) available at http://www.werksmans.com/legal-briefs-view/opportunities-arising-new-business-rescue-provisions-south-african companies-act-2008/.

616. See Jain "Alternative Investment Review: Investing in Distressed Debt" *Analyst* (2015) 32–51.

617. Harmer "Comparison of Trends in National Law: The Pacific Rim" (1997) 23 *Brooklyn Journal of International Law* 149.

618. Gilson "Investing in Distressed Situations: A Market Survey" (1995) *Financial Analysis Journal* 8. See Wachtell, Lipton, Rosen & Katz *Distressed Mergers and Acquisitions* (2014) available at http://www.wlrk.com/files/2014/DistressedMA.pdf 159–214.

trading in distressed claims.[619] As a general legal principle, an investor who purchases a distressed claim enjoys the same "rights and disabilities" as the original claim holder. As a result, the investor can assert the claim's full value in a bankruptcy or restructuring, regardless of how much was paid for it.[620]

Once a claim has been purchased, there are several ways that an investor can influence the manner in which the firm's assets are deployed:[621]

- The investor, as a creditor (having purchased a claim) can submit a reorganisation plan to be considered and voted on by the firm's claim holders;
- The investor can purchase further outstanding debt claims with the expectation that these eventually will be converted into voting stock under the firm's reorganisation plan. Owning a large block of equity stock will enable the investor to exercise control over the firm's assets after it reorganises;
- The investor can purchase new equity (shares/stock) and other securities that are to be issued under the firm's reorganisation plan.

In the US, the explosion in the growth in the demand side of the distressed debt market has greatly reduced the number of opportunities for buying underpriced claims. There is always risk when buying up distressed claims, as they are highly firm specific. In the US, distressed funds are generally legal and institutional in nature, and most risk is controlled through careful planning and by conducting adequate due diligence. Many firms are represented by individuals who have a sound working knowledge of bankruptcy law and many are former practicing bankruptcy attorneys or have access to legal counsel experienced in bankruptcy matters.[622]

Vulture funds can add or subtract value in a corporate reorganisation process and this topic is fairly controversial. Often the term "vulture" is equated to "raider" and it is often used to describe proactive investors in a takeover market. In the US, many bankruptcy judges are philosophically opposed to the idea that people can insert themselves into a distressed

619. Gilson "Investing in Distressed Situations: A Market Survey" (1995) *Financial Analysis Journal* 9–10.
620. Ibid.
621. Ibid 11–12.
622. Ibid 13. For an analysis of the profile of risk in distressed debt investing, see pp. 13–22.

situation for profit, while at the same time the firm's original lenders and stockholders are being asked to make material financial sacrifices. Such hostility to the activities of vulture investing overlooks the critical role it plays in creating value in a restructuring situation.[623] When a firm becomes financially distressed, there are various reasons why the original lenders can benefit from less than full face value. Firstly, bank lenders can profit on a distressed loan sale and would sooner exit as creditors then have to actively manage the recovery through a workout department. Trade creditors can also benefit from selling their claims against a distressed firm rather than be faced with waiting for a recovery in the restructuring. By buying up and consolidating distressed claims, vultures can also facilitate a reorganisation by reducing the so-called "hold-out problem".[624] By consolidating claims, vulture funds help reduce the hold-out problem and make it easier for firms to restructure their debt. A key to sourcing upside in a purchase of distressed debt, is the ability to identify and be able to accurately value a firm's assets in the restructuring process. Investors must be adept at identifying the value assets, obtain and locate pertinent information about those assets and process such information to ensure the correct valuation outcome.[625]

The "loan to own" principle in a Chapter 11 restructuring is fast taking a hold on the objectives of debt purchasing by vulture funds. By purchasing debt, professional debt investors in Chapter 11 cases facilitate control of the firm with the potential acquisition of the equity as a viable outcome. In a "loan to own" strategy, the investor extends debtor-in-possession finance to the debtor in order to facilitate the investor's ultimate objective, the ownership of the debtor's business, through a debt-for-equity exchange or a sale transaction.[626] Activist institutional investors might purchase company debt to seek to change management and board members, or to effect operational strategies, asset holdings or capital structure. This might not benefit the debtor and other stakeholders. As a result,

623. Ibid 23.
624. Ibid.
625. Ibid.
626. Harner "Trends in Distressed Debt Investing: An Empirical Study of Investor's Objectives" (2008) *American Bankruptcy Institute Law Review*. For an excellent analysis of empirical data supporting these investment practices in a Chapter 11, see this article. Also see Harner "The Corporate Governance and Public Policy Implications of Activist Distressed Debt Investing" (2008) *Fordham Law Review*; Whelman *Distress Investing: Principles and Techniques* (13 April 2009).

financially troubled companies that are targeted by such activist investors might file for bankruptcy as a defensive measure to a hostile takeover bid.[627]

As set out above, in the UK, the UK Insolvency Act, 1986 (as amended by the Enterprise Act, 2002) provides a company with both restructuring (administration) and liquidation alternatives. In contrast to the US, a company's management is subject to the direction and control of a third party administrator in the restructuring context. Institutional investors in the UK do pursue distressed debt investing opportunities depending on the value existing at the distressed company. A negotiation would ensue between the administrator and the investor in respect of a possible debt for equity exchange. This would occur with little or no substantive court involvement.[628]

The issue of value creation or destruction is present in both the US and in the UK. Again, investors looking to acquire the company or to take control via a debt to equity swop, will have influence on management and existing shareholders. This needs to be carefully managed, as it can result in destruction of value while the company is in its process of administration.[629]

However, not every distressed investment situation leads to conflict. Regardless, a distressed debt investor might be the only source of rescue capital for the company. A distressed debt investor that offers new capital to the restructured company, either directly or by impairing the company's balance sheet through a debt-equity exchange can give a troubled company a second chance.[630]

In the UK, interest in corporate debt trading began to emerge once the US market began to get saturated. Making use of vulture funds to provide alternatives for the acquisition of debt was encouraged by the Bank of England. At an INSOL International Conference, the involvement of vulture funds was supported:

> [Such funds] make the whole [restructuring] process a much quicker and less expensive way to proceed and also you get very sophisticated investors who are able to spend the time to try fix the company and bankruptcy, even though they have a

627. Harner "The Corporate Governance and Public Policy Implications of Activist Distressed Debt Investing" (2008) *Fordham Law Review* 2–3.
628. Ibid 19.
629. Ibid 20.
630. Ibid.

> profit motive. If they can fix the company, make a profit and get out, that's fine. For the banking community and the trade creditor community it provides a market to sell out. They don't have to hang in for the uncertainty of bankruptcy over a two or three or five year period.[631]

The Bank of England's motives were clear. They preferred that companies not be placed into liquidation unnecessarily for economic reasons. Jobs and productive capacity had to be preserved. With the increasing use of the London approach to restructuring and the need to restructure balance sheets, the need for distressed debt investors introducing funding was a strong draw for vulture funds investors to consider entering the UK market.[632]

In Canada, the tightening of global credit markets since 2008 has brought about conditions in credit markets which present attractive opportunities for distressed debt funds. Canadian distressed debt funds or "vulture funds" look at acquiring the debt of a company that is either bankrupt or, more often, near bankruptcy, at a considerable discount. As in the US, once debt has been purchased (either from creditors or from the companies themselves) such purchase or investor is able to yield considerable influence over any restructuring or liquidation process that follows thereafter.[633]

Canadian venture capital funds often see investing in distressed debt as an opportunity to make a profit, either through the liquidation of the assets of the company, or to have its debt converted to equity in a restructuring of the company and to emerge as a major shareholder. Once achieved, such a shareholder will use its position to initiate change in an attempt to increase the value of its equity stake in the company. Access to short-term funding and a deteriorating debt market in Canada has left vulture funds considering and monitoring opportunities on a constant basis.[634]

As a result, management companies in Canada have to constantly be aware of who holds their company's senior debt, whether it be a primary lender or through secondary markets,

631. Flood "The Vultures Fly East: the Creation and Globalisation of the Distressed Debt Market" in Nelken (ed) *Adapting Legal Cultures* (2001) 272. See this contribution for an excellent synopsis of distressed debt funding in Europe, the UK, the US and Canada.
632. Ibid.
633. Magee and Partridge *Distressed Debt Investors in the Current Market – Banking and Finance Update* (Wildeboer Dellelce LLP *Business Law* October 2008) available at www.archive-ca-2012,wildlaw.
634. Ibid 1.

as distressed debt investors may be focused on making their returns through a restructuring or liquidation process.[635]

In Australia, the secondary market for buying debt has increased. There is an increasing availability of distressed debt coupled with a deep market of buyers who are interested in acquiring Australian distressed debt. In Australia, trends reflect that buyers of debt are typically motivated by either trading profits or a longer-term interest in the assets and business of the borrower. Debt to equity swops appear to be a driving factor in such investment strategies.[636]

Australian buyers of distressed debt have a number of options available to them when they are looking to convert debt to an equity ownership under Australian law. Ownership can be achieved through a recapitalisation of the existing business through a debt or equity swop or by the enforcement of security provided by the lender which would lead to a sale of the company's assets to a party related to the lender.[637]

In an Australian scenario, a consensual debt for equity swop is an option but would have to be negotiated by the lender and the debtor company. Alternatively, there can be a consensual issue of equity to a financier in consideration of forgiveness of the debt. The debt for equity swop would generally occur where the secured creditor uses the potential of enforcement as leverage in a negotiation.[638]

Generally it has been found that the credit crisis pervading world economies since 2007 has stifled the access of distressed business to financial facilities so needed for successful restructuring. This has impacted negatively on the prospects for preventing or even ending the bankruptcy procedure with a reorganisation, instead of a winding up of the estate assets. There are various reasons for this, as set out by Vriesendorp and Gramatikov:

> Several reasons have been pointed out by insolvency professionals. First, there is the objective decrease of cheap and liquid financial resources. The traditional funders of

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635. Ibid 2. Also see Muglich "Canada: How not to Buy a Distressed Business" (2014) *Clark Wilson LLP Securities Law Update*.

636. Marshall and Wilde *Distressed Investing in Australia* (2011) 16. The distressed debt market has expanded significantly in Asia and Australia since the Asian banking crises in the late 1990s. The number of funds and amount of capital dedicated to this sector has increased considerably. Certain Asian and European distressed funds have opened up offices in Australia highlighting the recognition that Australia is seen as an attractive market for distressed debt acquisitions. Australia's strong legislative framework means that it is a low-risk premium when funds consider evaluating investment opportunities in Australia. See p. 31.

637. Ibid 16.

638. Ibid.

> distressed business – banks and hedge funds – are in financial troubles themselves and apply more selective and cautious risk management rules. Furthermore, the banks nowadays operate under more rigid public policies and the political and public expectations are for prudency and restraint. Financing of restructuring may be high risk and on the one hand, the insolvency professionals see in their practices that the banks do not welcome this risk. On the other hand, they also think that the banks are overly risk aversive and eager to show constraint. Some of the respondents even think that as the bankers failed to recognize the symptoms of the credit crunch, they nowadays have become short-sighted to recognize the long term interests of their clients.[639]

It is submitted that without debtor-in-possession financing becoming available to a company about to go through a restructuring process, the prospects of such a company surviving are close to zero. Finance is required to ensure that operationally the company can continue to pay its ongoing expenses to creditors and employees. If the company is to be sold to a third party in a restructuring, then such third party might put up post-commencement finance to "prop up" the asset while the acquisition transaction is being negotiated. Alternatively, it might be that the company itself can continue to trade and pay creditors in the ordinary course while it is being restructured.

Overall debtor-in-possession or post-commencement funding is the lifeblood of a reorganisation/restructuring. Without it, the endeavour to rescue the company will be stillborn.

5.5.6 THE BUSINESS RESCUE PLAN AND THE ABILITY TO CRAM DOWN ON DISSENTING CREDITORS

Legislation must provide for a reorganisation plan allowing the company to be restructured in a particular manner. Laws must provide guidelines to the nature and form of the plan; when it is to be prepared; who is permitted to prepare a plan; its content; how it is to be approved by creditors; whether court confirmation is required; the effect of the plan, and how it is to be implemented.[640]

A rescue/reorganisation might perform difference functions in different types of proceedings. In some, the plan may be the tailpiece of the reorganisation proceedings which would deal with the pay-out of a dividend in full and final settlement of all claims

639. Vriesendorp and Gramatikov "Impact of the Financial Crisis" (2010) *INSOL International Survey* 18. This article contains an analysis of financing in restructuring.

640. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 209.

and the final structure of the business after the reorganisation is complete.[641] Details such as the manner in which the company and its business should be dealt with in the reorganisation period, expected dividends and dates of payment, the manner in which contracts are to be dealt with and the benefits for creditors in supporting the plan, should all be included.[642] The main purpose of the plan is to maximise the possible return to creditors, providing a better result than if the debtor were to be liquidated. Other objectives would be to preserve viable businesses so as to preserve jobs for employees and trade for suppliers.[643]

Different stakeholders will view the plan in accordance with their own preferred outcomes. Some creditors, such as major customers or suppliers, may prefer continued business with the debtor company to ensure the repayment of their debt. Certain creditors may favour taking an equity stake in the company, while others may not.[644] What should be averted is a prescriptive approach to the content of the plan and to the range of options available. It is preferable to have a nonintrusive approach that does not prescribe limitations. This provides sufficient flexibility allowing for the most suitable range of possibilities for the distressed debtor.[645]

Other jurisdictions prefer to give the practitioner some guidelines on what should be dealt with in the plan. Guidelines should rather be provided listing some of the possibilities and requirements for an effective plan. Issues such as priorities afforded to creditors in the reorganisation, the likely dividend to be received as opposed to what would be received in the liquidation of the company are prerequisites, enabling creditors to vote effectively on the plan.[646]

A business rescue plan should serve as a tool for feasibility declaration, a medium of communication, an enabler of transparency, a contractual obligation and finally to assist in

641. Ibid.
642. Ibid.
643. Ibid.
644. Ibid 210.
645. Ibid.
646. Ibid. For an excellent analysis of business rescue plans in different international jurisdictions, see Pretorius and Rosslyn-Smith "Expectations of a Business Rescue Plan: International Directives for Chapter 6 Implementation" (2014) 18(2) *SABR* 108–139.

decision making for attracting post-commencement financing.[647]

International principles have been set as the benchmark for rescue plans. These include the acceptance of business rescue plans as tools for "feasibility declarations" that can assist in the rehabilitation of the company and which result in achieving better returns for creditors. The plan should include a strategy upon which the objectives of the recovery plan are based; an indication of how the business will become operational and successfully reorganised, and how the implementation of the plan will be supervised within specified time frames.[648] The plan must be effectively communicated and assist in the clarification of the deliverables set out in the plan to all stakeholders, particularly creditors. The plan must result in a contractual obligation by means of a binding contract between the practitioner, creditors and other relevant parties. In addition the plan must be transparent and predictable. This will enable potential lenders and creditors to understand the plan itself, and allow them to properly assess their risk in the event of possible rehabilitation of the company. Lastly (and most importantly), the plan should attract and secure PCF to ensure the continued operation of the distressed entity after the commencement of formal rescue proceedings.[649]

Rather than specify a wide range of detailed information to be included in a plan, it is desirable for the legislation to identify the minimum content of the plan, focusing on its key objectives and procedures for implementation. Details should include the classes of creditors and the treatment each is to be accorded (such as the treatment of contracts and the on-going role of the debtor and its management), as well as what is required for the implementation of the plan (such as the sale of assets or parts of the business, extension of material dates for debt and loan formalities, changes to the structure of the business and the nature of the supervision of the implementation of the plan).[650]

Many jurisdictions require a special meeting of creditors to be called for the purpose of voting on the reorganisation plan. Circulation of the plan would need to occur prior to the

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647. Rosslyn-Smith and Pretorius "Stakeholder Expectations of the Business Rescue Plan from a South African Perspective" (2015) 146 *SAJESBM* 7–9. Also see McCormack *Corporate Rescue Law: An Anglo American Perspective – Corporations, Globalisation and the Law* (2008) Chapter 8 – The Restructuring Plan, 251–287.

648. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 207–209. Also see Pretorius and Rosslyn-Smith "Expectations of a Business Rescue Plan: International Directives for Chapter 6 Implementation" (2014) 18(2) *SABR* 128–132, where the authors analyse the UNCITRAL principles for business rescue plans.

649. Ibid.

650. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 215.

meeting itself to enable those parties who are entitled to vote at the meeting to consider the content of the plan and the proposals contained in the plan.[651] Requirements on voting procedures and the division of creditors into voting pools depending on classes or rights of creditors is often determined by legislation. Issues such as voting on value, number, in separate classes, preference to priority claims, dealing with nonparticipating or abstaining creditors would all be considered. Ensuring that all creditors receive adequate notice of meetings where voting would be required serves to alleviate the potential for abuse. This in turn facilitates the use of proxies and electronic voting mechanisms.[652]

It is important that secured creditors have an opportunity to vote. Secured claims often represent a significant portion of the value of the debt owed by the debtor. The ability of secured creditors to vote will be determined by the manner in which legislation treats secured creditors in the reorganisation, the extent to which a reorganisation plan can affect the security interest of the secured creditor and the extent to which the value of the encumbered assets will satisfy the secured creditors claim.[653]

Equity or shareholders need to also be considered in approving a plan. This would generally occur where the capital structure or the membership of the debtor company is affected by the reorganisation plan. Where there is going to be a debt-equity conversion, or where shareholders are to be diluted, such equity holders should be allowed to vote on the plan.[654]

The voting in of a plan by a requisite majority is the culmination of the restructuring process and thus minimum thresholds need to be put in place for the plan to be approved by creditors. The requisite majority can be calculated in a number of different ways, depending upon whether or not creditors vote in classes and how those classes are treated in determining the majority vote.[655] The majority may be determined by reference to the support of a proportion or percentage of the value of claims, or to a number of creditors, or a combination of both. Various proportions can apply and can be limited to those creditors who actually vote on approval of the plan or by way of different proportions with reference

651. Ibid 219.
652. Ibid.
653. Ibid 220–221.
654. Ibid 222–223.
655. Ibid 223.

to the total value of debt and total number of creditors, irrespective of whether or not they voted.[656]

If the proposed plan cannot be approved, different jurisdictions might legislate on a flexible basis, by allowing a plan to be submitted on an alternative basis, modified to accommodate the interests of all creditors. Generally this occurs by way of further negotiation on the part of creditors. Flexibility may be achieved by allowing a majority of creditors to vote to adjourn the meeting convened to vote on the plan it if appears that further negotiations on the plan may produce a favourable result, or that unresolved disputes and issues can further be addressed.[657] If a plan is not approved, then certain jurisdictions require a conversion from the reorganisation process to liquidation. Failure to approve is generally seen as an indication that creditors favour liquidation and that reorganisation has failed as a potential outcome. Unfortunately for the debtor company, the failure of the reorganisation plan leaves the debtor in a state of continued financial difficulty, where further debts have been incurred during the reorganisation proceedings, where the value of assets have diminished and where the postponement of liquidation proceedings has left the debtor in a far worse position than would have been the case had reorganisation not commenced.[658]

Certain jurisdictions require plans to be ultimately approved by a court, despite the fact that creditors have approved the plan. Court approval might be required for the plan to become effective and binding on all creditors, including dissenting creditors. If court approval is required, challenges to the plan can be made by disapproving creditors, placing the reorganisation in jeopardy.[659] After approval of a plan, the implementation of such plan must be expedited. This must either be driven by the practitioner or by the debtor company and its management. The required degree of supervision in the implementation phase will be determined by the need for a debtor-in-possession regime versus one which requires a higher degrees of supervision throughout the process. In certain jurisdictions, no further supervision is required, once the plan becomes effective. The court might also be required

656. Ibid 223–224.
657. Ibid 225.
658. Ibid.
659. Ibid 226–231.

to play an ongoing supervisory role after approval of the plan, and pending completion of its implementation.[660]

If the reorganisation proceedings fail or implementation is unsuccessful, there may be a need for an orderly conversion of the debtor company to liquidation. The principal grounds for a conversion would be a failure to propose or approve a reorganisation plan; a failure to approve proposed modifications to the plan; failure to obtain confirmation; a successful challenge to an approved or confirmed plan; a majority vote by a meeting of creditors to terminate reorganisation proceedings; a substantial or material default by the debtor of its obligations under the plan, or failure of implementation of the plan for some or other reason.[661]

Of course, another important reason to consider conversion will be where there is a strong indication that there is no longer a reasonable likelihood of the business being successfully reorganised. Some jurisdictions impose an obligation on the practitioner to terminate reorganisation or administration proceedings in order to preserve the value for creditors.[662]

The basic reason for a reorganisation case is that more value can be realised if the going concern is kept intact. By definition, a liquidation will lose much of that value, even if court authority is obtained to operate the business on some sort of interim basis. The American legislative scheme believes that current management (though perhaps lacking in some areas) is part of that going-concern value, and generally speaking can be part of the solution for the company.[663]

In the US, the event toward which all things point in a Chapter 11 case, is the filing and confirmation of a plan of reorganisation.[664] The plan is essentially a contract between the debtor and its creditors, under which the debtor restructures its debt and equity, thereby creating a rational and feasible method for the debtor to maximise the return to all parties

660. Ibid.
661. Ibid 232.
662. Ibid.
663. Rochelle "Lowering the Penalties for Failure: Using the Insolvency Law as a Tool for Spurring Economic Growth: The American Experience, and Possible Uses for South Africa" (1996) *TSAR* 328.
664. See Ferriell and Janger *Understanding Bankruptcy* (2013) 738–739.

over time. Within certain limits, just about any restructuring can be implemented if the parties agree.[665]

The plan is driven by a negotiation process amongst the debtor and creditors (and in some instances equity interest holders). Generally, a Chapter 11 plan must be approved by the requisite majority of creditors for it to be implemented. In a Chapter 11 procedure, creditors vote under a modified form of majority rule. If the requisite majority is obtained, then all creditors are bound. As set out above, in limited circumstances, the plan may be "crammed down", i.e. confirmed in spite of the objection of a class of creditors.[666]

Section 1123(a) of the US Bankruptcy Code contains a number of mandatory provisions that must be addressed in the plan. These include *inter alia* a designation of classes of creditors and interests, a specification of unimpaired classes, the specification of the treatment of claims and interests within a class, adequate means for the plan's implementation, and the protection mechanisms for shareholder voting rights.

Creditors would express their agreement to the plan by participating in negotiations leading up to the promulgation of the debtor's plan and by voting to accept it. Chapter 11 creditors vote in classes and voting proceeds on a dual "one creditor, one vote" and a "one debtor, one vote" regime. More than half of a debtor's creditors must vote for the plan and at least two-thirds of the dollar value of claims against the debtor must approve the plan. Thus most confirmed Chapter 11 plans are set to implement the collective wisdom of the debtor's creditors.[667]

Generally speaking, plans must give the same treatment to parties similarly situated, and a senior class of creditors must be paid before junior creditors receive anything, unless the senior class consents to another sharing ratio. In addition, there are a number of other outcomes which a plan will be set to achieve. In the US, among the more common are the following: [668]

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665. Ibid.

666. Ferriell and Janger *Understanding Bankruptcy* (2013) 779–796. Also see Epstein and Nickles *Principles of Bankruptcy Law* (2007) 96–97; Howard *Bankruptcy Overview: Issues, Law and Policy* (2002) 82–85.

667. Ferriell and Janger *Understanding Bankruptcy* (2013) 759–760. Also see Epstein and Nickles *Principles of Bankruptcy Law* (2007) 99–100.

668. Rochelle "Lowering the Penalties for Failure: Using the Insolvency Law as a Tool for Spurring Economic Growth: The American Experience, and Possible Uses for South Africa" (1996) *TSAR* 328. Also see Ferriell and Janger *Understanding Bankruptcy* (2013) 776–777.

- Secured and unsecured debt may be renegotiated or forgiven;
- Executory contracts and unexpired leases may be assumed, assigned, or rejected;
- Claims or causes of action belonging to the debtor may be settled, or the debtor may retain the right to further pursue the matters after confirmation;
- Some or all of the debtor's property may be sold and the proceeds distributed;
- Anything else which is not inconsistent with the provisions of the US Bankruptcy Code may be done under a plan.

In the US, plans generally fall into two broad categories: restructuring of a going business or the sale of the property to a third-party purchaser. Either approach is acceptable under the US Bankruptcy Code; and the decision on which route to take will depend largely upon which method the creditors believe will give them a better return in the distressed entity. The rules governing the case and plan process in the Chapter 11 reorganisation in the US are intentionally drafted to make the parties come to an agreed solution for reorganisation. This goal is accomplished by giving no one enough power to dominate the case, and it encourages each group to build alliances to accomplish the main goals in the case.[669]

The formulation of a restructuring plan is the fundamental aim of any restructuring. Thus all rescue models require that a plan be formulated for the rescue of the corporation. The question is who should propose this plan? In some countries such as the US, the debtor has an exclusive right to propose a plan for a limited period, whereas in other countries such as Australia, the debtor in conjunction with the administrator proposes the plan.[670] It would be extremely difficult to draft legislative provisions that make provision for all eventualities under a business rescue plan. Such an approach would be too prescriptive, not allowing enough flexibility for business administrators to propose a workable plan. It is probably more acceptable to identify the minimum content of a plan which focuses on its key objectives and procedures for its implementation. The plan should also clearly set out the impact it will have on the various parties which are subject to the plan. Suggestions as to

669. Ibid. Also see Epstein and Nickles *Principles of Bankruptcy Law* (2007) 101–110.
670. Burdette "Development of a Modern and Effective Business Rescue Model for South Africa" (2004) Centre for Advanced Corporate and Insolvency Law, University of Pretoria 80–81.

what should be included in the business rescue plan should however be made known in the legislation.[671]

It is important that as much information as possible should be provided in the plan prior to creditors or interested parties voting on the proposal. Legislative provisions should determine the minimum amount of information that should be provided and which must accompany the plan when it is submitted to the stakeholders for their consideration. Minimum information should include the following:

- Full information regarding the financial position of the debtor (including assets and liabilities and cash flow statements);
- A comparison between what will be received by creditors under the plan and what could be expected to be received by them under liquidation;
- The basis upon which the debtor will be able to continue trading and subsequently be reorganised;
- The voting mechanisms that apply in approving the plan;
- Information showing that the plan is capable of implementation and that the debtor is able to meet its commitments under the plan.[672]

The plan is the fruit of a process of negotiation between the debtor, creditors and in some cases equity interest holders. In the US, Chapter 11 plans are likely to involve considerably more property and debt issues and therefore the financial structure is likely to be more complex, with multiple layers of claims and interest, each entitled to different priority.[673] This in itself makes the Chapter 11 plan process more complex than others. However, additional layers of complexity are added by the following facts:

- The debtor has greater flexibility in formulating a plan;
- The plan confirmation process gives creditors the vote and hence more voice in the plan negotiation process.

671. Ibid.
672. Ibid 81.
673. Ferriell and Janger *Understanding Bankruptcy* (2013) 738–740.

The usual justification for this greater flexibility is precisely the fact that the Chapter 11 creditors have a much greater degree of input. Chapter 11 debtors commonly delay filing a plan for several months or, if the court permits, even years.[674] A plan is properly developed only after the debtor has had an opportunity to adjust its business operations to correct whatever circumstances led it into financial difficulty in the first place, and has had an opportunity to negotiate with its creditors about how to reorganise its financial structure. The Chapter 11 plan is often partially or fully negotiated even before the Chapter 11 petition is filed. Often a bankruptcy is filed after attempts to negotiate a workout have failed. The principle advantages of the process are as follows:[675]

- The control that Chapter 11 gives to the debtor over the process;
- The automatic stay, which gives the debtor some breathing space;
- The power to bind holdouts to the plan, so long as the plan is supported by a sufficient number of creditors and otherwise meets the requirements of the US Bankruptcy Code.

In the UK, it is the administrator's job to put together proposals in an attempt to satisfy the principles of administration by rescuing the company as a going concern or achieving a better result for the company's creditors as a whole than would be likely if the company would have wound up (without first being in administration), or realising property in order to make a distribution to one or more secured or preferential creditors.[676] The creditors are sent a statement of the administrator's proposals and such proposals are dealt with at creditors' meetings.[677] These proposals will be put to the creditors for their approval at a meeting convened to consider the administrator's proposals (initial creditors' meeting).[678] The proposal must be approved by resolution at the relevant creditors' meeting and passed by a simple majority in value of those present and voting, in person or by proxy. Creditors vote in accordance with the amount of their claim as at the date upon which the company

674. The debtor may file a plan either with the petition or at any other time during the case – section 1121(a) of the US Bankruptcy Code.
675. Ibid.
676. Para 49 of Sch. B1. See Fletcher *The Law of Insolvency* (2009) 555–556.
677. For objectives required to be met in the administrator's proposals, see para 3 of Sch. B1.
678. Para 53(1) of Sch. B1 to the UK Insolvency Act.

entered administration, less any payments or set-offs made after that date.[679] If approved, the proposal is implemented by the administrator.[680]

In terms of the administrator's proposals, he or she may make distributions to creditors of the company within the parameters of the approved proposal. This allows the administrator to exercise his or her own initiative in a positive manner without being required to seek permission from the court.[681]

In Canada, the objective of a commercial restructuring is to come up with an agreement that will be approved by creditors. The agreement is referred to as a plan of compromise or agreement in CCAA proceedings, and as a commercial proposal in BIA proceedings (generally referred to as a plan in the latter proceedings). The plan usually separates the creditors into a number of different classes. It is not binding on any class of creditors unless the class of creditors approves it. Unanimous consent of all the creditors within the class is not needed in order to bind the creditors.[682] It is sufficient if a majority of creditors who hold at least two-thirds of the value of the claims vote in favour of it. A court would then review the plan to ensure that it is not unfair. If the court approves it, the plan becomes binding on all the creditors who are affected by its terms. The creditors relinquish (discharge) their former claims against the debtor and obtain in their place the rights specified in the plan.[683]

Both the BIA and the CCAA set out a number of mandatory features that must be included in a plan.[684] A failure to include them will necessarily result in its failure, since a court has no power to approve it if any feature is absent. The plan must include, *inter alia*, a payment in full for government claims (e.g. income tax), payment to employees of no less than the amount that the employees would be qualified to claim as a preferred creditor in the event of bankruptcy, together with all amounts earned after the commencement of restructuring

679. Para 53 of Sch. B1.

680. Para 53(1) of Sch. B1. There are two possible forms of positive outcomes from the initial creditors' meeting. Either (a) the administrator's proposals are approved without modification, or (b) the proposals are approved with modification to which the administrator consents. The meeting can be adjourned for the purposes of achieving a workable compromise. Fletcher *The Law of Insolvency* (2009) 556–557. See Rajak *Company Rescue and Liquidation* (2013) 111–113.

681. See para 65(1) of Sch. B1 of the UK Insolvency Act. Also see Fletcher *The Law of Insolvency* (2009) 597–599.

682. Wood *Bankruptcy and Insolvency Law* (2009) 421.

683. Ibid.

684. Section 6 of the CCAA and section 60 of the BIA.

proceedings. Further, the plan must provide for unremitted pension contributions and payment in is priority to other claims of all fees and expenses of the trustee (in a BIA).[685]

Approval of a plan occurs if a majority of the creditors representing two-thirds of the value of the claims vote in favour of such plan. Classes of creditors must each approve of the plan by such dual majority for the plan to be binding on all creditors.[686] Within a class of creditors, a majority of that class may bind a dissenting majority to the terms of the plan.[687] In order for the plan to be binding on all creditors, the court must also approve the plan, provided that it is fair and reasonable and that the terms are calculated to benefit the general body of creditors. In assessing what is fair and reasonable, the Canadian courts have deliberated extensively over what the assessment should be for plan approval.[688]

In Australia, once an administrator (in terms of a voluntary administration) is appointed, various creditors' meetings will be held in order to consider whether or not a DOCA is concluded.[689] Typically, DOCAs allow either the administrator to remain in control of the company while the DOCA is being implemented, or allows directors to regain control of the company while the administrator exercises a supervisory role in relation to the implementation of the debt restructuring.[690]

A DOCA between a company and its creditors may be tailored to suit the circumstances of each case. The Australian legislation places few restrictions on the form that such an arrangement may take. It may involve a continuation of the company's business, a sale of part of the assets, a rescheduling of debts, a composition of debts, an exchange of debt for equity, a continued moratorium on creditors' rights, and so forth. However, the arrangement must ultimately deal with the debts and liabilities of the company by providing for their satisfaction in part or in full.[691]

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685. Wood *Bankruptcy and Insolvency Law* (2009) 426.
686. Section 7 of the CCAA and section 6 of the BIA.
687. Section 7 of the CCAA and section 6 of the BIA. See also Wood *Bankruptcy and Insolvency Law* (2009) 426.
688. Ibid 447–448.
689. See section 444D of the Australian Corporations Act.
690. Sections 437A and 442A set out the powers of the administrator in implementing the DOCA. Ziegel *Current Developments in International and Comparative Corporate Insolvency Law* (1994) 45. Also see Symes and Duns *Australian Insolvency Law* (2012) 298–300; Murray and Harris *Keay's Insolvency* (2014) 692–699.
691. Section 444A sets out certain regular clauses that should be included as a minimum in the DOCA. See Symes and Duns *Australian Insolvency Law* (2012) 298–299 and Ziegel *Current Developments in International and Comparative Corporate Insolvency Law* (1994) 45.

A schedule to the legislation assists in providing a number of basic provisions to be concluded in a DOCA.[692] If creditors agree to a DOCA, the resulting deed will bind all the creditors specified in the deed: secured creditors who have executed the deed, owners/lessors of property possessed, used or occupied by the company who have executed the deed, the administrator of the deed, the company and the officers of the company. A person bound by the deed cannot take or continue proceedings against that property. A DOCA is a flexible document. It might be amended at a meeting of creditors;[693] creditors might, after it becomes effective, amend the DOCA by resolution, and lastly, a court may amend the DOCA.[694] All of this eliminates the cost and delay in having to terminate the DOCA and recommencing the administration process in cases where there is a change in circumstances.[695]

While a company is subject to a DOCA it binds all ordinary unsecured creditors in relation to debts incurred prior to a specified date, usually the date of commencement of the administration (even if they voted against the DOCA).[696] If a secured creditor did not vote in favour of the DOCA, it is not bound by the DOCA and can proceed to enforce its security. If a secured creditor does vote in favour of the DOCA, it will be bound and would be entitled to enforce its security during the operation of the DOCA.[697] A voluntary administration in Australia therefore ends in one of several ways –

- The creditors vote to return the company into the control of its directors;
- The creditors vote to implement a DOCA;
- The creditors vote to place the company in the creditors' voluntary winding-up.[698]

Many jurisdictions require a specific provision in restructuring legislation for a cram-down on dissenting creditors. The mechanisms vary but generally there is a requirement that will

692. Section 444A of the Australian Corporations Act.
693. Section 445A of the Australian Corporations Act.
694. Section 445G(1) of the Australian Corporations Act.
695. Ziegel *Current Developments in International and Comparative Corporate Insolvency Law* (1994) 46. Also see Murray and Harris *Keay's Insolvency* (2014) 692–699; Symes and Duns *Australian Insolvency Law* (2012) 300–302.
696. Section 444D of the Australian Corporations Act.
697. Section 444F of the Australian Corporations Act.
698. Creditors can terminate a DOCA at a creditors' meeting convened in terms of section 44F. A DOCA can be completed and administration terminated in terms of section 445F(1)(c) and a court order can terminate a DOCA in terms of section 445D(1)(a). See Symes and Duns *Australian Insolvency Law* (2012) 307–311. Also see Murray and Harris *Keay's Insolvency* (2014) 711–723.

enable the support of one or more classes of creditors to make the plan binding on other classes (including in certain cases, on secured and priority creditors) that do not support the plan:[699]

> A "cram down" is to prevent obstruction of a feasible plan. An insolvency system must address the electoral structure of forced acceptance of a plan. One is majority rule by a vote of creditors overall, while the other is acceptance by the majority in each class. Dissenting minorities overall or by class are required to accept the results of the vote. Nearly all modern systems have this feature, which solves the "hold out" problem.[700]

The US cram down process (imposed by the US Bankruptcy Court) imposes a rehabilitation plan on a whole class, a majority of which had voted down the plan. The US cram down rule requires strict control over the circumstances in which it can be used. Cram down against a secured creditor requires payment of the secured creditor's collateral value, plus a market rate of interest. Cram down against unsecured creditors requires that any junior interests, including the equity owners, receive nothing, so that the creditors effectively own the company.[701]

Notwithstanding the ability to cram down, legislation should also protect the interests of those dissenting classes of creditors. Conditions might include; that requisite approvals of the plan have been obtained and that the mechanisms for the approval of the plans were properly conducted; that creditors will receive at least as much under the plan as they would have received in liquidation proceedings; that the plan does not include provisions that are contrary to insolvency laws or other relevant laws; that administrative claims and expenses will be paid in full except to the extent that the holder of such claim or expense has agreed to different treatment and that the claims of classes of creditors that do not support a plan are treated in accordance with the rank accorded to them under the relevant insolvency laws of that jurisdiction. The court might be required to consider whether

699. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 226. Also see Burdette "Legislative Framework for the Facilitation of Turnarounds" in Harvey (ed) *Turnaround Management and Corporate Renewal – a South African Perspective* (2011) 136.

700. Westbrook, Booth, Paulus and Rajak (eds) *A Global View of Business Insolvency Systems* (2010) available at https://www.openknowledge.worldbank.org/bitstream/handle/10986/13522/68423.pdf?sequence=1 156. It should be noted that the purpose of providing a secured creditor with its collateral value, plus interest, effectively provides that creditor the equivalent of the "present value" of its collateral. Also see comments on cram-down mechanisms and hold out creditors in the UK and US in McCormack *Corporate Rescue Law: An Anglo American Perspective – Corporations, Globalisation and the Law* (2008) Chapter 9 – Conclusion 288–307.

701. Westbrook, Booth, Paulus and Rajak (eds) *A Global View of Business Insolvency Systems* (2010) available at https://www.openknowledge.worldbank.org/bitstream/handle/10986/13522/68423.pdf?sequence=1 156.

certain of these conditions have been satisfied and thus rule that creditors are bound by the plan.[702]

The court may further have to order that secured creditors are bound by the plan, provided certain conditions have been satisfied. These conditions might include that if the secured creditor is not bound by the plan, that enforcement of the security interest by the secured creditor will have a material adverse effect on achieving the purpose of the plan. Additional conditions could include that the security interests of the secured creditor will be sufficiently protected under the plan, and that the position of the secured creditor will not deteriorate under or as a result of the plan.[703]

In addition to the treatment of secured creditors, careful consideration must be given to treating dissenting creditors who are in the minority but who vote down the plan for whatever reason. The cram-down on these dissenting creditors is necessary so as to ensure the chances of success of the reorganisation. Protection of minority dissenting creditors is however required. Thus, appropriate protection which ensures that these minority dissenters are not unlawfully affected must be considered.[704]

To the extent that the cram-down results in a significant impairment of the claims of dissenting creditors without their consent, there is always the risk that creditors (and in particular foreign creditors) would be unwilling to provide credit in the future.[705]

The term "cram-down" is derived from the provisions of Chapter 11 of the US Bankruptcy Code.[706] It has two possible meanings in the context of bankruptcy proceedings. The more limited form of cram-down is where a class of creditors by a majority vote of the creditors in that class are able to impose their will on the minority members of that class.[707] Almost all corporate rescue models contain some mechanism which allows for a cram-down within a class.[708]

702. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 226.
703. Ibid.
704. Ibid 218.
705. Ibid.
706. Section 1129(b) of the UK Bankruptcy Code. The cram-down occurs when a class as a whole rejects the plan.
707. Smits "Corporate Administration – A Proposed Model" (1999) *De Jure* 91.
708. Ibid.

The US goes further. They also provide a mechanism whereby one class may impose its will on one or more separate dissenting classes of creditors through an order of court.[709]

Ideally, a Chapter 11 plan will be approved by the requisite dual majority of creditors in each class voting on the Chapter 11 plan.[710] Every class of claims and interests is either impaired or unimpaired by the debtor's reorganisation plan. This distinction plays a crucial role because impaired classes vote, unimpaired classes are deemed to have accepted the plan and have no right to vote. Section 1124 of the US Bankruptcy Code confirms that a class of claims or interests is impaired unless the plan either –

- leaves the legal, equitable and contractual rights of the holder of a claim or interest holder unaltered;[711] or
- cures the debtor's defaults, decelerates the obligation, compensates the holder of the claim or interest for damages and does not alter the legal acquitable or contractual rights of the holder.[712]

If one or more of the classes of creditors reject the plan, the debtor may still seek confirmation. Confirmation over the objection of a class of creditors is graphically known as "cram-down" (as the plan is crammed down the objecting creditor's throat).[713]

In some cases, agreement with each class of creditors will be reached and a cram-down does not become necessary. In other cases, agreement with each class will not be reached and the plan may only be confirmed over the dissent of a class of claims or ownership interests – "the cram-down power".[714]

709. See section 1129(b) of Chapter 11 of the US Bankruptcy Code. Also see Ferriell and Janger *Understanding Bankruptcy* (2013) 779. Also see Epstein and Nickles *Principles of Bankruptcy Law* (2007) 102–103; Howard *Bankruptcy Overview: Issues, Law and Policy* (2002) 83–84.

710. See Sections 1121–1126 of the US Bankruptcy Code. Approval does not require a unanimous vote. Instead it requires a dual majority. The first is a simple majority of more than half of the number of claims. The second is a super-majority of at least two-thirds of the amount of the claims. See Ferriell and Janger *Understanding Bankruptcy* (2013) 765–766.

711. Ferriell and Janger *Understanding Bankruptcy* (2013) 750 and 780–781. The test for a plan to be fair and equitable is different with respect to classes of creditors' claims (secured, unsecured, classes of interest) but it essentially requires adherence to the "absolute priority" rule. This rule prevents a debtor from distributing anything to a junior class over the objection of a senior class, unless the senior class is paid in full.

712. Ibid 750. Although Section 1124 speaks in terms of impairment of classes of both claims and interests, its biggest practical impact is in respect of claims. Few Chapter 11 plans leave equity holders unimpaired.

713. Ibid 779. Note that dissenting creditors in a class that have accepted the plan will have the plan "crammed down" their throats. Section 1129(b) of the US Bankruptcy Code comes into play, however, only a class as a whole rejects the plan.

714. Klee "All You Ever Wanted to Know About Cram Down under the New Bankruptcy Code" (1979) 53 *American Bankruptcy Law Journal* 134.

Most, if not all, Chapter 11 debtors have some type of secured debt on their balance sheet. Secured creditors enjoy certain enhanced rights in a bankruptcy, such as the right to adequate protection if the debtor uses or sells the collateral of such secured creditor. Further, secured creditors have the right to satisfaction of the secured creditor's claim before any distributions to junior creditors flowing from the lender's collateral. The latter benefit often gives secured creditors substantial leverage in the planned negotiation process and can be particularly challenging for debtors.[715]

However, the US Bankruptcy Code offers the debtor some assistance by providing the cram-down options referred to above. This assists greatly (in practice) in the negotiations that occur both in the prepetition and post-petition phase of the reorganisation process.[716]

There are three key requirements for a confirmation of a Chapter 11 plan over the objection of a class of creditors. The plan (as set out above) must be accepted by at least one class of impaired claims. The plan must be fair and equitable,[717] and must not discriminate unfairly.[718] This would protect those dissenting creditors who get crammed down on a plan. The test for considering whether a dissenting creditor is being discriminated unfairly comprises various aspects[719] –

- Whether the discrimination has a reasonable basis;
- Whether the discrimination is proposed in good faith; and
- Whether the degree of discrimination is directly related to the basis for the rationale for the discrimination.

715. Section 1129(b)(2)(A)(i), (ii) and (iii) of the US Bankruptcy Code. Also see Lennox, Harner and Goodman "Reinstatement v Cramdown: Do Secured Creditors Win or Lose?" (2007) 4 *Norton Journal of Bankruptcy Law and Practice* 461. See this article for a full analysis of the rights of a secured creditor in a Chapter 11 filing.

716. Lennox, Harner and Goodman "Reinstatement v Cramdown: Do Secured Creditors Win or Lose?" (2007) 16 (4) *Norton Journal of Bankruptcy Law and Practice* 461.

717. The test for a plan to be fair and equitable is different with respect to classes of creditors claims (secured, unsecured, class of interest) but it essentially requires adherence to the absolute priority rule. The absolute priority rule prevents a debtor from distributing anything to a junior class over the objections of a senior class, unless the senior class is paid in full. See section 1129 and discussion in Ferriell and Janger *Understanding Bankruptcy* (2013) 780–782.

718. See US Bankruptcy Code, Section 1129(b)(1). Also see Ferriell and Janger *Understanding Bankruptcy* (2013) 794–796.

719. Ferriell and Janger *Understanding Bankruptcy* (2013) 794 – 796.

For example, a plan that treats the deficiency claim of the main secured creditor vastly different from the other long-term unsecured claims, usually fails this test. Treating key suppliers differently from other creditors, however, usually passes the test.[720]

Another key element for a Chapter 11 plan to be crammed down on a dissenting class of creditors, is the "best interests of creditor's" test.[721] The test protects dissenting members of a class (as distinguished from the cram-down power which protects dissenting classes) by requiring each member to receive under the plan at least as much as would be received on liquidation.[722]

The rationale of a cram-down procedure evidences not only a goal of promoting debtor-creditor agreement but also a goal of obtaining reorganisation of a debtor facing ultimate bankruptcy. Cram-down deals with a situation in which goals diverge. The creditors do not support the debtor in its reorganisation objective, or at least not on terms proposed. This places the two goals in conflict. The US Bankruptcy Code places the goal of obtaining a reorganisation above the goal of obtaining consensus.[723]

In the UK, the approval of the administrator's proposals is placed before all creditors at the initial creditors' meeting.[724] The approval must be made by way of a resolution passed by a simple majority in value of those present and voting in person or by proxy. Each creditor's vote is assessed according to the amounts of its claim as at the date on which the company entered administration, less any payments made after that date in respect of such claim. Either the administrator's proposals are approved without modification or the proposals are approved with modification to which the administrator consents.[725]

If no majority can be obtained for the approval of the proposals either in their original or in modified form, the meeting might be adjourned for 14 days for further consideration.[726]

720. Ibid.
721. Section 1129(a)7 of the US Bankruptcy Code. See Ferriell and Janger *Understanding Bankruptcy* (2013) 772–774.
722. Klee "All You Ever Wanted to Know About Cram Down under the New Bankruptcy Code" (1979) 53 *American Bankruptcy Law Journal* 137. Also see Ferriell and Janger *Understanding Bankruptcy* (2013) 771–772.
723. Herbert *Understanding Bankruptcy* (1996) 342. For a further analysis of the US cram-down procedure see pp. 342–347.
724. Para 53, Sch. B1 to the UK Insolvency Act. The rules on voting are found within rr 2.34 to 2.44 of the Insolvency Rules (as amended) to the UK Insolvency Act.
725. Fletcher *The Law of Insolvency* (2009) 556–557. See Rajak *Company Rescue and Liquidation* (2013) 112–113.
726. R 2.34(4) of the Insolvency Rules.

This option allows all the stakeholders to consider whether there is any possibility of achieving a workable compromise, as an administration procedure.[727]

When the administrator reports to the court that the meeting has declined to approve his or her proposals (even in modified form) the court has a wide range of discretionary powers.[728] The court may provide that the creditors' refusal to endorse the administrator's proposals be dealt with in a particular manner. These directions remain flexible and within the discretion of the court. If there is persuasive evidence to suggest that the purposes for which the administration was embarked upon may yet be attained, possibly through the substitution of a new or additional administrator, the court is likely to deploy its discretionary powers in such a way as to ensure the smoothest possible transition to the next appropriate form of insolvency proceedings, such as a voluntary or compulsory winding up. Thus, in the UK, the UK Insolvency Act does not have any formal legislated cram-down procedure, but rather leaves the ultimate approval in the hands of the court and to a degree, the administrator.[729]

The UK Insolvency Act contains protective provisions for the benefit of those creditors who hold security or whose debts are preferential within the meaning of the UK Insolvency Act.[730] The administrator's proposals may not include any action which –

- affects the right of a secured creditor of the company to enforce its security, or
- would result in a preferential debt of the company being paid otherwise that in priority to its non-preferential debts, or
- would interfere with the operation of the *pari passu* principle as between all those creditors whose debts are preferential,

unless the relevant creditor consents to the action in question.[731]

727. Para 53, Sch. B1. See Fletcher *The Law of Insolvency* (2009) 557.
728. Paras 54–55 of Sch. B1.
729. Fletcher *The Law of Insolvency* (2009) 558.
730. Para 73, Sch. B1.
731. Fletcher *The Law of Insolvency* (2009) 561. See para 73, Sch. B1, UK Insolvency Act. Also see Rajak *Company Rescue and Liquidation* (2013) 111–113.

It may well happen that there are some creditors who are unhappy with the decision made by the majority, and whose interests may even be harmed by a specific decision. Such grievances in themselves may not be sufficient to convince the court that the decision or proposal taken by the creditors' meeting is unfairly harmful to the complaints, when considered in context. It would be detrimental to the expeditious implementation of his or her democratically approved proposals, if the administrator's (professional) commercial judgement could be too easily called into question. Unless the applicant's case is a strong one, the court may prefer to adopt a "wait and see" approach, relying on the administrators liability in damages if it is subsequently established that a wrongful course has been pursued.[732]

In Canada, the need for creditor approval of the restructuring plan is essential. The restructuring plan involves the deal that is presented to the creditors. It will set out the manner in which the claims of creditors will be treated and will not be binding on creditors, unless they approve it.[733]

The restructuring plan does not require unanimous consent in order to be binding on the creditors. Dissenting creditors voting on a restructuring plan and who vote against the plan may nevertheless find that they are bound by its terms. In order to bind creditors to a plan, a "head count" and a "dollar count" is undertaken.[734] The plan must be approved by a majority in number of creditors who hold at least two-thirds of the value of the claims for each class of claimant. The ability of a majority to bind a minority to a modification of contractual or other claims represents a marked departure from ordinary private law principles. It is however considered necessary to achieve the reorganisation goals of Canadian restructuring law. When creditors and the debtor are negotiating in a reorganisation, a complex dynamic comes into play where multiparty negotiations are involved.[735] The position of the hold-out creditor was dealt with by Wood as follows:

> Opportunistic creditors may adopt "hard line" bargaining positions in the hopes that their threat to upset the applecart will induce the debtor to agree to give preferred treatment to their claims. This is undesirable for two reasons. First, it results in

732. See challenges that can be brought to the administrator's conduct of the company in administration, para 74, Sch. B1. See Fletcher *The Law of Insolvency* (2009) 563.

733. Wood *Bankruptcy and Insolvency Law* (2009) 317 and 421–453.

734. Section 6 of the CCAA and section 52 of the BIA set out the rules that govern creditor approval.

735. Wood *Bankruptcy and Insolvency Law* (2009) 426.

> similarly situated creditors being afforded different treatment and rewards non-cooperative behaviour over cooperative behaviour on the part of creditors. Second, it makes it much less likely that any agreement will be concluded among the creditors. Creditors will naturally prefer to obtain the greater rewards afforded by non-cooperative behaviour, but, if all creditors behave in this fashion, no agreement will be reached. A dual-majority requirement is imposed in order to curtail the power of creditors who adopt value-reducing holdout strategies.[736]

Both the CCAA and the BIA provide that the plan must be approved by a majority of creditors representing two-thirds of the value of the claims. Where creditors are classified into different classes of creditors, each class of creditors must approve it by this dual majority in order for a plan to be binding on that class of creditors. This means that within a class of creditors, a majority of creditors of that class may bind a dissenting minority to the terms of the plan. The ability to bind dissenting creditors to a plan operates only within each class of creditor. As an example, suppose that a plan has three classes of creditors. Two classes approve the plan by a dual majority, while the other does not.[737] The vote of the two classes that approved cannot bind the class that did not. Nor does it matter if in the aggregate, the creditors who approve the plan pass a majority in number representing two-thirds of the value of all claims. Each class has a veto and cannot be forced to accept the plan. There is therefore nothing equivalent to the "cram-down" power that permits a court in the US to bind a dissenting class to a plan even though the class has voted to reject the plan.[738]

In a BIA procedure, if the proposal does not attract the required level of creditor support, a vote defeating it will result in an automatic bankruptcy. However, a failed vote in a CCAA does not give rise to automatic bankruptcy. Practically speaking, however, if a CCAA plan does not receive the requisite creditor support and the stay period expires or is terminated by the court, a receiver, trustee or liquidator can be appointed to realise assets, sell the business or liquidate it. In practice, under the BIA proposal process, where a meeting of creditors is held and there is interest in finding an acceptable proposal, a vote is taken of the classes of creditors and if the requisite support does not exist, the parties attempt some renegotiation of the proposal.[739] This is so that a failed "official vote" does not automatically result in an assignment into bankruptcy. If a class or classes of secured

736. Ibid 318.
737. Ibid 424–427.
738. Approval is governed by section 6 of the CCAA and section 52 of the BIA. See Wood *Bankruptcy and Insolvency Law* (2009) 424–427.
739. Sarra *Rescue: The Companies' Creditors Arrangement Act* (2012) 27.

creditors reject the proposal, there is no deemed bankruptcy, rather the secured creditors of that class are free to exercise their rights under their security without further regard to the proposal proceedings. Thus, both Canadian statutes allow for a period of negotiation, but failing the debtor receiving sufficient support after a specific period, creditors are able to pursue their remedies that were stayed under the BIA or CCAA proceedings.[740]

Secured creditors do not have to approve a BIA proposal but given that they hold first rights to the property of the corporation, in almost all cases, their approval is necessary as enforcement of security by significant secured creditors will render a proposal workable. As a result, proposal approval is often expressly conditional on acceptance of the proposal by all classes of secured creditors. The same considerations exist for a proposed CCAA plan, in terms of generating support of the secured creditors in order to ensure that a plan is viable.[741]

In Australia, a simple majority of creditors must approve a DOCA.[742] The court has the power to order that secured creditors and owners or lessors of property be bound by the DOCA under section 445D(3) of the Australian Corporations Act 2001. The court can only make such an order after the creditors have resolved that the deed be executed (section 444F).[743]

In summary, it is submitted that the possibility to cram down a plan on dissenting creditors is a fundamental principle required in a restructuring. Without it, dissenting creditors could hold out (wanting a bigger pay-out) and could ultimately cause the company to be placed into liquidation.

The ability to cram down averts the danger of having obstructive (greedy) creditors wanting more out of compromise than that which would be acceptable to most other creditors and thus holding willing creditors to ransom in a situation where liquidation of the company is inevitable.

The plan itself (although subject to relevant jurisdictional statute) is nothing more than a contract between the debtor company and, in the main, the creditors. The plan will set out

740. Ibid.
741. Ibid.
742. Section 444D of the Australian Corporations Act.
743. Symes and Duns *Australian Insolvency Law* (2012) 307–311. Also see Murray and Harris *Keay's Insolvency* (2014) 711–723.

the extent to which creditors will be willing to reduce their debt to a compromised amount and walk away. Of course, certain creditors, such as key suppliers, do not want to see these companies fail and go into liquidation, as this would result in the cessation of possible business (and thus profits) to be made in the future.

It is for this reason that most creditors facing the company's imminent liquidation would far rather vote in favour of a plan which allows the company to continue trading and where they stand to receive a restructuring dividend which is in excess of a liquidation dividend. Of course, if this is not a viable outcome, the plan would be rejected and creditors would have to accept whatever dividend is secured by the liquidators in the asset realisation exercise as part of liquidation.

5.5.7 DISCHARGE OF CREDITORS' CLAIMS

The conclusion of restructuring proceedings must by necessity include a discharge of creditors' claims, albeit on a compromised basis. The required fresh start for debtor companies involves a discharge of their financial distress and the taking of other steps to reduce the stigma associated with business failure rather than punishing the debtor company.[744]

To ensure that a reorganised debtor company has the best chance of succeeding, legislation should provide for a discharge or alteration of debts and claims that have been discharged or otherwise altered under the plan. Commercial certainty must be a result of a reorganisation process. By giving binding effect to the forgiveness, cancellation or alteration of debts in accordance with the approved plan, the required level of certainty for all stakeholders is achieved. The discharge establishes unequivocally that the plan addresses the legal rights of creditors.[745]

744. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 281. There is increasing awareness that there is a need to reorganise business failure as a natural feature of an economy and to accept that both weak and good businesses can fail. This can occur without necessarily involving irresponsible, reckless or dishonest behaviour on the part of the management of the business. For an analysis of the Fresh Start Policy in Bankruptcy Law, also see Jackson *The Logic and Limits of Bankruptcy Law* (1986) 225–252.

745. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 284.

A discharge in a reorganisation might become effective from the time the plan becomes effective or from the time it is fully implemented. If the plan is not fully implemented or implementation fails, legislation may provide for the discharge to be set aside.[746]

Modern rescue regimes must provide a mechanism under which a specified majority of creditors can approve a plan under which the debtor company can emerge from protection and resume normal commercial dealings. What this percentage should be, whether there should be a US style cram-down procedure, precisely how preferential and secured debt should be dealt with, who may vote and a host of other procedural and policy questions will have to be determined by the legislature in each different jurisdiction.[747]

A debtor company may exit from the protective regime with restructured debtor contractual arrangements with its creditors and shareholders intact, albeit with compromised debt and a potential restructured shareholding. The manner in which debt and creditors' obligations are restructured will drive the potential to rescue companies.[748]

Reorganisation proceedings would generally come to an end when the reorganisation plan is approved (and confirmed, if this is required), the liabilities have been discharged in accordance with the plan and the plan has been formally implemented with or without the need for a formal court order. Alternatively, if the plan is not fully implemented, the court may convert the proceedings to liquidation in order to avoid the debtor company being left in an insolvent state with its financial situation unresolved.[749]

Upon confirmation of a plan, the running of the business would continue, with the company now trading on a solvent basis. A restructuring process should terminate with a formal discharge of claims and debts that existed prior to the time the business rescue procedure commenced,[750] as stated by Burdette:

> The principle of a discharge may be of particular importance in ensuring that the provisions of the plan will be complied with by creditors who rejected the plan, or by

746. Ibid.
747. Rajak and Henning "Business Rescue for South Africa" (1999) *SALJ* 286.
748. Ibid 287.
749. Ibid 286.
750. Burdette "The Development of a Modern and Effective Business Rescue Model for South Africa" (2004) Centre for Advanced Corporate and Insolvency Law (CACIL), University of Pretoria 90.

> those who did not participate in the process. A discharge therefore establishes "unequivocally that the plan fully addresses the legal rights of creditors".[751]

In the US a Chapter 11 process results in a discharge upon confirmation of its Chapter 11 plan.[752] If no plan is confirmed, the debtor does not receive a discharge, and the case is likely to be dismissed or converted into a Chapter 7 liquidation process.[753]

A Chapter 11 discharge is normally granted as soon as the plan becomes effective.[754] The result is that the obligations under the Chapter 11 plan are substituted for the debtor's pre-confirmation obligations. Virtually all existing debt is discharged and the sole remaining obligations are those undertaken in the plan.[755]

The effect of a discharge prohibits creditors from taking action to collect prepetition debts and provides debtors with a valid legal defence in any action brought by creditors in an effort to collect on such debts. This is the essence of the debtor's "fresh start" which flows from the effect of a discharge.[756]

A discharge in a Chapter 11 process is directly dependent on the success of the Chapter 11 plan. A Chapter 11 plan must be proposed in good faith and deal with, *inter alia*, claims, classes of claims and impaired claims, and provide adequate means for the plan's implementation. The plan must be "feasible", i.e. not likely to be followed by the need for liquidation or another financial reorganisation.[757]

Further, the legislation applies "the best interests of creditors test".[758] This ensures that creditors who do not vote in favour of the plan receive at least as much under the plan as

751. Ibid. See UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 665–666.
752. Section 1141(d)(2) of the US Bankruptcy Code.
753. Section 109(d) of the US Bankruptcy Code. See Ferriell and Janger *Understanding Bankruptcy* (2013) 516–517; Epstein and Nickles *Principles of Bankruptcy Law* (2007) 7–9; Howard *Bankruptcy Overview: Issues, Law and Policy* (2002) 72.
754. Section 1141(d)(1)(A) of the US Bankruptcy Code.
755. Section 1141(d)(1)(A) of the US Bankruptcy Code. See Ferriell and Janger *Understanding Bankruptcy* (2013) 518–519.
756. Section 524(a)(1) and (2) of the US Bankruptcy Code. The discharge voids any judgments, is an injunction against any action to collect, recover or offset any discharged debt of the debtor. See Ferriell and Janger *Understanding Bankruptcy* (2013) 521–522.
757. See above discussion in Chapter 5, para 5.5.6. Also see Leonard *Restructuring and Insolvency – Getting the Deal Through* (2013) 520. Section 1129(b) details the circumstances in which a plan is "crammed down" over the objection of a particular class of creditors. The "best interest" and "feasibility test" are often used to ensure that objecting creditors receive at least as much as they would get in a liquidation and that the plan is in itself feasible and can be practically implemented.
758. Section 1129(a)(7) of the US Bankruptcy Code.

they would if the debtor company were to be liquidated in terms of Chapter 7 of the US Bankruptcy Code.[759]

A Chapter 11 plan would fail if it is not confirmed by creditors in the different classes. Courts often cram down on opponent classes of creditors. After confirmation, all prior claims and interests against the debtor are replaced by the terms of the plan and all of the debtor's financial obligations follow he provisions of the confirmed plan. Failure to confirm a Chapter 11 plan provides grounds for dismissal or conversion to a Chapter 7 liquidation.[760] Confirmation of a Chapter 11 reorganisation plan generally discharges a debtor of all of its prepetition debt to creditors.[761] In the UK, once a proposal has been approved by creditors, the pre-administration debt is discharged on the basis of the proposal. In most jurisdictions, a discharge provides the need for commercial certainty by giving binding effect to the debt forgiveness principles and might include cancellation or alteration of debts in accordance with the approved plan.[762]

The discharge principle is particularly important for ensuring compliance with the proposal/plan terms by those creditors who rejected the plan or who did not participate in the approval process. A plan must be seen to be final and binding, failing which the necessary commitment from investors, lenders, employees, suppliers and other stakeholders will not be forthcoming.[763]

In Canada, the approved plan is recognised more as a contract than as a court order. Old obligations are replaced entirely by the arrangements which are set forth in the plan.[764] Through discharge the debtor is freed from the burdens of pre-existing indebtedness which is a fundamental in a restructuring process for the economic rehabilitation of the debtor. A discharge in a Canadian restructuring process releases the debtor from all claims payable in the process. Only those claims provable at the date of the order are released.[765]

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759. See above discussion in Chapter 5, para 5.5.6. Also see Westlaw UK "Insolvency Intelligence" in Frieze and Milman (eds) *The Rise of Pre-packaged Corporate Rescue on Both Sides of the Atlantic* (2007).(20) 9
760. See above discussion in Chapter 5, para 5.5.6. Also see Leonard *Restructuring and Insolvency – Getting the Deal Through* (2013) 521.
761. Ibid 522.
762. Westbrook, Booth, Paulus and Rajak (eds) *A Global View of Business Insolvency Systems* (2010) available at https://www.openknowledge.worldbank.org/bitstream/handle/10986/13522/68423.pdf?sequence=1 160.
763. Ibid.
764. Ibid.
765. Section 57 of the BIA and section 6 of the CCAA. See Wood *Bankruptcy and Insolvency Law* (2009) 273. Also see discussion on the policy behind discharge 273–275.

In Canada, once a plan is approved by the creditors and by a court, it binds every creditor in each class of creditor that voted in favour of it, and also binds the debtor. It does not bind creditors who are not covered by the plan (unaffected creditors) or classes of creditors that voted against it. Upon court approval, the obligations owed by the debtor to affected creditors are discharged and replaced with obligations that are provided for in the plan.[766]

In Australia, the DOCA will result in a discharge of claims incurred prior to the date of administration commencement and in terms of such DOCA.[767] The result is a compromise or composition of debt owed to creditors with the resultant discharge of the balance of such claim. As a result, many enterprises are preserved and saved and the process ultimately results in a better return to creditors than if the company were to be liquidated.[768]

The concept of discharge of claims is the objective in any restructuring process. Creditors have to accept less than their full claim, otherwise the debtor company will have no alternative but to file for liquidation.

The “fresh start” principle is premised on the acceptance of a “debt haircut” for creditors. Creditors cannot realistically expect the already “ailing” company from being in a position to pay out 100 per cent of their claims. Creditors who are dissatisfied with the outcome of the plan or the dividend on offer, will have had their opportunity to consider the plan and vote in favour of or against it. However, once the plan is sanctioned, coupled with the principle of cram-down referred to above, creditors have no choice but to accept such debt discharge. The alternative is a failed restructuring and the distribution of paltry liquidation dividends.

766. Ibid.

767. Generally, a DOCA comes to an end by way of the successful completion of its terms by the administrator. If a DOCA administrator has applied all of the proceeds of the realisation of the assets available to pay creditors or he/she has paid creditors 100 cents in dollar or a lesser sum determined by creditors, then the DOCA lodges a notice of termination of the DOCA. See section 445FA(1) of the Australian Corporations Act and Wood *Bankruptcy and Insolvency Law* (2009) 274–275.

768. Harmer “Comparison of Trends in National Law: The Pacific Rim” (1997) 23 *Brooklyn Journal of International Law* 149. See Symes and Duns *Australian Insolvency Law* (2012) 300–302; Murray and Harris *Keay’s Insolvency* (2014) 681.

SYNOPSIS OF PART 2

The analysis of international standards of best practice and corporate rescue themes set the international benchmark for a comparative analysis of the South African business rescue regime found in Chapter 6 of the 2008 Companies Act. The tools found in UNCITRAL, World Bank, INSOL, European Union, IMF and the European Bank for Reconstruction and Development provide working models and a sound base for a theoretical analysis of instruments for rescue. Coupled with the common rescue themes, they provide a springboard for a useful analysis of the existence of such common rescue themes in South Africa.[769]

Designing an effective legal rescue regime has its challenges. General objectives of maximising the country's level of employment, encouraging investment by giving creditors comfort through the recognition of security and an increase in overall economic activity will all assist in choosing the right rescue regime for a particular country.[770] Smits states as follows:

> Very few states will claim that their system of corporate rescue model is perfect. It is safe to say that commentators in most of the states would suggest that their particular system is uniquely suited for the particular society in which it is rooted. It is therefore virtually impossible to simply uproot and transplant "lock, stock and barrel" the system of corporate rescue from the United States, England, Canada, France and Australia …[771]

The manner in which contracts will be upheld, effective enforcement by the courts, easy access to a moratorium on creditor actions against the company, must be weighed up against the interruption to the pattern of investment and its impact on financial markets.[772]

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769. These international standards of rescue and common rescue themes are compared and considered in the analysis below of Chapter 6 of the 2008 Companies Act. Various cross references to the content contained in these Chapters 4 and 5 (international) will be found in Chapter 7 (South Africa). In addition, an appraisal of the manner in which the South African legislation compares to these international standards will be dealt with in Chapter 8, para 8.1.
770. Belcher *Corporate Rescue: A Conceptual Approach to Insolvency Law* (1997) 87.
771. Smits "Corporate Administration: A Proposed Model" (1999) *De Jure* 107. In the 1960s, Australia "imported" the system of South African judicial management into its insolvency system as a corporate rescue model. It was termed "official management" in Australia. It was abolished in 1992. Official management was a failure in Australia, which may have been as a result of simply transplanting a system designed for one society into another or because judicial management itself was fundamentally flawed.
772. Belcher *Corporate Rescue: A Conceptual Approach to Insolvency Law* (1997) 88. For a grading of reorganisation laws according to their accessibility to debtors and their impact on creditor rights, see Wood *Principles of International Insolvency* (2007) 43–47.

When one looks at the various regimes applicable in the US, the UK, Australia and Canada, many of these jurisdictions embrace all of the seven key essential concepts and principles for rescue.[773]

Present English rescue procedures are often portrayed as giving strong priority to the protection of creditor interests and limited priority to rescue, as being quite heavily fault-based and oriented to the control of errant directorial conduct, and as reliant on strong supervision of directors by independent insolvency practitioners and the courts. The English system is also quite diverse insofar as a number of rescue processes and gateways (informal and formal) may have relevance to a troubled company and it is set within a financial system that strongly favours the secured creditor.[774]

The corporate rescue regime encountered in the US offers a set of contrasting characteristics. Chapter 11 of the Bankruptcy Code is a "reorganisation" procedure whose policy objective is strongly oriented towards the avoidance of the social costs of liquidation and the retention of the corporate operation as a going concern. There is no requirement that the debtor be insolvent or near insolvent in order to apply for Chapter 11 protection: the process is an instrument for debtor relief, not a remedy for creditors.[775]

As in the UK, a central purpose of the process is to preserve the value of the enterprise where this is likely to be greater than the liquidation value. Chapter 11 is, however, to English eyes, highly sympathetic to the debtor, and is almost always started by a voluntary petition by the debtor.[776]

An important cultural difference between the UK and the US concerns the issue of fault, as stated by Moss:

> In England insolvency, including corporate insolvency, is regarded as a disgrace. The stigma has to some extent worn off but it is nevertheless still there as a reality. In the United States business failure is very often thought of as a misfortune rather than wrongdoing. In England the judicial bias towards creditors reflects a general social attitude which is inclined to punish risk takers when the risks go wrong and side with creditors who lose out. The United States is still in spirit a pioneering country where

773. For the seven key essential concepts of rescue, see Chapter 5, para 5.5. Also see Belcher *Corporate Rescue: A Conceptual Approach to Insolvency Law* (1997) 11.

774. Finch *Corporate Insolvency Law: Perspectives and Principles* (2002) 195.

775. Ibid 195–196.

776. Ibid 196.

> the taking of risks is thought to be a good thing and creditors are perceived as being greedy.[777]

Belcher confirms that both in the US and the UK, financial distress is a concept which would in all probability trigger a formal process. Distress plays an important part in the UK in the context of a corporate rescue. It is often financial distress which threatens the company's survival and which demands satisfaction. Financial distress can act as a warning signal, as a hurdle, and as a trigger. As a warning signal, financial distress will affect the market value of the company and may thus shape the course of its rescue attempts. As a hurdle, financial distress is required for entry into a legal regime. As a general rule, the earlier a rescue is mounted the greater its chances of success. Although financial distress requires that attention be paid to company finance first and foremost, it can also trigger other forms of beneficial organisational restructuring, including a change in top management.[778]

It is submitted that in Australia, rescue is principally concerned with preserving the income-producing business of the enterprise and the reduction, rescheduling or extinguishing of the debt. The overall aim is to provide an environment that can best achieve protection for employees, markets, suppliers and the like.

In Canada, it is similarly submitted that the preservation of the corporate entity is a goal, while creditors negotiate a compromise aimed at achieving a compromise of the debtor's obligations to creditors.

Countries vary on the priority they give to rescue and the balance they effect between creditor and debtor interests. In each jurisdiction, there is a host of different role players and stakeholders together with different processes and priorities dictating the application of each insolvency and rescue regime.

In all jurisdictions, difficult decisions have to be made on important issues: Who should control corporate rescue attempts? What sort of oversight regimes are appropriate? Should employees and shareholders play a more significant role? Who is to finance the operational

777. Moss "Chapter 11 – An English Lawyer's Critique" (1998) *Insolvency Intelligence* 18.

778. Belcher *Corporate Rescue: A Conceptual Approach to Insolvency Law* (1997) 54–55. For a useful comparison between restructuring mechanisms applicable in the UK and the US, see McCormack *Corporate Rescue Law: An Anglo American Perspective – Corporations, Globalisation and the Law* (2008) Chapter 9 – Conclusion 288–307. The author is of the view that the UK has a pro-creditor system and the US a pro-debtor system (see 292–296).

requirements of the company while in the restructuring process? How should the prerogative of rescuing the company be balanced against creditor rights? Should rescue processes be triggered only on insolvency or near-insolvency?

These are all fundamental questions which must be understood and analysed prior to deciding upon any business rescue culture or system within a jurisdiction. Rescues generally require a detailed assessment of the interests of all stakeholders within a very short time frame. Parties will no doubt be acting with divergent concerns and interests. The skill of the supervisor will be to manage these different interests and avoid the potential for conflicts of interest.

Wood highlighted the key lessons learned from international jurisdictions when one compares the regimes of liquidation versus reorganisations.[779] Final liquidations must always be seen as a last resort. Far more preferable is the judicial reorganisation process which stays creditor attachments and petitions for liquidation. Generally, creditors favour the workout process if they are achievable and where court processes can be avoided.

Success is in the eye of the beholder when it comes to corporate rescue. Various commentators apply a variety of functions which are indicative of a successful corporate rescue.[780]

Some view a successful corporate rescue if the corporation itself is saved, not merely the business and jobs of the corporation. This would allow the current shareholders to continue their control of the business with some form of debt restructuring. An example would be the confirmation of a plan of reorganisation under Chapter 11 of the US Bankruptcy Code where the debtor remains in control of the whole business after confirmation. Another example of a successful rescue might be the sale of the entire business to a third party, thereby preserving the ongoing enterprise, but allowing the debtor company to go into liquidation.[781]

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779. Wood *Principles of International Insolvency* (2007) 49.

780. Smit "Corporate Administration: A Proposed Model" (1999) *De Jure* 84. For an excellent analysis of what is meant by corporate rescue success, see Finch "Corporate Rescue Processes: The Search for Quality and the Capacity to Resolve" (2010) *Journal of Business Law* 1–31.

781. Smit "Corporate Administration: A Proposed Model" (1999) *De Jure* 84.

Others might argue that a successful rescue is one which results in creditors recovering more than they would under liquidation. A final example would be the successful continuation of the business enterprise and the preservation of jobs, with little or no emphasis on creditor recovery, as is the case in France.[782]

In summary, it is submitted that a successful rescue can manifest itself in the form of a sale of some or all of the debtor's assets, the total acquisition of the company, a management buy-out, and the continuation of the enterprise after a compromise with creditors or more formal rescue procedures such as Chapter 11 proceedings. Finch was of the view that it is difficult to clearly evaluate the quality of a rescue regime and to definitely offer a view what is precisely the "right" kind of rescue regime in respect of processes and outcomes. Key measures would include the level of openness and transparency and the capacity of the regime to resolve divergent interests and positions.[783]

Policy makers will ultimately determine what is a successful rescue. This might vary from jurisdiction to jurisdiction.

The advantages of a reorganisation via a rescue process are clearly confirmed by Wood. Wood confirms that a judicial rehabilitation by way of a rescue should only be contemplated if there is a realistic possibility of survival. The main advantage of a judicial rehabilitation as compared to a liquidation include the ongoing trading of the entity, the ability to retain value by not selling the assets of the entity by way of "fireside" bankruptcy sales and attempting to keep the group and company restructure intact.[784]

There is no debate that the US Chapter 11 reorganisation model has set the standard for restructuring around the world. Although there is some doubt as to whether the Chapter 11 process is effective, it is not likely that Chapter 11 will soon be abolished. Westbrook states:

> Rightly or wrongly, the belief that it saves companies and jobs is too well ingrained to be destroyed by any but the most unequivocal evidence that it does not. It is, however, probable that some future reform proposals will be adopted. It is also possible that Congress will continue its gradual return to something resembling the

782. Ibid.
783. Finch "Corporate Rescue Processes: The Search for Quality and the Capacity to Resolve" (2010) *Journal of Business Law* 21–22.
784. Wood *Principles of International Insolvency* (2007) 36–38. For the disadvantages of judicial reorganisation, see pp. 38–40.

> old Bankruptcy Act system, in which different types of business reorganisations will be placed under different Chapters.[785]

There is no empirical evidence that shows that Chapter 11 is a successful rehabilitation procedure. There is, however, evidence which supports the fact that Chapter 11 gives rise to better realisations than in a forced-sale liquidation. This is as a result of the protection of the statutory stay. The tension between the need to preserve the corporate entity must be weighed up against the needs of creditors to maximise realisations in a reorganisation.[786] This is an ongoing debate in the US and one which must focus more on the need for the results it achieves, namely a more beneficial realisation than in a forced-sale liquidation.[787]

Notwithstanding criticism, Chapter 11 is a unique, innovative procedure which has set the standard for reorganisations worldwide.[788]

The status and influence that Chapter 11 has had on corporate rescue procedures worldwide should not be underestimated. Loubser confirms the position:

> A large part of the world has come to believe that since Chapter 11 reorganisation seems to be working so well in America, it should also work for the rest of us. Paul Omar pointed out that one of the things most countries in Europe had in common when reforming their insolvency laws was “a fascination with the American ‘Chapter 11’ procedure…”
>
> This fascination is not confined to Europe. Just about every country has felt compelled to take a long hard look at its insolvency procedures to establish whether it also has a procedure that resembles, or at least measures up to Chapter 11 reorganisation. (And here I have to mention that, in contrast to South Africa where our corporate rescue procedure has always been regulated by a Companies Act, most other jurisdictions regard Business Rescue as part of insolvency law and it is therefore regulated by their insolvency laws.) Countries as diverse as Germany, France, Spain, the Czech Republic, Singapore, Japan and the People’s Republic of China used Chapter 11 reorganisations as a model in designing their corporate rescue procedures. And they are by far not the only ones.

785. Westbrook “A Comparison of Bankruptcy Reorganisation in the US With the Administration Procedure in the UK” in Leonard and Besant (eds) (1994) *Current issues in Cross-Border Insolvency and Reorganisations* 33–40. In England, the courts see such a failure as a breach of fiduciary duties on the part of a director and sanctions against such behaviour are stringent. See this contribution for an excellent comparison between the US Chapter 11 process and the UK administration procedure.

786. Moss “Chapter 11 – An English Lawyer’s Critique” (1998) 3 *Insolvency Intelligence* 17–20. In terms of the most costly Chapter 11 findings of all time, Lehman Bros (collapsed in 2008) is one of the most significant, followed by Worldcom, Enron, General Motors and Delta Airlines.

787. Ibid.

788. The largest bankruptcy in terms of Chapter 11 occurred on 15 September 2008, when Lehman Brothers Holdings Inc. filed for Chapter 11 protection involving more than USD 663 billion in assets. Other large bankruptcies assets under administration included Worldcom, Inc. (USD 103 billion), General Motors (USD 82 billion) and Enron Corporation (USD 65 billion). Also see Warren and Westbrook “The Success of Chapter 11: A Challenge to the Critics” (2009) *Michigan Law Review* 604–606; Jackson and Skeel *Bankruptcy and Economic Recovery* (2 July 2013) available at http://scholarship.law.upenn.edu/faculty_scholarship/476/.

> It would be fair to say that in the area of corporate rescue, Chapter 11 reorganisation has reached cult status.[789]

Directors and officers of the company who comply with corporate law formalities are generally not liable for the debts and liabilities of the corporation in the US. This contributes to the success of the Chapter 11 process, if there is a breach by a director of his or her fiduciary duties, this might attract personal liability for pre-bankruptcy actions. Generally, there are no fiduciary obligations to creditors. Mere insolvency or operating a company whilst insolvent, does not in itself give rise to liability.[790]

A Chapter 11 debtor emerges from bankruptcy protection when its confirmed plan becomes effective and it can resume operations without court oversight. After the Chapter 11 estate has been fully administered, the court enters a final decree closing the case.[791]

As reported in January 2014, low interest rates and a strong credit market have resulted in new major corporate bankruptcy filings in the US remaining at low levels. In 2013/2014, corporate defaults were rare in the US. Highly leveraged businesses were generally able to refinance or extend their debts to avoid defaults. As a consequence, companies in distress are often finding it unnecessary to resort to Chapter 11 with its attendant costs and risks. Preference is given to using out-of-court strategies to restructure debts and complete transactions.[792]

In October 2013, Bloomberg Brief reported that the number of US businesses filing Chapter 11 bankruptcy petitions listing assets and liabilities of USD 1 million or more, fell by 19,5 percent (from 474 in the third quarter to 362 in the second quarter).[793] It was reported in January 2015 that Chapter 11 filings remained relatively low for 2014 due to a

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789. Loubser "Tilting at Windmills? The Quest for an Effective Corporate Rescue Procedure in South African Law" (2013) 25 *SA Merc LJ* 439. Also see Moore "Outlook: Chapter 11 is Not a Bankruptcy Panacea, But it Does Have its Merits" (18 February 2014) *The Independent* available at http://www.independent.co.uk/news/business/comment/outlook-chapter11.

790. See Kinnison, Lee and Yates "Piercing the Corporate Veil: Before or After Winding Up" (April 2014) *Howse, Williams, Bowers Law Firm Insolvency/Restructuring Alert* available at http://www.hwbhk.com/en/news/all-news/insolvency – a useful synopsis of the current law on holding a director liable for a company's debts in the UK and in the light of the English Court of Appeal's decision in *Antonio Gramsci Shipping v Recoletos Ltd* [2013] EWCA Civ 730.

791. Warren and Westbrook "The Success of Chapter 11: A Challenge to the Critics" (2009) *Michigan Law Review* 524.

792. See Wachtell, Lipton, Rosen & Katz Publications (New York) *Corporate & Restructuring – 2013/2014* available at http://www.wlrk.com.

793. See *Bloomberg Brief* 3Q2013 Review (October 2013) available at www.bloombergbriefs.com. For the latest analysis of Chapter 11 trends see figures released on the American Bankruptcy Institute's website www.abiworld.org. Also see Davidoff *What's up for Restructuring Professionals in 2014?* (22 January 2014) available at http://www.jdsupra.com/legalnews/whats-up-for-restructuring-professional-93662/. For statistics on US Chapter 11 filings, see Capstone Advisory Group, LLC's website www.capstoneadvisorygroup.com.

robust capital market environment, low interest rates and continued easy access to financing in the US.[794]

Chapter 11 remains a process subject to constant re-examination. There is substantial activity in the US examining the workings of Chapter 11, and whether it needs a major revision to work better for the modern US economy and finance system. Levin and Klee are of the view that an efficient and effective insolvency system must grow out of the legal, economic and financial system in which it operates:

> Although its fundamental structure and principles have not been amended since 1978, chapter 11, and the judges and lawyers who operate the system, have done extraordinary work to make the system handle distressed companies and preserve going concern values, jobs and capital investments through sale or reorganization. However, the chapter 11 system is itself in distress, having been asked to do far more than it was designed to do and to operate in an entirely different environment. There are increasing disputes in cases over the fairness, efficiency and cost of chapter 11's operation. As a result, several efforts are underway among the practicing bar to rethink chapter 11, with a view toward making it work with today's (and tomorrow's) economic and financial system.[795]

In the UK, administration has generally had a good track record. The administrator is obligated to look after the interests of all creditors and not only a single creditor or class of creditors affected by the administration. The protection of the moratorium seeks to preserve the goodwill and value of the business and, if properly dealt with by the administrator, would enable him or her to offer a better return to unsecured creditors than an immediate liquidation would have done. Although administration may ultimately lead to liquidation of the company, the business itself may well be saved in whole or in part, by sale or "hire down" to a third party.[796]

There has been substantial debate in the UK on the efficacy of the administration procedure.[797] Issues with the administration procedure were highlighted by Rajak in 1995. At the time, the extent of the criticism of the administration process were as follows:

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794. See Skadden's 2015 Insights *Trends in Corporate 11 Filings* (January 2015) available at http://www.skadden.com/insights/trends-chapter-11-filings. Skadden's reported that although Chapter 11 filings increased exponentially in 2008 and 2009, this was followed by a steady decline in filing volumes after 2010.

795. Levin and Klee *Rethinking Chapter 11* (International Insolvency Institute, 12th Annual International Insolvency Conference, Paris, France, 21–22 June 2012).

796. Fletcher *The Law of Insolvency* (2009) 604–607.

797. For a detailed analysis of the success of the UK rescue regime, see Finch "Corporate Rescue Processes: The Search for Quality and the Capacity to Resolve" (2010) 6 *Journal of Business Law* 502–521.

1 The procedure is expensive, involving as it does at least three sets of professionals: accountants, insolvency practitioners, solicitors and barristers) plus the inevitably high cost of litigation. It has sometimes been said that an insolvent company must have to be very rich to afford administration proceedings!

2 The procedure is inaccessible, partly owing to the expense and partly owing to the ignorance of management in general, i.e. the directors of the huge number of small companies which could as well be run as partnerships and where the level of awareness of the technicalities of company law and insolvency is very low.

3 Following on from the inaccessibility point, the further point arises that help when sought is often sought too late. Everyone seems to be agreed that if help is sought early, it is likely to be far more effective in any attempted rescue.

4 Administration is dominated by receivership, which although capable of being an effective rescue facility is tainted by also being a highly effective debt collection procedure for the debenture holder.[798]

In the UK, a successful rescue can be defined by several outcomes. Belcher highlighted what counts as a successful rescue and the manner in which success is judged. In order to define success in a rescue context, one would have to consider "partial rescue" or "complete rescue". A completely successful rescue would result in the company ending up in a healthy position, continuing with its business with the same management, its workforce, its financing arrangements and to its scope and level of activities. This is coupled with losses incurred on the part of creditors (secured), its management, employees, shareholders and the national economy. Thus, according to Belcher, all rescues can be considered, in some sense, partial.[799]

Belcher was further of the view that "success" is very much in the "eye of the beholder". The measure of success would differ depending on the identity of the stakeholder: success for debt holders might be the return of their capital; but this is likely to be coupled with failure from the point of view of managers or employees who lose their jobs. A company might be restructured by closing down a section/part of their business. Creditors might still be fortunate enough to exit with their capital and with the opportunity to reinvest elsewhere; but certain employees exit with claims and very little possibility of future

798. Rajak "The Rescue of Insolvent Companies in the United Kingdom" (1995) 20 (1/2) *JJS* 27.
799. Belcher *Corporate Rescue: A Conceptual Approach to Insolvency Law* (1997) 22–24.

employment. Thus, it may be difficult to accurately determine or assess the overall success or failure of a corporate rescue.[800]

Many insolvency lawyers in turn have criticised the UK administration as being an unsuccessful way to rescue faltering companies. Draper is of the view that the new administration procedure in the UK has failed to fulfil the desired expectations. Many administrations have been succeeded by liquidations. Issues relate to the fact that often secured lenders exercise their power of veto. Recently, Draper concludes, there has been a gradual change in attitude and a willingness to allow the administration procedure to be followed and implemented. There is a perception that administration is a "half-strength" version of Chapter 11. If a "stronger" version was available in the UK, more could be done to protect the general body of creditors.[801]

The new-style rehabilitation regime (as found in the UK under administration) of corporate rescue can now be found in a substantial number of legal systems across many jurisdictions. The process of rescue and rehabilitation of a bankrupt business (as opposed to its liquidation) is recognised by many different international treaties dealing with insolvency proceedings.[802]

The extra flexibility that administration has brought to the UK has all but eliminated the difficulty that liquidators faced before in not being able to continue the running of the business.[803] The ability of the administrator to run the business with the cooperation of existing management is of huge advantage in an administration. The introduction of an outside professionally qualified insolvency practitioner being appointed as administrator with all the powers of a board of directors assists greatly in the effective administration of the company.[804] Westbrook et al. highlight that the key is early intervention:

> One cannot overemphasize the importance of providing a system under which debtors are encouraged to seek the help of the protective rehabilitation regime early enough to ensure that the maximum benefit can be achieved, with the caveat that too great an incentive (negative or positive) to seek this help early, might have the effect of

800. Draper and Brown "City Comment – Taking a leaf out of chapter 11?" (1991) *Law Society Gazette*, 8 May, 88 (28).
801. Ibid.
802. Westbrook, Booth, Paulus and Rajak (eds) *A Global View of Business Insolvency Systems* (2010) available at https://www.openknowledge.worldbank.org/bitstream/handle/10986/13522/68423.pdf?sequence=1 127.
803. Ibid.
804. Ibid 136.

> pushing some rehabilitation regimes too soon with possible adverse consequences for existing creditors.[805]

The aim of administration in the UK is clearly to ensure that the business is preserved and an arrangement concluded with creditors by which debts owed by the company are restructured and where creditors agree that they will have little choice but to receive less than the amount due, but more than that received in a liquidation.

This principle remains fundamental to the corporate rescue culture in the UK, which is mirrored in most of the developed jurisdictions around the world.[806]

In Australia, "rescue" does not mean that an insolvent enterprise is, literally, saved and fully restored, nor that the main participants in the insolvency (the creditors and owners of the enterprise) are eventually restored to their respective pre-insolvent positions. Rescue, through the application of legislation, should result in more value than that which might be obtained from the standard liquidation-style sale of the assets of the enterprise through a liquidation.[807]

In Canada, the CCAA approach to a rescue process would be to provide a structured, stable environment in which large insolvent companies can continue to carry on business and retain control over their assets while their creditors, shareholders and the court consider a plan or compromise that would permit the company to continue its business going forward and to permit a broad balancing of stakeholder interests in the insolvent corporation.[808]

The CCAA proceedings are directed at compromise. Parties, often have diametrically opposed rights and goals, are obligated to seek to achieve some resolution of their differences, or risk losing all in a liquidation proceeding.[809]

A restructuring under the CCAA offers the opportunity for creditors to "settle". If not it is a "zero sum game with winner takes all".[810]

805. Ibid 161.

806. For a synopsis of the success of administration in the UK, see Fletcher *The Law of Insolvency* (2009) 604–607.

807. Harmer "Comparison of Trends in National Law: The Pacific Rim" (1997) 23 *Brooklyn Journal of International Law* 144.

808. McDougall and Fleming *ADR in Cross-Border Canadian Corporate Restructuring* (presentation to International Bar Association Presentation 7–9 May 2006) 2. For statistics on the number of Canadian companies that have been granted protection under the CCAA, see Government of Canada , Office of the Superintendent of Bankruptcy for Canada "CCAA Records List" available at http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/h_br02281.html.

809. McDougall and Fleming *ADR in Cross-Border Canadian Corporate Restructuring* (presentation to International Bar Association 7–9 May 2006) 3.

The Canadian view is that ongoing tension between creditors, members and the company must be resolved. If not, the company will not survive.[811]

In research conducted on the success of restructuring in various international jurisdictions, Vriesendorp and Gramatikov were of the view that despite worldwide markets having access to easy credit, restructuring remains a "rare and uncertain event". Divergent views range from some that are adamant that rescue is less desirable than liquidation/bankruptcy; while others are of the view that restructuring provides more favourable outcomes in times of financial crises. Attitudes could possibly be linked to the role of insolvency and rescue in the business environment of the countries that were the subject matter of such research.[812]

Vriesendorp and Gramatikov also considered the views of insolvency professionals in these various jurisdictions. Saving jobs was seen as the most persuasive motive for restructuring distressed businesses. In the main, large corporations with large numbers of employees are targets for rescue, while small/medium sized corporations are often less rescued through the restructuring process. They were of the view that the viability of rescue is dependent on the particular insolvency system prevailing in the jurisdiction, the characteristics of the debtor, its creditors and a combination of all of these factors.[813]

In summary, effective corporate rescue procedures promote economic and social stability by preserving the value of assets represented by an insolvent or borderline solvent company (where the survival of the company, or its business, as a going concern is likely to be more profitable than a break-up sale of the company upon liquidation), and by preserving the jobs of employees. It contributes enormously to the correct allocation of resources and supports struggling but viable enterprises during times of financial difficulty; thereby preserving long-term value. Sufficient checks should be in place to ensure that companies that are beyond salvage are placed into liquidation promptly, rather than generating further costs in a futile rescue attempt.[814]

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810. Ibid.
811. Ibid.
812. Vriesendorp and Gramatikov "Impact of the Financial Crisis" (2010) *INSOL International Survey* 18.
813. Ibid.
814. Wood *Corporate Rescue: An Overview of Recent Developments from Selected Countries in Europe* (2004) 3.

However, as has been pointed out, one has to be sensitive to the dangers of transplanting insolvency systems from one jurisdiction to the other, without taking into account the impact that the imposition of such system will have on society at large. Insolvency systems profoundly reflect the legal, historical, political and cultural context of countries that have developed them. Countries such as the US, the UK, Canada and Australia display marked differences in how they approach business bankruptcies.[815]

Given the vast cultural differences around the world, and the history of each country's economy and attitudes about money and debt, there is no one-kind-fits-all bankruptcy system for companies. New company insolvency and reorganisation systems must reflect how that nation has experienced the growth of their market economies and how philosophically, such countries have viewed debt historically. Bankruptcy systems are social tools aimed at reflecting the particular value system of that jurisdiction's culture.[816]

The fundamental premise of the rescue culture is for creditors to accept that through the rescue process, losses by creditors might have to be accepted. Compromise of debt and the acceptance of a proportion of what creditors are owed in terms of the rescue proposal are part of the reorganisation package. Compromise will, in the main, always deliver more to creditors than they would receive if the ailing company were to be placed into liquidation. The added benefit of the rescue outcome is that the company can continue to trade into the future and, as a consequence, the business relationship with the creditor may be preserved.[817]

All in all, corporate rescue procedures may therefore enable losses to be minimised, with the concurrent beneficial economic and social implications.[818]

It is submitted that as can be seen by the previous analysis of the corporate rescue regimes applicable in foreign jurisdictions, a business rescue regime must incorporate various international essential core rescue principles and rescue philosophies, all of which culminate in a fundamental premise: the establishment of an efficient and effective framework to address the financial difficulty of debtors and, most importantly, the

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815. Martin "The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation" *Boston College International & Comparative Law Review* (2005) 28(1) Article 2 4.
816. Ibid 4–5.
817. Ibid.
818. Ibid.

effective compromise of creditors' claims. South Africa has drawn on many of the existing corporate rescue regimes that exist in foreign jurisdictions. The benchmarks that have been set provide a useful starting point for an analysis of effectiveness of Chapter 6 of the 2008 Companies Act.

PART 3 – SOUTH AFRICA'S BUSINESS RESCUE REGIME

CHAPTER 6 : THE ESTABLISHMENT OF A BUSINESS RESCUE REGIME FOR SOUTH AFRICA

6.1 THE RECOGNITION OF THE FAILURE OF CORPORATE RESCUE IN SOUTH AFRICA

South Africa was one of the first countries to introduce a corporate rescue mechanism in 1926 in the form of judicial management.[1] However, since the mid-1980s, South Africa was lagging behind most developed and some developing countries when it came to modern international trends associated with turnarounds or corporate rescue. South Africa had hung on to a liquidation (creditor-focused) culture despite continued developments in international jurisdictions which were focused on developing a more rescue-orientated approach.[2]

In 2004, the Department of Trade and Industry recognised that South Africa was in dire need of new legislative provisions to replace judicial management.[3] Rajak and Henning state in this regard:

> To insist, as the South African rescue provision does, that a protective moratorium is available only where 'there is a reasonable probability that if [the debtor] is placed under judicial management, it will be unable to pay its debts or to meet its obligations' is to ignore the well-nigh universal reality of creditors being prepared, for their own benefit to forgive part of the debt. It is frequently the case that a creditor will benefit far more from having the debtor back in the market place than from suing the debtor into extinction. A radically new rescue provision should provide a mechanism under which a specified majority of creditors can approve a plan under which the debtor may emerge from protection and resume normal commercial dealings.[4]

1. Judicial management was first introduced in the 1926 Companies Act and thereafter retained in the 1973 Companies Act.
2. Burdette "Legislative Framework for the Facilitation of Turnarounds" in Harvey (ed) *Turnaround Management and Corporate Renewal – a South African Perspective* (2011) 131.
3. Department of Trade and Industry *South African Law for the 21st Century: Guidelines for Corporate Reform* (2004). See discussion in Chapter 3, para 3.2.
4. Rajak and Henning "Business Rescue for South Africa" (1999) *SALJ* 286.

In the parliamentary debates which took place in September 2008, the need for a corporate rescue mechanism was extensively debated.[5]

The shortcomings of judicial management and the recognition of the fact that South Africa did not have an effective rescue regime in place were debated by members of parliament present at the sitting. The Minister of Trade and Industry advised the National Assembly that the Companies Bill was aimed at overhauling the current regulatory framework for companies as enshrined in the 1973 Companies Act. Specific reference was made to the core principles set out in the Department of Trade and Industry's discussion document entitled "South African Company Law for the 21st Century – Guidelines for Corporate Reform"[6] and to the comments made about the current state of insolvency and corporate rescue in South Africa.[7]

Members of parliament welcomed the new rescue provisions with specific recognition of the need to take international rescue principles into account. At the time, there was already a widespread acceptance that the existing judicial management procedure under Chapter 14 of the 1973 Companies Act was failing the local economy as few, if any, judicial management processes resulted in success. Consequently, predictability, effectiveness and flexibility guided the reform in this area of law.[8]

Recognition was given to the fact that judicial management legislation was outdated, highly formalistic and creditor-orientated. There was recognition that reform had to be introduced in order to deal with "the scourge of corporate failures and scandals pointing to weaknesses in corporate governance".[9]

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5. These debates took place on 26 September 2008, when the Minister of Trade and Industry introduced the Companies Bill to the National Assembly; see http://www.parliament.gov.za. Evident from the debates were the extensive series of workshops and meetings which had taken place since the commencement of the drafting of the Bill in 2005. The National Economic Development and Labour Council (NEDLAC) had been extensively involved in the drafting of the Bill.

6. Department of Trade and Industry *South African Law for the 21st Century: Guidelines for Corporate Reform* (2004). The DTI Guideline was the only comprehensive document published by the DTI in relation to the corporate law reform process. Not surprisingly, given the time which elapsed between the production of the Guidelines and the promulgation of the Act, the principles laid down in the Guideline differ considerably in certain respects from the provisions contained in the 2008 Companies Act. See Parliamentary Debates *Proceedings of the National Assembly* available at https://pmg.org.za/ 43–45. Also see Yeats "Putting Appraisal Rights into Perspective" (2014) 2 *Stell LR* 328–329.

7. Government Gazette No. 26493 Notice 1183 *South African Company Law for the 21st Century – Guidelines for Corporate Law Reform* (23 June 2004) 43–45.

8. Mongalo "An Overview of Company Law Reform in South Africa: From the Guidelines to the Companies Act, 2008" in *Modern Company Law for a Competitive South African Economy* (2010) xviii.

9. Parliamentary Debates *Proceedings of the National Assembly* available at https://pmg.org.za/ 60–61.

The failure of judicial management as a rescue mechanism was dealt with, as was the recognition that its failure had caused liquidations with the consequent "negative impact on the economy with regard to employment, loss of production and loss of revenue from tax".[10]

Members of parliament recognised the inherent benefits of business rescue thus:

> The idea behind business rescue, therefore, is an appreciation of the necessity to intervene at an early stage when a company is facing financial difficulties, but is not yet insolvent, with the sole objective of wanting to salvage, save or rescue it from certain downfall. A business rescue process can be initiated by various interested parties including trade unions, creditors, the board and shareholders.
>
> Once a decision has been taken to initiate a rescue process, a business rescue practitioner has to be appointed. The practitioner has been given wide-ranging powers, including powers to suspend payments to creditors and to appoint managers.
>
> Time and precision are of the essence when it comes to rescuing companies and as such the Bill specifies timeframes within which certain milestones have to be achieved, including the appointment of a business rescue practitioner, the finalisation of a business rescue plan, consultation with interested parties and finalisation of the whole rescue process. A new crop of professionals trained in business turnaround strategies will be appointed as business rescue practitioners, and this will have to evolve over time …

There was an overall sense that the provisions of the Companies Bill brought South Africa's company law into line with international trends and brought South Africa's commercial legislation up to date.[11]

The effect on the employment rate, the prospect of fewer companies being placed into liquidation and the potential to increase profit were all viewed as important consequences of the proposed business rescue legislation.[12]

Government clearly recognised the importance of saving jobs and reducing unemployment. Clearly, the interests of workers and the fact that it had been proposed that they participate

10. Ibid. 66.
11. Ibid 68, 70.
12. Ibid 71.

extensively in the business rescue process fitted well with the overall objectives of improving high unemployment rates.[13]

It was inevitable that judicial management was destined to be discarded in favour of corporate or business rescue procedures which had been receiving considerable attention worldwide for the last few decades. The "corporate rescue" trend had commenced with the introduction of the Chapter 11 procedure in the US with the Bankruptcy Reform Act 1978. Since the commencement of the Chapter 11 procedure, the worldwide trend was to attempt to rehabilitate insolvent companies instead of the traditional approach of liquidating them.[14]

In an address given by Associate Professor Tshepo H. Mongalo on 7 October 2014, the following was stated:

> At the outset, no one can dispute the reality that time had come in South Africa at the time of the reform of business rescue for the strictly creditor-friendly commencement procedures of judicial management proceedings to be replaced by a system which accommodates the voluntary access to business rescue protection in line with the debtor-friendly system of business rescue already in place somewhere else within the Anglo-American and Commonwealth jurisdictions.[15]

Judicial management was meant to be a corporate rescue procedure. However, as set out above, the procedure failed in many respects. Attempts at reform were unsuccessful. What was needed was a new dispensation, bringing South Africa into line with international economic principles of corporate rescue that met the needs of a modern South Africa and which fostered the benefits of an entrepreneurship culture.[16]

It is submitted that as South Africa moved towards acceptance of a rescue culture, providing credit or further funding to a company in business rescue found greater acceptance than doing so in a liquidation. The harsh lessons of the 2008 financial crisis had a severe impact on the development of a rescue culture in South Africa. Like creditors worldwide, South African creditors became far more accepting of taking a debt haircut than ever before. Commenting on the concept of credit, Graeber states:

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13. Ibid 74, 77.
14. Kloppers "Judicial Management: A Corporate Rescue Mechanisms in Need of Reform?" (1999) 3 *Stell LR* 417.
15. Mongalo "Two Steps Forward and One Step Back is better than One Step Forward and Two Steps Back: A Limited Comparative Analysis of Business Rescue in South Africa" Opening address for *Business Rescue – First three years* University of Pretoria (7 October 2014) 3.
16. Kloppers "Judicial Management: A Corporate Rescue Mechanisms in Need of Reform?" (1999) 3 *Stell LR* 434.

> We live, now, at a genuinely peculiar historical juncture. The credit crisis has provided us with a vivid illustration of the principle set out in the last chapter: that capitalism cannot really operate in a world where people believe it will be around forever.
>
> For most of the last several centuries, most people assumed that credit could not be generated infinitely because they assumed that the economic system itself was unlikely to endure forever. The future was likely to be fundamentally different. Yet, somehow, the anticipated revolutions never happened. The basic structures of financial capitalism largely remained in place. It's only now, at the very moment when it's becoming increasingly clear that current arrangements are not viable, that we suddenly have hit the wall in terms of our collective imagination.[17]

It is thus further submitted that by the mid-2000s, South Africa was in dire need of corporate law reform in the field of rescue of financially distressed companies. With the ultimate introduction of Chapter 6 and its principles of controlled and effective debt compromise, South Africa was in the throes of changing its perceived and historical view on debt, its compromise and ultimate discharge.[18]

6.2 THE LAW REFORM PROCESS IN ITS POLITICAL CONTEXT

A number of workshops was held in South Africa in December 1998 where a possible business rescue regime for South Africa was discussed. Various parties undertook to draft new legislation to replace the existing judicial management provisions.[19]

In 2003, the Department of Trade and Industry ("DTI") formally announced that it was undertaking a large-scale, fundamental revision of South African company law.[20]

In January 2004, David Burdette of the Centre for Advanced Corporate and Insolvency Law ("CACIL") of the University of Pretoria published a most important document entitled "The Development of a Modern and Effective Business Rescue Model for South

17. Graeber *Debt: The First 5,000 Years* (2011) 381.
18. See discussion in Chapter 2, para 2.4.
19. For a background to the reform initiatives, see Burdette "The Development of a Modern and Effective Business Rescue Model for South Africa" (2004) Centre for Advanced Corporate and Insolvency Law (CACIL), University of Pretoria 3–4. Also see Mongalo "An Overview of Company Law Reform in South Africa: From the Guidelines to the Companies Act, 2008" in *Modern Company Law for a Competitive South African Economy* (2010) xiii–xxv.
20. Government Gazette No. 26493 Notice 1183 *South African Company Law for the 21st Century – Guidelines for Corporate Law Reform* (23 June 2004).

Africa".[21] This document was prepared as a "pre-consultation working document" in order to assist participants in their preparation for a workshop held on 16 January 2004.

At the time, there was a clear recognition that judicial management had failed and the question remained as to what would be done in order to rectify the position in South Africa, especially taking into consideration the premium that government was now placing on saving jobs and businesses. At the time, the dramatic failure of businesses such as the Central News Agency (CNA), the Retail Apparel Group (RAG) and LeisureNet, were prompting government to take the necessary steps to bring about reform in the area of business rescue.[22]

At the time, South Africa's long antiquated insolvency laws were reviewed and resulted in the unified version of a new Insolvency Bill which had been accepted by the South African Cabinet.[23]

The workshop held on 16 January 2004 dealt with, *inter alia* –

- The reasons for the failure of judicial management as a viable business rescue mechanism, and the lessons to be learnt from its failure;

- Options, both old and new, that had been included in the draft Insolvency and Business Recovery Bill;

- The underlying philosophy and meaning of "business rescue"; and

- The main elements of a successful business rescue regime (within the South African context).

At the culmination of the workshop, all delegates shared the view that a new, modern corporate rescue regime had to be incorporated into South African law.[24] The workshop

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21. Burdette "The Development of a Modern and Effective Business Rescue Model for South Africa" (2004) Centre for Advanced Corporate and Insolvency Law (CACIL), University of Pretoria.

22. Burdette "The Development of a Modern and Effective Business Rescue Model for South Africa" (2004) Centre for Advanced Corporate and Insolvency Law (CACIL), University of Pretoria.

23. The South African Cabinet approved the unified version of a new insolvency statute on 5 March 2003 which had been submitted to the State Law Advisors under the title *Draft Insolvency and Business Recovery Bill*. See Burdette "The Development of a Modern and Effective Business Rescue Model for South Africa" (2004) Centre for Advanced Corporate and Insolvency Law (CACIL), University of Pretoria.

24. Smits "Corporate Administration: A Proposed Model" (1999) 32 *De Jure* states the following at 83:

identified key elements flowing from the UNCITRAL Guide on Insolvency Law and the World Bank principles and their impact on the development of a successful and workable business rescue model for consideration in the South African context.[25]

In May 2004, the DTI published a policy paper[26] which established guidelines for Corporate Law Reform entitled "South African Company Law for the 21st Century". The DTI set out its intention "to create a system of corporate rescue appropriate to the needs of a modern South African economy".[27] These were gazetted[28] and published for the purpose of obtaining public comment.

In the foreword, the Minister of Trade and Industry, Mr Mandisa Mpahlua stated, *inter alia*, that there was a drastic need for a programme of reform and a need to bring corporate South Africa into line with international trends which would reflect the changing environment for business in South Africa. There was a recognition that South Africa's company law regime had to become up-to-date, competitive and designed for a modern corporation.

It is submitted that this statement of intent by the Minister set the tone for South Africa to have a really good look at its existing insolvency and corporate rescue provisions and to adapt them to international norms and standards. Reference was made to the existing judicial management provisions and to the fact that [j]udicial management is rarely used and even more rarely leads to a successful conclusion".[29]

> Modern "corporate rescue" and reorganisation 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. Through judicial bankruptcy procedures, reorganisation seeks to maximise, preserve and possibly even enhance the value of a debtor's business enterprise, in order to maximise payment to the creditors of the distressed debtor.

Also see Trebilcock and Katz "The Law and Economics of Corporate Insolvency: A North American Perspective" in Rickett (ed) *Essays on Corporate Restructuring and Insolvency* (1996), where the following is stated at 7:

> The collective interest of all creditors requires the maximisation of the aggregate value of the assets of the debtor. In many cases, an insolvent firm is worth more as a going concern than the sum value of its discrete assets sold on a piecemeal basis. In these situations, it is in the collective interests of all creditors that the business be preserved as a going concern.

25. See analysis of these main characteristics in Burdette "The Development of a Modern and Effective Business Rescue Model for South Africa" (2004) Centre for Advanced Corporate and Insolvency Law (CACIL), University of Pretoria.
26. Government Gazette No. 26493 Notice 1183 *South African Company Law for the 21st Century – Guidelines for Corporate Law Reform* (23 June 2004).
27. Ibid at para 4.6.2.
28. Government Gazette No. 26493 Notice 1183 *South African Company Law for the 21st Century – Guidelines for Corporate Law Reform* (23 June 2004). Both projects were probably the result of organised labour applying pressure in their quest to save jobs where employers were experiencing financial difficulties. See Burdette "Legislative Framework for the Facilitation of Turnarounds" in Harvey (ed) *Turnaround Management and Corporate Renewal – a South African Perspective* (2011).
29. Government Gazette No. 26493 Notice 1183 *South African Company Law for the 21st Century – Guidelines for Corporate Law Reform* (23 June 2004) 43.

It was apparent that there was a clear recognition that existing judicial management provisions had remained relatively untouched since their introduction in 1926, and that there was a dire need for a new and updated system for business rescue as had already been adopted in international jurisdictions.

The Minister quoted an extract from the *South African Law Journal* by Rajak and Henning:[30]

> It has been observed that "all modern corporate rescues are united on one matter, the absence which, possibly more than anything else, has helped to bring South Africa's judicial management to its present perceived impotence". This is the recognition that the agreed plan by which the future relations between the debtor and its creditors will be governed may well include the reduction of the debtor's overall indebtedness. To insist, as the South African rescue provision does, that a protective moratorium is available only where "there is a reasonable probability that if [the debtor] is placed under judicial management, it will be unable to pay its debts or to meet its obligations", is to ignore the well-nigh universal reality of creditors being prepared, for their own benefit to forgive part of the debt. It is frequently the case that a creditor will benefit far more from having the debtor back in the market place than from suing the debtor into extinction. A radically new rescue provision should provide a mechanism under which a specified majority of creditors can approve a plan under which the debtor may emerge from protection and resume normal commercial dealings.[31]

The objective was clear. The law review process was committed to creating a system for corporate rescue in South Africa. Reference was made to the existing provisions of Chapter 11 in the US and to the work already done in the proposed draft Insolvency and Business Recovery Bill.[32]

6.3 THE DEVELOPMENT OF A SOUTH AFRICAN CORPORATE RESCUE CULTURE

Having completed the Guidelines for Corporate Law Reform in May 2004, the DTI approached the Cabinet of the Republic of South Africa in early June 2004 for approval to publish the guidelines, to conduct public information sessions and to solicit public comments on the proposed guidelines. The DTI conducted public consultation sessions in

30. Rajak and Henning "Business Rescue for South Africa" (1999) *SALJ* 286.
31. Government Gazette No. 26493 Notice 1183 *South African Company Law for the 21st Century – Guidelines for Corporate Law Reform* (23 June 2004) 43.
32. This document was drafted by the Centre for Advanced Corporate and Insolvency Law at the University of Pretoria. The draft resulted in the publication of the Final Report Containing Proposals on a Unified Insolvency Act, in August 2000. The project was not taken to its final conclusion.

all nine provinces from 24 June to 23 September 2004. At the same time, the Department tabled the guidelines within the National Economic Development and Labour Council's ("NEDLAC") Trade and Industry Chamber as required in terms of the National Economic Development and Labour Council Act.[33] Further consultations were held with the Portfolio Committee on Trade and Industry of the National Parliament of South Africa.[34]

The process of legislative drafting began in August 2005.

In 2005, writers and academics were beginning to get to grips with what was meant by a "corporate rescue" culture. What was certain, was that although judicial management in South Africa had been seen as achieving the complete resuscitation of a company, it differed quite substantially from the modern definition of business rescue.[35]

Despite its name, the purpose of "business rescue" was not necessarily to prevent a company from being wound up or liquidated. Stakeholders began to accept that even if the business could not be restored to a solvent and profitable status, the return to creditors in the long run would be much higher.[36]

The first exposure draft was published in April 2006. The Bill was finalised for submission to the Minister and to Cabinet in July 2006 and was published for public comment on 12 February 2007.[37]

In 2007, academics reached consensus on the fact that judicial management had failed as a process and were now looking to what would replace it.[38]

In 2007, the international ratings agency, Standard & Poor,[39] assessed South Africa as a Group A2 jurisdiction, based *inter alia* on the South African regime's relative degree of

33. Act 35 of 1944.

34. Mongalo "An Overview of Company Law Reform in South Africa: From the Guidelines to the Companies Act, 2008" in *Modern Company Law for a Competitive South African Economy* (2010) xxii.

35. Burdette "The Development of a Modern and Effective Business Rescue Model for South Africa" (2004) Centre for Advanced Corporate and Insolvency Law (CACIL), University of Pretoria.

36. Ibid 5. See Smits "Corporate Administration: A Proposed Model" (1999) 32 *De Jure* at 83.

37. Mongalo "An Overview of Company Law Reform in South Africa: From the Guidelines to the Companies Act, 2008" in *Modern Company Law for a Competitive South African Economy* (2010) xxiv.

38. See Loubser "Business Rescue in South Africa: A Procedure in Search of a Home?" in Joubert, Botha and Schulze (eds) *Comparative and International Law Journal of Southern Africa* (2007) *XL CILSA* 152–171. Also see Mongalo "An Overview of Company Law Reform in South Africa: From the Guidelines to the Companies Act, 2008" in *Modern Company Law for a Competitive South African Economy* (2010) xvi. Mongalo sets out details of the key participants in the South African company law reform process.

"creditor-friendliness" as defined in Standard & Poor's report titled "Jurisdiction-Specific Adjustments to Recovery and Issue Ratings".[40] At that time, South Africa's insolvency regime was viewed by this rating agency as follows:

> South Africa, on a global scale, is a friendly jurisdiction for secured creditors and is, most likely, the friendliest in Africa. Similar to the most creditor-friendly jurisdictions in Europe and Asia, South Africa's insolvency regime is focused more on liquidating insolvent debtors rather than rescuing debtors in distress. Creditors benefit from a relatively independent judiciary and a judicial process that is generally predictable. However, in contrast to some of the most creditor-friendly jurisdictions around the world, secured creditors in South Africa generally do not have an unrestricted ability to foreclose on collateral outside of court proceedings, and such proceedings can be relatively slow and inefficient, with delays on enforcement of up to two years in some contested cases. While debt recovery prospects for secured creditors are generally strong, such recoveries may be reduced not only by procedural delays, but also by the relatively high costs (and fees) of the enforcement process. Moreover, lawmakers are considering substantial reforms to the South African insolvency regime with an aim to encourage more corporate rescues of debtors in distress, which may materially impact creditor rights in the future. It's still unclear the extent to which the reforms will amend the current regime and when they'll be enacted, but they're not considered likely to be implemented within the next two years.[41]

This was followed up by the publication of the draft Companies Bill on 13 February 2007. In the "Memorandum on the objects of the Companies Bill, 2008", the legislature introduced Chapter 6 of the Bill. This chapter was to effectively replace the existing regime of judicial management with a "modern business regime, largely self-administered by the company, under independent supervision within constraints set out in the Chapter and subject to court intervention at any time by way of application to court by any of the stakeholders".[42]

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39. Standard & Poor Financial Services LLC (S & P) is an American financial services company based in New York. It is a division of McGraw Hill Financial that publishes research and analysis on stocks and bonds. S & P are considered as one of the big three credit-rating agencies in the world. See http://www.standardandpoor.com.

40. Standard & Poor *Jurisdiction-Specific Adjustments to Recovery and Issue Ratings* (5 July 2007) available at http://www.ratingsdirect.com.

41. See Standard & Poor htpp://www.standardandpoor.com/ratings/articles/en/us 1.

42. The Companies Bill 2008 was published by the Department of Trade and Industry on 27 June 2008 and was introduced into Parliament in Government Gazette No. 31104 Notice 677 *Notice of introduction of a bill into Parliament: Companies Bill* (30 May 2008). Reference to the Parliamentary Debates dealing with the introduction of Chapter 6 (Business Rescue) are dealt with earlier. In some jurisdictions turnaround legislation, which is designed for the facilitation of corporate rescue, is found in insolvency laws, while in other jurisdictions it is found in the company laws. One of the disadvantages, alluded to above, is that if corporate rescue legislation is included in the insolvency laws of a country, people tend to associate insolvency law with failure, a negative connotation that could suppress any attempt at rescuing a business. Conversely, by including the turnaround legislation in the company laws of a country, a corporate rescue mechanism has a more positive connotation. However, it needs to be pointed out that insolvency and corporate rescue are closely associated, and it makes sense to include both the insolvency procedures and the corporate rescue procedures in the same legislation. See Burdette "Legislative Framework for the Facilitation of Turnarounds" in Harvey (ed) *Turnaround Management and Corporate Renewal – a South African Perspective* (2011) 133.

Reference was made to the recognition of the interests of shareholders, creditors and employees which allowed further participation in the development and approval of a business rescue plan. The memorandum further confirmed that the interests of "workers" would be recognised by the new legislation, including providing them with a voting interest to the extent of any unpaid remuneration prior to the commencement of the rescue process, allowing them opportunities to consult in the development of the business rescue plan, permitting them opportunity to address creditors prior to voting on a plan and according to them as a group, the right to buy out any dissenting creditor or shareholder who had voted against approving a rescue plan.[43]

In the King III report on Corporate Governance,[44] Professor Mervyn King referred specifically to the value of the board considering business rescue proceedings and the position of the financially distressed company.

King made suggestions that the board must carefully consider whether or not a company is in fact "financially distressed" (with reference to the definition in the Bill), and provided guidelines as to when a board should consider "appropriate action" to avoid or overcome financial distress. King advised that directors must take it upon themselves to become aware of and understand the duties and powers of the practitioner to be appointed.[45]

In a presentation to the Portfolio Committee on Trade and Industry on 25 January 2011,[46] further deliberations were made on enhancements to the proposed legislation and subsequent to public submissions being made to the Portfolio Committee.

The drafting process which was adopted by the DTI to produce the Act is both interesting and illuminating. As an integral part of the process, an international reference team was appointed. The team included experienced specialist attorneys and academics from the US, UK and Australia. Philip Knight, a Canadian lawyer, was appointed as chief drafter of the legislation.[47]

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43. This "upfront" recognition of worker's rights in the memorandum is of fundamental importance. It reflects the South African Government's need to ensure that employees are well "looked after" in the business rescue process, which is set out clearly in their recognised right as superpriority creditors in the process. See Chapter 7, para 7.6.2.
44. Institute of Directors in Southern Africa *King 3 Code of Corporate Governance for South Africa* (September 2009) Ch 2 Principle 2.15.
45. Ibid.
46. Report to the Portfolio Committee on Trade and Industry (Parliament, Cape Town 25 January 2011).
47. See Yeats "Putting Appraisal Rights into Perspective" (2014) 2 *Stell LR* 329.

The drafting of the legislation was centred around a clear intention to retain the common law where it was effective and only to add or deviate from it where necessary.[48]

The influence of the US Chapter 11 as a process (despite the Canadian influence in the drafting of the new legislation)[49] should not be underestimated. Chapter 11 was seen as a success in the US and thus has had a significant influence in the development of other rescue regimes, including Chapter 6 in South Africa.[50]

Although the provisions of Chapter 6 are fairly unique to the South African economy and legal framework, there are many similarities borrowed from foreign jurisdictions (such as those referred to above) which embrace international standards of corporate rescue culture. Modern business rescue regimes all have similar provisions and themes which address important issues for any jurisdiction considering the introduction of a rescue process for distressed companies. These include, *inter alia*, the following:[51]

- Which corporate entities would be subject to the rescue legislation?
- How does a company achieve a "protected status"?
- If proposed, how far must a debtor company go to show that it is financially distressed/insolvent and that, if placed into a process, it could be successfully rescued?
- The extent of the moratorium applicable: which creditors, and from when, are prohibited from proceeding with claims against the company?
- Who will play the supervisory/management/administrative role?
- What will be the role of the courts and how accessible will they be to support the rescue process?

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48. Ibid 330.
49. It should be pointed out that it appears that the main drafters of the Companies Act, 2008 were Canadians. This appeared to be a strange decision on the part of government as there is no basis to believe that South African common-law principles or case precedent on insolvency issues were taken into account when Chapter 6 was initially drafted.
50. See Loubser "Tilting at Windmills? The Quest for an Effective Corporate Rescue Procedure in South African Law" (2013) 25 *SA Merc LJ* 438–446. See discussion in Chapter 5, para 5.2.2.
51. Rajak and Henning "Business Rescue for South Africa" (1999) 2 *SALJ* 263–264.

- Will finance be available to "prop up" the company during the restructuring/rescue process?

- How does the company emerge from its protective regime and what form does the "plan" take in order to ensure a successful turnaround?

In view of its labour laws and policy, especially since 1994, it is submitted that South Africa has always had a strong need to deal with employee rights in a restructuring process and the influence of labour in support of the Chapter 6 provisions was an important factor in the introduction of this legislation. It is submitted that the role of employees (mainly led by management) in a corporate rescue should therefore not be underestimated. As discussed later,[52] employees generally have a huge incentive to ensure that the company becomes subject to business rescue proceedings rather than liquidation. Initially in a liquidation, employment used to be terminated. Section 38 of the Insolvency Act[53] was amended in 2002 to allow for a dispensation where employment contracts were initially suspended with the view of granting the trustee or liquidator the opportunity to try and sell the business as a going concern, in which case contracts of employment could be transferred to the new business. In the business rescue context, employees continue to work for the company during business rescue proceedings. In terms of section 136(1) of the 2008 Companies Act, during a company's business rescue proceedings employees continue to be employed on the same terms and conditions. Remuneration due to employees ranks as post-commencement finance, thus elevating employees to the rank of superpriority creditors during business rescue.[54]

It is submitted that the rescue provisions applicable in foreign jurisdictions are mostly very similar to the new provisions of Chapter 6 of the 2008 Companies Act. The same theme of offering creditors something less than a full dividend, balancing the rights of the debtor company with those of creditors, the challenges of debtor-in-possession (post-commencement) finance, the challenges of implementing a successful moratorium, the involvement of the courts; all have a very similar objective: either allow a company to be

52. See Chapter 7, para 7.6.2.
53. See section 38 of the Insolvency Act, 1936.
54. Section 135(1) and section 136(1) of the 2008 Companies Act.

fully resuscitated from its position of financial distress, or return a better dividend than creditors would get in a formal winding-up procedure.[55]

It is further submitted that the common themes found in Chapter 6 of the 2008 Companies Act, including the moratorium on creditor's claims, the cram-down on dissenting creditors,[56] supervision by an independent person and the voting in (compromise on creditors' claims) of a plan, are shared in many foreign jurisdictions.

Many of these themes have been debated and discussed in the last few decades by South African delegates attending conferences at INSOL International (INSOL).[57]

The world insolvency organisation INSOL, at its core, a strong theme of corporate workout and restructuring. As set out on its website,[58] the group's focus has been on international turnaround, insolvency and related credit issues. Objectives include the exchange of information and ideas to encourage cooperation and communication among the insolvency profession, credit community and related constituencies. Pre-2011, INSOL's world conferences, held in various jurisdictions around the world, pointed to the shortcomings of South Africa not having had a developed, operational rescue provision which provides financially distressed companies with a second chance, one aimed at the rehabilitation of such company into a successful concern.[59]

At these INSOL world conferences, developed international jurisdictions have presented their often unique rescue systems to INSOL which have been operating in those countries for decades.

55. See Chapter 8, para 8.1 below. One of the most important objectives of the legislative framework for corporate rescue in South Africa was to prevent asset stripping that so often took place under South Africa's outdated insolvency laws. South African insolvency practitioners were often (unfairly at times) referred to as "glorified auctioneers". Assets were more often than not sold off almost immediately after a liquidation order had been granted. Very few genuine attempts were made to keep acting businesses intact and to then sell them off as going concerns. See Burdette "Legislative Framework for the Facilitation of Turnarounds" in Harvey (ed) *Turnaround Management and Corporate Renewal – a South African Perspective* (2011) 131.

56. Note that the cram-down mechanism set out in Chapter 11 differs from the South African version contained in section 153 of the 2008 Companies Act. See Chapter 7, para 7.8.2.

57. INSOL International (established in 1992) is a world-wide federation for accountants and lawyers who specialise in turnaround and insolvency. There are currently 40 member associations world-wide with over 9000 professionals practising in approximately 70 countries across the globe. The author has participated at INSOL's international conferences almost on an annual basis since 1999 (New Orleans Conference). INSOL provides an extremely useful and informative insight into international insolvency and rescue regimes operating around the world.

58. http://www.insol.org.

59. http://www.insol.org.

The author has attended many of these INSOL conferences and has noted that South Africans (including lawyers, insolvency practitioners, liquidators, judges and academics) attending these conferences (pre-2011),[60] had often raised the fact that South Africa was lagging behind when it came to legislated mechanisms for change in the restructuring field. This debate and discussion, in the author's view, laid the foundation for the need to introduce a restructuring regime as found in Chapter 6 of the 2008 Companies Act.

It is submitted that the introduction of Chapter 6 in the 2008 Companies Act, its regulations and already developing case law, has brought South Africa into line with foreign jurisdictions and the developed restructuring regimes already operational worldwide. The interpretation of Chapter 6 will be developed over time, with strong references being made to those foreign rescue regimes already operational around the world.[61]

The historical tension in South Africa between creditors on the one side and management of distressed companies on the other will be the fundamental hurdle to overcome. The important driver behind any successful business rescue regime is the implementation of a moratorium against creditors' claims and continued funding within the business rescue process. If this is not achieved, there is every likelihood that the business rescue process will fail and end up in liquidation.[62]

60. The last regional conference was held in San Francisco in March 2015.

61. As an example see Chapter 7, para 7.8.2, where it is discussed how the court in *Africa Banking Corporation of Botswana v Kariba Furniture Manufacturers & Others* (228/2014) [2015] ZASCA 69 [20 May 2015] at paragraph 16, made clear references to the US Bankruptcy legislation and Chapter 11 of the US Bankruptcy Code. The court confirmed that US Bankruptcy legislation provided for a rearrangement of the debt structure of a business and the protection of the company from the enforcement of claims by creditors whilst the company was in a Chapter 11 process. Despite the imposition of a Chapter 11 process, the business of the company continued. However, the court distinguished the US Bankruptcy procedure from the process provided for in Chapter 6 of the 2008 Companies Act. On the lead-up to replacing judicial management with business rescue, see also Lambrecht "Business Rescue Replacing Judicial Management: An Assessment of the Extent of Problems Solved" (2008) 1 *SAJAR* 183–196.

62. For the advantages of business rescue as opposed to liquidation, see Loubser "Tilting at Windmills? The Quest for an Effective Corporate Rescue Procedure in South African Law" (2013) *SA Merc LJ* 447–453.

CHAPTER 7 : THE NEW SOUTH AFRICAN RESCUE REGIME – A LEGAL ANALYSIS OF CHAPTER 6 OF THE ACT

7.1 INTRODUCTION

Chapter 6 of the 2008 Companies Act, promulgated in April 2009, fundamentally rewrites South African company law from a restructuring perspective and, accordingly, has had far-reaching effects for the rescue of South African companies. The new business rescue procedure has been designed to prevent the demise, through winding-up, of viable companies by making provision for their possible rescue. If a plan cannot be devised to rescue the company under the provisions of Chapter 6, then a plan that would achieve a better return for a company's creditors than that which would ensue pursuant to its winding-up, is the next alternative objective. If none of the objectives set by Chapter 6 are achieved, the company may be wound up.[63]

The new business rescue regime in South Africa was developed from similar themes and concepts applicable in other jurisdictions, in particular in the US and the UK. The seven international corporate rescue themes referred to above[64] have been incorporated into Chapter 6, such as the moratorium on claims, the need for a supervisor, a restructuring of contracts, the need for DIP finance (post-commencement finance), the requirement of a cram-down process on dissenting creditors[65] and the fundamental principle of a discharge of creditors' claims. It is submitted, that the new Chapter 6 process has succeeded in including all of these fundamental (and necessary) international principles of corporate rescue.[66]

63. Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-1 at par. 18.1.

64. See the seven international core rescue themes dealt with in Chapter 5, para 5.5. Additionally, Chapter 6 of the 2008 Companies Act brings South Africa into line with modern rescue regimes and international standards of best practice discussed in Chapter 4. In 1999, there was a recognition that in order for South Africa to bring itself into line with modern regimes of rescue, certain core fundamental rescue themes had to be considered. See Rajak and Henning "Business Rescue for South Africa" (1999) *SALJ* 262–287. At 263, the authors recognise the relevant and essential (core) themes/provisions necessary to align any jurisdiction with a modern business rescue regime already applicable in various jurisdictions across the world – see 263–264 and 270–287.

65. Note that the US Bankruptcy cram-down provision is different from that provided for by section 153 of Chapter 6 of the 2008 Companies Act. See Chapter 7, para 7.8.2. The term "cram-down" is used colloquially in this study to reflect the South African "binding offer" mechanism dealt with in Chapter 7, para 7.8.2.

66. See Levenstein "Business Rescue: A Guideline for the South African Banking Sector" (March 2011) *Legalbrief* available at http://www.werksmans.com; Levenstein "The New Business Rescue Procedure: Chapter 6 of the Companies Act 71 of 2008" (2010) *INSOL World* available at http://www.insol.org 26–28.

Business rescue thus achieves the international principle of striking 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.[67]

Business rescue in terms of Chapter 6 brings South Africa into line with modern jurisdictions. The aim is to mirror the modern approach reflected in international jurisdictions by giving a distressed company the opportunity to place itself onto a sound financial footing, thereby saving the underlying business, with the rights of employees and the interests of society generally being recognised.[68]

One of the major themes of the 2008 Companies Act is the creation of a system of "corporate rescue appropriate to the needs of a modern South African economy".[69]

This theme is amplified in section 7(k) of the 2008 Companies Act which confirms that one of the purposes of the 2008 Companies Act is to "provide for efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders".[70]

Government's persistence with the concept of business rescue is based on empirical evidence to the effect that attempts to rescue companies that are already insolvent or are bordering on insolvency met with less success, than attempts to rescue companies that can begin almost immediately after a board first realises that the company faces financial problems which are reasonably likely to render it insolvent in the near future.[71]

The Minister of Trade and Industry explained the need for business rescue as follows:

> [The Act] introduces the principle that the idea of business rescue schemes rather than summary liquidation are more preferable, with the idea in mind that it is better to try and save a business in distress rather than summarily close it down because creditors exceed debtors, the possibility of restoration being more equitable for all interested

67. Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-1–18-4 at para 18.1 (with reference to case law).
68. Rushworth "A Critical Analysis of the Business Rescue Regime in the Companies Act 71 of 2008" (2010) *Acta Juridica* 376.
69. Government Gazette No. 26493 Notice 1183 *South African Company Law for the 21st Century – Guidelines for Corporate Law Reform* (23 June 2004), para 4.6.2.
70. Stein and Everingham *The New Companies Act Unlocked: A Practical Guide* (2011) 408.
71. Ibid.

> parties than the current somewhat immediate, maybe too early in some instances, brutal settlement and distribution process.[72]

By "rescue" is meant the reorganisation of the company to restore it to a profitable entity and avoid liquidation. As has been set out above,[73] corporate rescue found a place in US restructuring and bankruptcy legislation through the Chapter 11 process of the US Bankruptcy Code and Bankruptcy Reform Act, 1978; in the UK, through the voluntary arrangements and administration process of the UK Insolvency Act, 1986 and the Enterprise Act, 2000; in Australia through Pt 5.3A of the Corporations Act, 2001; and in Canada through the restructuring processes set out in the CCAA and BIA. All of this international legislation has, as its fundamental premise, the recognition that when companies are in financial difficulties, they must be given the opportunity to reorganise and restructure their financial obligations to creditors.[74]

In South Africa, the 2008 Companies Act likewise attempts to make it easier for companies in financial difficulty to be rescued, to avoid insolvency and consequent winding up, and to continue as commercially viable entities. The fundamental purpose of a business rescue or reorganisation is to prevent a debtor from going into liquidation, with the attendant loss of jobs and possible misuse of economic resources.[75]

The economy as a whole suffers when a company is shut down. Rescue legislation provides an opportunity for a company to be successfully rescued or turned around.[76] As a result creditors will get paid, jobs will not be lost and the company will be able to pay taxes to the revenue authorities.

Companies in financial difficulties cannot hope to achieve a controlled restructuring without some form of breathing space. Chapter 6 provides the moratorium required to

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72. Ibid.

73. See Chapter 5, para 5.2.3.

74. The business rescue provisions set out in sections 128–154 of Chapter 6 of the 2008 Companies Act imports many aspects of the Chapter 11 process of the US Bankruptcy Code that apply to companies in financial difficulties. See Cassim *Contemporary Company Law* (2011) 783.

75. Ibid. Also see Levenstein "Business Rescue: help is at hand" (November 2008) *Without Prejudice* 12–14; Sher *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, University of Johannesburg 2013) available at https://ujdigispace.uj.ac.za.

76. See Levenstein "Sink or Swim? Business Rescue the Art of Treading Water" (7 March 2012) *Without Prejudice* 14–15; Levenstein "New Companies Bill Addresses Business Rescue" (February 2009) *Sawubona Magazine* (SAA) 126–127; Levenstein "South Africa has much to learn from the Chrysler bankruptcy filing" (June 2009) *Boardroom* 12–14.

achieve this objective while the company's business rescue plan is being drafted and ultimately placed before creditors for approval.[77]

However, not all companies are suitable for business rescue.[78] Much will depend on the cause of the company's financial distress. In some cases, a business rescue may be a prohibitively expensive process for a company to adopt. It might be that a straightforward sale of its business to an interested purchaser would be a quicker, more effective and less expensive option. It should be noted further that a business rescue does not always entail a complete recovery of the company in the sense that after the procedure, the company will have regained its solvency, its business will have been restored and its creditors repaid. While this may be the ideal outcome, it is seldom attainable.[79]

Since 1 May 2011, Chapter 6 of the 2008 Companies Act has been exposed to interpretation by lawyers, academics and by the South African courts.[80]

Since its implementation, over 100 judgments have been handed down by the High Court of South Africa dealing specifically with the interpretation of sections contained in Chapter 6. There has also been some deliberation by our Supreme Court of Appeal on certain aspects.

Business rescue and the application and interpretation of Chapter 6 is an evolving concept and clearly, as is reflected in the judgments handed down (and referred to below), will continue to be so over the next few years. Ensuring continued stability of viable businesses is a goal worth pursuing for any modern country, and any business rescue regime adds a dimension to this objective.[81]

It is submitted that South Africans have, for the most part, embraced the new legislation and have begun to accept that business rescue is now part of the South African legal

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77. Cassim *Contemporary Company Law* (2011) 783. Also see Levenstein "Business Rescue: At Last, a Workable Solution for Formal Restructuring of Companies in Financial Distress?" *The Corporate Report* 1 (2) 7–14.

78. On which business entities qualify for business rescue, see Kloppers "Judicial Management Reform: Steps to Initiate a Business Rescue" (2001) *SA Merc LJ* 368–371.

79. Cassim *Contemporary Company Law* (2011) 783.

80. It should be noted that this thesis will not consider the various drafts of the Bill, nor the numerous representations given to the legislature prior to the finalisation of the present Act in early 2011. There is also currently talk about amendments being effected by the legislature to certain of the sections of Chapter 6, but to date these amendments have not yet been made public. It is understood that the South African Law Commission in conjunction with the Department of Trade and Industry will be proposing such amendments.

81. See Levenstein and Barnett "Overview of the Business Rescue Proceedings in South African Law" in Harvey (ed) *Emerging Markets Africa* (February 2013) available at http://www.legalweek.com; Museta *The Development of Business Rescue Law in South African Law* (LLM dissertation, University of Pretoria 2011) available at http://repository.up.ac.za/handle/2263/27867.

restructuring landscape. Most companies would, in the ordinary course, be exposed to business rescue (whether as creditors or as part of the process) and have no choice but to participate in the new dispensation. Whether one is a corporate creditor having to deal with attendances at creditor meetings and having to consider the business rescue plan, or a director of a financially distressed company having to deliberate over whether or not to notify creditors of the company's pending position of financial distress, or filing for a business rescue process or alternatively liquidation, all stakeholders seem to have accepted that having some knowledge about South Africa's new legal restructuring dispensation is an essential.

From the very outset, lawyers have spent a considerable amount of time considering the new sections, their impact on legal practice and the manner in which professional legal advice is dispensed to clients.

The challenge is, of course, twofold. Firstly, lawyers have to cope with sections in Chapter 6 that are not entirely clear and which often contradict other sections in the 2008 Companies Act. Secondly, there is limited legal precedent (although this is changing almost on a weekly basis) to refer to, when interpreting the sections of the 2008 Companies Act.

This chapter will examine the practical implementation of the business rescue process, the challenges and pitfalls of implementing the sections of Chapter 6, and the rulings made by our courts in the interpretation of Chapter 6. Reference and comparative comment will be made to the rescue themes and concepts applied in foreign jurisdictions and as dealt with in the previous chapters of the thesis to establish whether they are being applied in the current implementation of Chapter 6 in South Africa. Support for the proposition that South Africa has moved from a "pro-creditor" position to that of "pro-debtor" will also be considered.

Since 1 May 2011, and to this date, business rescue has become the "flavour of the month".[82] Many companies with debt issues will consider business rescue as an option to

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82. In *Kovacs Investments 571 (Pty) Ltd v Investec Bank Ltd and Another, Investec Bank Ltd v Aslo Holdings (Pty) Ltd* (25051/11, 18112/2011) [2012] ZAWCHC 110 (22 February 2012) 9 at para 13, Le Grange J states the following:

> There can be no doubt that the Companies Act 71 of 2008 ("the Act") brought about a new approach to the rescue of companies that are in financial difficulties to avoid unnecessary loss of jobs and productive economic activity. It seems the object of the provisions relating to business rescue is to provide a less cumbersome and more effective procedure for reviving companies that are financially distressed in a manner that balances the rights and interests of all relevant stakeholders. In this regard see section 7(k) of the Act.

buy more time to deal with aggressive creditors and as a result of the benefits obtained from the moratorium on claims.[83] We have already seen the procedure being abused, in that financially distressed companies, with no realistic hope of survival, are filing (by way of board resolution) for business rescue, with the inevitable liquidation that ultimately follows.[84] Nevertheless, many companies in a financial distressed position would prefer to attempt the business rescue option, rather than go directly to liquidation.

The aim of business rescue is to allow for the supervision of the company by the business rescue practitioner with the objective of either rescuing the company and allowing it to trade out of its financial predicament, or to offer a better dividend to creditors than would otherwise be achieved by way of liquidation.[85]

In both instances, Chapter 6 introduces the novel concept (for South Africa) of a statutory moratorium, providing the distressed company with a "breathing space" to deliberate over the alternatives. Liquidations have been dropping steadily since the introduction of Chapter 6 and business rescue proceedings. Liquidations have undoubtedly been reduced, clearly due to the alternative of business rescue.[86]

7.2 CHAPTER 6 OF THE COMPANIES ACT 73 OF 2008

As a corporate rescue model, Chapter 6 of the 2008 Companies Act contains the essential characteristics of a modern and effective corporate rescue mechanism.[87] In this section, the relevant sections of Chapter 6 of the 2008 Companies Act are dealt with; in particular, the manner in which business rescue practitioners have implemented the provisions of the 2008 Companies Act, as well as interpretations of the 2008 Companies Act by lawyers,

83 Although judicial management provided an opportunity for a moratorium to be imposed, it was not automatic and required it to be ordered by the court – see Chapter 3, para 3.2.

84. In the early days of the legislation, in 2011/2012, the reason for many of these companies ending up in liquidation was the defective nature of the court application. Without a well-thought-out exposition of at least the "skeleton" of a business rescue plan being set out in the application, such application will inevitably result in the company's liquidation. Another reason was the lack of post-commencement finance being available to companies under business rescue. The initial negative perceptions of business rescue (amongst the sceptics in the early days after implementation in May 2011), were aimed at the fact that Chapter 6 was introduced into the 2008 Companies Act when it should have formed part of the Insolvency Act 34 of 1936 (the Insolvency Act). After all, companies in financial distress should be candidates for insolvency and not ongoing entities to be dealt with by an operative Companies Act. These criticisms were responded to by the fact that the negativity of placing the business rescue provisions into the Insolvency Act would have left any attempts at rescue stillborn. Any association with the stigma of "insolvency" as a concept, would have been problematic. Having said this, one must consider how many times the word "insolvency" is used in Chapter 6 and which inherently carries strong insolvency connotations.

85. See Rushworth "A Critical Analysis of the Business Rescue Regime in the Companies Act 71 of 2008" (2010) *Acta Juridica* 375.

86. Recent figures, as at November 2015, show that while business rescues are on the rise, liquidations are on the decline. The number of liquidations decreased by 18,3 per cent year on year in November 2015 when compared to the first quarter of 2014. See Statistics South Africa (Stats SA) – ongoing and updated monthly statistics of liquidations and insolvencies in South Africa available at http://www.statssa.gov.za/?s=Statistics+of+Liquidations+and+insolvencies&sitem=publications accessed 30 November 2015.

87. Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-4 at para 18.2.

academics and the courts. Certain comparisons to similar provisions existing in foreign jurisdictions will also be considered. Further, criticisms of the legislation and difficulties of interpretation will also be addressed.

The common themes applicable in international corporate rescue culture will be compared to those introduced by the 2008 Companies Act. Whether these common themes are being applied effectively within the new South African rescue regime will be considered.[88]

Although the concept of corporate rescue is strongly linked to concepts such as "financial distress" and "insolvency", Chapter 6 was incorporated into the 2008 Companies Act and was not included as part of the existing Insolvency Act. This has a number of disadvantages, one of the most important being that it can only apply to companies and close corporations and not to other forms of business enterprise such as partnerships, business trusts and sole proprietorships.[89]

7.2.1 SOME IMPORTANT CONCEPTUAL DEFINITIONS

In order to fully comprehend and understand the business rescue procedure, it is necessary to understand the terminology that has been used by the legislature in Chapter 6 of the 2008 Companies Act and to discuss some of the terms used.[90]

7.2.1.1 DEFINITION OF "AFFECTED PERSONS"

The definition of "affected person" is set out in section 128(1)(a) of Chapter 6:

> "Affected Person", in relation to a company, means –
>
> (i) a shareholder or creditor of the company;
>
> (ii) any registered trade union representing employees of the company; and
>
> (iii) if any of the employees of the company are not represented by a registered trade union, each of those employees or their respective representatives.

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88. For a comparative analysis of Chapter 6 of the 2008 Companies Act with the provisions of the US Bankruptcy Code, see Mindlin *Comparative Analysis of Chapter 6 of the South African Companies Act, No. 71 of 2008* (Presentation to the Company Law Symposium organised by the South African Department of Trade and Industry and the Specialist Committee on Company Law, Johannesburg, 1 March 2013) available at http://www.thedti.gov.za/business_regulation/presentations/symposium1of6.pdf.

89. See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-1 at para 18.1 It is hoped however that business rescue will be extended to these alternative business enterprises in the proposed Unified Insolvency Statute (still to be promulgated).

90. Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-7 at para 18.3.1. It is important to note that some of the concepts and terms used under the insolvency and winding-up provisions of the Insolvency Act are used again in the 2008 Companies Act. There are also some terms that are completely new. Unfortunately there are a number of key terms used in the 2008 Companies Act for which no definitions have been provided and which make the interpretation of Chapter 6 difficult.

The term "affected person" is used to define all parties who are stakeholders in a business rescue proceeding. Trade unions and employees are significant parties in a business rescue and can themselves initiate a business rescue proceeding.[91] These parties are given a considerable role, unlike the role they play in a liquidation. In terms of section 66(1) of the Close Corporations Act 69 of 1984 (the "Close Corporations Act"), Chapter 6 applies *mutatis mutandis* in the case of a close corporation.[92]

The term "creditor" has not been defined. The term "creditor" includes employees of the company if any amounts are due and payable prior to the commencement of business rescue proceedings.[93]

7.2.1.2 DEFINITION OF "BUSINESS RESCUE"

The definition of "business rescue" is contained in section 128(1)(b) of Chapter 6:

> "Business rescue" means proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for –
>
> (i) the temporary supervision of the company, and of 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; 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 maximises 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.

It is submitted that the reference to the word "rehabilitation" is significant. Although the word is vague, it is submitted that it envisages the "rescue" or "saving" of a company that

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91. Section 131 of the 2008 Companies Act. See Meskin, Kunst, Galgut, Delport, Vorster and Burdette *Henochsberg on the Companies Act 71 of 2008* (2011+) 444–445. The need to identify "employees" as role players in business rescue proceedings is aligned with the core principle or theme of ensuring that employees have a say in restructuring/rescue proceedings. See Chapter 5, para 5.5.4.2.

92. Section 66 of the Close Corporations Act confirms that the laws mentioned or contemplated in item 9 of Schedule 5 of the 2008 Companies Act apply to the liquidation of a corporation in respect of any matter not specifically provided for in this part or in any other provision of this Act. More specifically, section 66(1A) states that the provisions of Chapter 6 of the 2008 Companies Act, read with the changes required by the context, apply to a corporation.

93. See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-9 at para 18.3.4. For a consideration of the meaning of a "contingent creditor" see Chapter 7, para 7.5.7.

is financially distressed (a definition which will be dealt with extensively below).[94] It is submitted that the word "rehabilitate" is unfortunate, as it has strong connotations of what is required to "rehabilitate" an insolvent individual in terms of section 124 of the Insolvency Act.[95]

The definition of business rescue in Chapter 6 of the 2008 Companies Act is in line with international principles of corporate rescue culture. The need for the intervention of an independent supervisor who will temporarily supervise the business of the company while all claims are temporarily stayed during such process is a core theme of rescue.[96] Rather than face the limited prospects of recovery in a liquidation, rescue provides an alternative mechanism with achievement of greater returns.[97]

The need to formulate a rescue plan to restructure the company's affairs and to seek creditors' approval is an essential international mechanism designed to ensure that creditors participate in approving a plan for the reorganisation of the entity.[98]

Section 128(1)(b)(iii), however, envisages two outcomes in a business rescue. The first is the development and implementation of a plan to rescue the company which has the aim of allowing the company to continue in existence on a solvent basis into the future. This is done by approving a plan which involves restructuring the affairs, business, property debt, liabilities and equity of the company. This would certainly fit into the meaning and intention of the words "to rehabilitate".[99] It means some form of restructuring and revival of the company's business to allow it to continue on a solvent and viable basis into the

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94. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 448 state as follows:

> Rehabilitation would appear to intimate the recovery of the company to complete solvency. This is supported by the wording "continuing in existence on a solvent basis". However, if this is not possible, the second part of the definition would also suffice, namely a higher return for creditors than they would have received in a liquidation.

Notwithstanding the above, there is no definition of the word "rehabilitation". See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-7–18-8 at para 18.3.1. Further, the words "temporary supervision of the company" indicates that there is a temporary substitution of the board and its management by the business rescue practitioner. While the board remains in place, it can only carry out duties and functions under the supervision of the business rescue practitioner. Once the business rescue proceedings come to an end, for whatever reason, the board and management of the company resume their duties and functions unless the company is wound up by the court, in which case the provisions of Chapter 14 of the 1973 Companies Act take effect.

95. See discussion in Chapter 2.3 in respect of advantage to creditors and the possibility of rehabilitation.

96. The moratorium is an international core principle which provides a "breathing space" to allow the supervisor an opportunity to restructure the business and the company's affairs while all claims (subject to certain exceptions) are stayed during the restructuring process. See Chapter 5, para 5.5.2.

97. See Chapter 5, para 5.3.

98. See Chapter 5, para 5.5.6.

99. The *Webster's New World Law Dictionary* defines the word "rehabilitation", in the context of bankruptcy, as "restoring a corporation's solvency by satisfying creditors' claims with future earnings so that the corporation may be in a position to continue to do business".

future.[100] This is what is termed in practice as "the first part of the business rescue definition".

In *Antonie Welman v Marcelle Props*,[101] Tsoka J, dealing with the first part of the definition, stated the following:

> In my view, business rescue proceedings are not for the terminally ill close corporations. Nor are they for the chronically ill. They are for ailing corporations, which given time will be rescued and become solvent.

As has been seen in practice, certain companies have been successfully rescued in terms of the first part of the definition. Once a business rescue has been implemented in terms of a business rescue plan, the business rescue practitioner is obligated to file a notice of substantial implementation.[102] There is no provision to report the manner in which the company exited successfully from the business rescue process.[103]

It is submitted that in terms of the first part of the business rescue definition, as per international business rescue principles, South Africa's business rescue model is aimed at ensuring that financially distressed debtors are reorganised and placed back into the marketplace where such entity can continue to resume the purchase of goods and services and continue to contribute to the economy as quickly as possible.[104]

The second part of the business rescue definition appears to have nothing to do with rehabilitation. It is submitted that the alternative to rescuing the company is a "quasi-liquidation" which results in a sale of the assets or business of the company which would result in a better return (dividend) for creditors than what they would have received in a liquidation. This involves selling off the assets of the company leaving it to ultimately be deregistered. This is certainly not a "rehabilitation", and thus the use of this word in the

100. The international concept of the rehabilitation of firms is prevalent in many of the foreign jurisdictions referred to in Chapter 5. Reorganisation of firms preserve wealth, creditors get repaid (compromised), shareholders preserve their investments, suppliers retain customers and the company gets an opportunity to trade on a solvent basis. Thus, the rehabilitation of a company through a reorganisation benefits almost all interested parties. See Carruthers and Halliday *Rescuing Businesses: The Making of Corporate Bankruptcy Law in England and the United States* (1998) 244.

101. *Antonie Welman v Marcelle Props 193 CC* 2012 JDR 0408 (GSJ) 12 at para 28.

102. Form CoR125.3 in terms of section 152(8) of the 2008 Companies Act and regulation 125(5) to the Companies Regulations, 2011.

103. Statistics have been released by the Commission of Intellectual Property and Companies (CIPC) at various report-back meetings to numerous stakeholders in the period 2012–2014. The fact that the practitioner is not obligated to explain the reasons for the "exit" results in minimum information to stakeholders and to particular creditors.

104. Rajak "The Rescue of Insolvent Companies in the United Kingdom" (1995) 20(1/2) *JJS* 4.

definition is odd and contradictory to the second part of the definition.[105] It is submitted that the "quasi-liquidation" process offered by the second part of the definition is comparable with the results of a liquidation; that is a fair distribution of realisable value to creditors of assets sold in the administration. It has been argued that the costs of a liquidator in giving effect to the sale of such assets (liquidator is entitled by statute to charge 10% on movable assets sold)[106] makes this a more expensive process than what would occur in terms of the second part of the definition.

Many of the judgments handed down by the various High Courts in South Africa have dealt with the meaning of the second part of the definition.

In *Gormley v West City Precinct Properties (Pty) Ltd*[107] Traverso J stated:

> The Act envisages a short-term approach to the financial position of the company. This is so for self-evident reasons. There must be a measure of certainty in the commercial world. Creditors cannot be left in a state of flux for an indefinite period. The provisions of the Act make it clear that the concept of business rescue only applies to companies which are financially distressed as defined in the Act.

The Judge was not convinced that the company could continue to function as a viable corporate entity. All that was being proposed was a realisation of assets over a period of time. No detailed proof was set out to explain why creditors would receive a larger dividend at the end of the moratorium. There was no viable plan, and the suggested "wind down" of the company did not assist creditors.[108]

Again, in *Investec Bank Limited v Aslo Holdings (Pty) Ltd*,[109] Le Grange J dealt with the definition of business rescue and was of the view that in order to support an argument that a better return would be available than in a liquidation, a "reasoned factual basis" would have to be set out in the court papers. Vague and speculative averments would not suffice.

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105. In the US, the principal goal of Chapter 11 of the Bankruptcy Code is to reorganise the business of the company in financial distress (debtor) to allow the debtor to emerge from Chapter 11 as a going concern. This would align with the first part of the definition set out in section 128(1)(b)(iii). However, where a rescue of the debtor is unachievable, Chapter 11 can also be used to effect the liquidation or sale of the debtor's assets for the benefit of all creditors; see section 363 of the US Bankruptcy Code. This would be what was envisaged in the second part of the definition set out in section 128(1)(b)(iii).
106. See tariffs of fees charged by liquidators in terms of section 73(2) the Insolvency Act.
107. *Gormley v West City Precinct Properties* (Pty) Ltd 2013 JDR 1895 (WCC).
108. Ibid 10 at para 12.
109. *Kovacs Investments 571 (Pty) Ltd v Investec Bank Ltd and Another, Investec Bank Ltd v Aslo Holdings (Pty) Ltd* (25051/11, 18112/2011) [2012] ZAWCHC 110 (22 February 2012).

In both instances, the respondents were placed into provisional liquidation due to the fact that the applicant was unable to provide sufficient facts before the court to show that a business rescue proceeding would result in the achievement of a better dividend than creditors would have received in a liquidation. It is submitted that such an approach must be correct. If the company is not a candidate for business rescue and cannot achieve either of the objectives set out in section 128(1)(b)(iii), then such company should be placed into liquidation.

Generally, our judges have refused to place companies under supervision solely to achieve a controlled liquidation in terms of the second part of the definition. The stance adopted is that where a liquidator could achieve a distribution of the same or very similar dividends for creditors, there is no need to place the company under the supervision of a business rescue practitioner to achieve the same outcome. The differential and determining factor would always be that business rescue must deliver a better dividend than a liquidation.

In the case of *AG Petzetakis International Holdings Limited v Petzetakis Africa (Pty) Ltd and Others (Marley Pipe Systems (Pty) Limited and Another intervening)*,[110] Coetzee AJ referred to Anderson[111] and stated that "the Australian Courts on occasion utilised the Australian equivalent of the alternative object to assist in interpretation of sections their rescue provisions" [*sic*]. Coetzee AJ went on to state as follows:

> They accepted that it is possible to use rescue procedures despite there being no intention to have the company or its business survive. They considered the alternative object[112] a worthwhile goal in itself so as to justify rescue in preference to moving directly into a liquidation.[113]

Coetzee AJ ultimately placed the respondent into liquidation and concluded that –

> The important defect in the founding papers is that, as pointed out above, they do not demonstrate a reasonable prospect that Petzetakis Africa can be saved or (to the

110. *AG Petzetakis International Holdings Ltd v Petzetakis Africa (Pty) Ltd and Others (Marley Pipe Systems (Pty) Ltd and Another Intervening) 2012 (5) SA 515 (GSJ) Absa Bank Limited v Caine NO, In Re; Absa Bank Limited v Caine NO and Another* (3813/2013, 3915/2013) [2014] ZAFSHC 46 (2 April 2014) 520 at para 11.2.

111. Anderson "Viewing the Proposed Business Rescue Provisions from an Australian Perspective" (2008) 1 (4) *PER* 4.

112. The "alternative object" was defined by Judge Coetzee in his judgment to refer to the second part of the business rescue definition contained in section 128(1)(b) of the 2008 Companies Act.

113. *AG Petzetakis International Holdings Ltd v Petzetakis Africa (Pty) Ltd and Others (Marley Pipe Systems (Pty) Ltd and Another Intervening) 2012 (5) SA 515 (GSJ) Absa Bank Limited v Caine NO, In Re; Absa Bank Limited v Caine NO and Another* (3813/2013, 3915/2013) [2014] ZAFSHC 46 (2 April 2014) 520.

> extent that this might have sufficed) that there is a prospect that the alternative object is achievable.[114]

The *Petzetakis* judgment set the tone very early on for the threshold required to place a company into business rescue. A "quasi-liquidation" – effectively an informal wind down by the sale of assets – was a sufficient objective of business rescue, and this could be done by way of a sale of assets, in line with the second part of the definition of business rescue (the alternative aim of rescue).[115] However, sufficient facts to support such a proposition had to be in place to support such an objective.

In the case of *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others; Farm Bothasfontein (Kyalami) (Pty) Ltd v Kyalami Events and Exhibitions (Pty) Ltd and others*,[116] Claassen J placed the respondent into final liquidation and was of the view that a business rescue order was not appropriate in the circumstances. There was no basis upon which it could be argued that a liquidator would be less successful in realising a proper market value for the immovable property than a business rescue practitioner. Despite negative connotations surrounding liquidation, there was no reason that such process would not yield a better financial return for the creditor.[117]

Clearly, the court was of the view that there was no merit in placing the company into a business rescue process, when a liquidation could achieve the same result.

In *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd*, Eloff AJ stated:

> In relation to the alternative aim referred to in section 128(b)(iii) of the new Act, being to procure a better return for the company's creditors and shareholders than would result from the immediate liquidation thereof, one would expect an applicant for business rescue to provide concrete factual details of the course, nature and extent of the resources that are likely to be available to the company, as well as the basis and terms on which such resources will be available. It is difficult to see how, without such details, a Court will be able to compare the scenario sketched in the application

114. Ibid 523 at para 23.
115. Section 128(1)(b)(iii) of the 2008 Companies Act.
116. *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others; Farm Bothasfontein (Kyalami) (Pty) Ltd v Kyalami Events and Exhibitions (Pty) Ltd and others* 2012 (3) SA 273 (GSJ) 446 at para 49.
117. Ibid. Also see comments by Bradstreet "The New Business Rescue: Will Creditors Sink or Swim?" (2011) *SALJ* 364.

> with that which would obtain in an immediate liquidation of the company. Mere speculative suggestions are unlikely to suffice.[118]

The respondent company was placed into provisional winding-up. Similarly, the *Southern Palace* judgment set the "bar" as to what would be required in the application to court, in terms of section 131, to support an order for business rescue.

The courts have also provided guidance in respect of the expectations that would be given in a business rescue process as opposed to liquidation proceedings.

In the *Oakdene*[119] matter, Judge Claassen went on to state:

> In my view, the interests of the creditors as opposed to that of the Company, should carry more weight in the circumstances of this case. There is no "business" of the company to be rescued. The benefit of placing the business of the company on its feet again does not arise in this case. The applicants' counsel, however, relied on the provision in the definition of 'business rescue' to the effect that,[120]
>
> > "… 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."
>
> It is correct that this is a "secondary" goal of business rescue.[121] It has been held in Australia in Dallinger v Halcha Holdings[122] that such statutory rescue machinery should also be available –
>
> > "where, although it is not possible for a company to continue in existence, an administration is likely to result in a better return for creditors."
>
> The application of this provision to the facts of the present case begs the question, "well, will business rescue render a better return for the creditors?"

It is submitted that the second part of the definition is really what is termed a "controlled liquidation". The business rescue practitioner attempts to persuade creditors that the dividend (usually realised from a sale of assets) will be greater than that in a liquidation. Forced sales of assets in a liquidation, together with liquidators' fees and costs of administration would in most cases make the winding-up procedure more expensive with

118. *Southern Palace Investments 256 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd* 2012 (2) SA 423 (WCC) at para 25.
119. *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others; Farm Bothasfontein (Kyalami) (Pty) Ltd v Kyalami Events and Exhibitions (Pty) Ltd and others* 2012 (3) SA 273 (GSJ).
120. See section 128(1)(b)(iii) of the 2008 Companies Act.
121. The comparable provisions in the UK also recognise this ground as a "secondary goal" when applying for an administration order. See UK Insolvency Act, Schedule B1M, para 3; Wood *Principles of International Insolvency* (2007) 203 at Note 1. Also followed in *Propsec Investments (Pty) Ltd v Pacific Coast Coast Investments 97 Ltd and Another* 2013 (1) SA 542 (FB).
122. *Dallinger v Halcha Holdings* (1996) 14 ACLC 263 at 268.

less left in the "pot" for concurrent creditors. As a result, it is submitted, more and more creditors would favour the alternative found in the second part of the definition.

Costs of administration in a liquidation would include all the costs incurred by the liquidator in realising assets in terms of section 83 of the Insolvency Act. The liquidator generally charges a percentage of asset realisations in terms of the provision of the Insolvency Act. In business rescue, the practitioner is entitled to charge the company fees on an hourly basis in terms of the provisions of section 143 as read with regulation 128(1).[123] Costs and disbursements incurred by the practitioner are further paid for by the company in terms of regulation 128(3). The debate would be which would be the more expensive process for creditors, i.e. which process would result in a greater distribution to creditors? In principle there is no "limit" to what the practitioner can charge. His or her fees are a function of how long the rescue will take and how many hours will be charged in the process. The comparison between the costs of business rescue when compared to that of liquidation is a difficult analysis and is open-ended from the commencement of business rescue and remains so until the termination of the process. However, it is submitted that distributions in a business rescue should always result in a greater return for creditors than in a liquidation. As stated above, a fundamental principle as set out in the definition of business rescue[124] is that a favoured outcome must be a "better return for the company's creditors or shareholders than would result from the immediate liquidation of the company". If this is so, practitioners should in most instances be able to reflect such a position in the plan and support a position where they can deliver a better distribution to creditors in a business rescue.

In *Southern Palace Investments 256 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd,*[125] Eloff AJ summed up the overall approach to the analysis as follows (and which included a useful comparison of the Australian system):

> Like its Australian equivalent, one of the aims of the remedy is to render it possible for companies in financial difficulty to avoid winding-up and to be restored to commercial viability. Both jurisdictions recognise the desirability of a company in

123. Note that in the longer business rescues (in practice), practitioners would be entitled to negotiate an agreement for the payment of "further remuneration" as contemplated by section 143(2)(a) or (b) of the 2008 Companies Act. This would have to be with the consent of creditors in terms of section 143(3).

124. Section 128(1)(b) of the 2008 Companies Act.

125. *Southern Palace Investments 256 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd* 2012 (2) SA 423 (WCC).

> distress to continue in existence. Business rescue does, however, not necessarily entail a complete recovery of the company in the sense that, after the procedure, the company will have regained its solvency, its business will have been restored and its creditors paid. There is also the further recognition that even though the company may not continue in existence, better returns may be gained by adopting the rescue procedure.
>
> The scheme created by the business rescue provisions in Chapter 6 of the new Act envisages that the company in financial distress will be afforded an essential breathing space while a business rescue plan is implemented by a business rescue practitioner. It is, however, necessary to caution against the possible abuse of the business rescue procedure, for instance, by rendering the company temporarily immune to actions by creditors so as to enable the directors or other stakeholders to pursue their own ends. The Courts in Australia have been careful not to allow their equivalent procedure to be used where there appears to be an ulterior purpose behind the appointment of an administrator by the directors. It is necessary that an application for business rescue be carefully scrutinised so as to ensure that it entails a genuine attempt to achieve the aims of the statutory remedy. The instant case is one where such attempt was not discernible from the affidavits filed of record.

The dictum of Eloff AJ has been quoted with approval many times in judgements handed down by our courts in business rescue matters. In the early days of the implementation of Chapter 6, many companies saw the opportunity to hold off creditors (whether to stop applications for winding up or writs of execution) by filing for business rescue. The urgent need for a moratorium on creditors' claims was seen as an opportunity worth taking advantage of by debtor companies and their management. Thus the bar was set by Eloff AJ (fairly early on) to ensure that applications brought by way of court proceedings for business rescue needed to be "scrutinised carefully", so that a case was made out for a *bona fide* attempt by the debtor company to seek proper protection from creditors, but coupled with a sustainable plan for rescue.

In *Griessel and Another v Lizemore and Others,*[126] the court held that the section 129 resolution must only be passed when directors are of the view that the company (which is financially distressed in terms of section 128) has a period of time to regain viability by being allowed to formulate and implement a rational plan to rehabilitate itself. The 2008 Companies Act also contemplates a business rescue if the company cannot continue in

126. *Griessel and Another v Lizemore and Others* 2015(4) ALL SA 433 (GJ).

existence but can obtain a better return for creditors or shareholders than if the company was immediately liquidated.[127]

It is submitted that the definitive statements made by Judge Eloff and following as to the purpose of business rescue with reference to *Oakdene (supra)* sets the expected standard for South African directors when considering a section 129(1)(a) resolution for business rescue.

It is submitted that the majority of business rescue matters have, to date, been commenced by way of resolution (and not by way of court application).[128] It is submitted that the ease of entry into business rescue by way of resolution makes this the favoured mechanism. Most companies entering into the business rescue process have dealt with plans dealing with the second part of the definition. We have seen that certain of these companies were property-owning companies that have attempted to argue (in the court papers) that a business rescue practitioner would be able to deliver up a "better dividend" than a liquidator could achieve in a liquidation. Some of the plans filed have dealt with these comparisons quite effectively, with a detailed analysis of what creditors could expect in a business rescue as opposed to a liquidation.

It is further submitted that the starting point is that there must be a "reasonable prospect" of the company being rescued. The first part of the definition clearly reflects a company being restructured and continuing to trade on a solvent basis. The second part of the definition reflects a similar theme, namely, if there is a "reasonable prospect" of offering creditors a better dividend than they would get in a liquidation, business rescue would be applicable. If an application to court makes out a case for either of the above (subject to the statements made in the abovementioned cases), then it is submitted that a court should grant an order for business rescue.[129]

It is clear that the South African legislation aligns itself with the international rescue theme of providing a financially distressed debtor the opportunity to restructure its debt (coupled with a debt discharge), with the prospect of such entity continuing to trade (on a solvent

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127. Ibid 451. Also see comments on the requirement that the resolution must be taken "in good faith" with a legitimate purpose at 453.

128. Section 129 of the 2008 Companies Act. This is an observation made by the author and supported by the UP Report – see Part 4, Chapter 8, para 8.3.1.

129. See discussion in Joubert "'Reasonable possibility' versus 'reasonable prospect': Did business rescue succeed in creating a better test than judicial management?" (2013) 76 *THRHR* 550.

basis) in the future. Chapter 6 allows financially distressed companies to have access to a corporate rescue regime which is aimed at the survival of an entity with the opportunity for future solvent trading; and if this is not possible, initiating a controlled winding-down (which might include a possible sale of the shares, assets of business) of the company, thus providing creditors with a higher dividend than they would receive in a liquidation.

It is clear that the modern approach of rescue, namely the restructuring of a potentially viable company, is achieved by the need to assess whether or not there is a reasonable prospect of the company being rescued. The "inward looking" analysis of assessing the reasonable prospect of the company surviving reflects a clear intention by the legislature to move towards a debtor-orientated approach, ensuring that potentially viable companies are provided with the option of the international principle of a "fresh start". This principle has now been firmly entrenched into South African rescue legislation.

7.2.1.3 DEFINITION OF "COURT"

The definition of "court"[130] in Chapter 6 allows business rescue proceedings to be determined either by the High Court that has jurisdiction over the matter, or by a designated Judge of the High Court (if designated in terms of section 128(3), or by any Judge that has been assigned by the relevant Judge President to hear the particular matter).

The role of the courts internationally and the extent of their involvement in reorganisation and/or rescue matters is important and is a key rescue theme. Court process is often time consuming, costly and protracted. This serves to delay matters which can result in the loss in value of the business which is the target of the rescue. In addition, courts play a fundamental role in the jurisprudential development of the rescue process, even more so when the legislation is new and subject to interpretation. Furthermore courts are instrumental in providing the mechanism for the entry of a company into a rescue process. Internationally, entry criteria differ with "burden of proof" levels differing in the various jurisdictions.[131]

Minimal court involvement is, it is submitted, the more favoured approach. To become bogged down in lengthy and costly court proceedings could result in the financially

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130. Section 128(1)(e) of the 2008 Companies Act. See Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 450.
131. See Chapter 5, para 5.5.3.3.

distressed company going into liquidation. Rather, the process should be driven by the practitioner with the cooperation of all stakeholders, especially the directors, shareholders and creditors.[132]

In South Africa, we are fortunate in having had minimum court involvement, with practitioners taking control of the process. From time to time, there has been little alternative but to involve the court to ensure cooperation between parties or to interpret the legislation to the advantage of a successful business rescue.

Section 128(3) allows the Judge President to designate a judge to generally act as a specialist to determine issues relating to commercial, matters, commercial insolvencies or business rescue matters. In practice, the relevant Deputy Judge Presidents have only allocated (assigned) commercial judges to hear these matters and there have been no formal designations (appointment of specialist judges) to hear business rescue matters.

Generally, the judgments that have been handed down in all of the High Courts have been by judges of commercial background who have generally displayed a sound grasp of the elements of Chapter 6.[133]

In South Africa, prior to the implementation of the 2008 Companies Act, all insolvency or winding-up cases were heard by judges situated in the various courts of the provinces of South Africa. No specialised courts were ever set up for insolvency or winding-up cases.

In the 2008 Companies Act, provision has been made to allocate business rescue matters to a "designated judge" of the High Court to hear these matters as a "specialist" to determine issues relating to commercial insolvencies and business rescue.[134] To date this has not occurred. All business rescue and insolvency matters are allocated to judges of commercial background who have all displayed some expertise in rescue or insolvency matters. This appears to be the case in the various High Courts around the country.

132. See Chapter 5, para 5.5.3.3.
133. To date there have been well over 100 judgments on business rescue matters countrywide.
134. Section 128(1)(3) of the 2008 Companies Act.

Once appointed, the practitioner administers the company in business rescue without any court involvement. In practice, practitioners have applied to court for guidance and interpretation of the provisions of the 2008 Companies Act.[135]

Courts can become involved in Chapter 6 proceedings. These include, *inter alia*, the launch of an application for the commencement of business rescue proceedings;[136] the setting aside of a company resolution for the commencement of business rescue proceedings;[137] the conversion of business rescue proceedings to liquidation proceedings;[138] giving a ruling (giving leave) on the continuation of legal proceedings despite the section 133 moratorium;[139] cancellation of contracts or obligations due by the company;[140] removal of a practitioner from office;[141] discontinuation of business rescue proceedings and placing the company into liquidation;[142] the setting aside of an inappropriate vote on a plan,[143] and review or revaluation of a determination by an independent expert of a liquidation value set pursuant to a binding offer.[144]

Most of these provisions have been included in Chapter 6 in order to ensure the smooth and efficient running of the business rescue process. In practice, and in the ordinary course, business rescue proceedings are not becoming inundated with frivolous or vexatious court intervention. Parties appear to realise that protracted litigation will cause delays in the publication and approval of the plan, with the consequent reduction in business rescue dividends as a result. Further ongoing litigation can result in the practitioner having no alternative but to discontinue the business rescue proceedings and place the company into liquidation.[145]

135. See *Ex Parte Van Den Steen NO and Another (Credit Suisse Group AG and Another Intervening)* 2014 (6) SA 29 (GJ). Further, even if the business rescue process is not completed within the three-month statutory period provided by section 132 (3), the practitioner can extend the period without a further application to court by providing ongoing monthly reports to affected persons and to the court in practice by filing such reports in the court file.
136. Section 131 of the 2008 Companies Act.
137. Section 130 of the 2008 Companies Act.
138. Section 132(2)(a)(ii) of the 2008 Companies Act.
139. Section 133(1)(b) of the 2008 Companies Act.
140. Section 136(2)(b) of the 2008 Companies Act.
141. Section 139(2) of the 2008 Companies Act.
142. Section 141(2)(a)(ii) and (b)(i) of the 2008 Companies Act.
143. Section 153(1)(b)(i)(bb) of the 2008 Companies Act.
144. A binding offer is the South African version (although unique and distinguishable) of the cram-down procedure used in foreign jurisdictions; see Chapter 5, para 5.5.6.
145. Section 141(2)(a)(ii) of the 2008 Companies Act.

South Africa has no specialised business rescue courts, although these have been contemplated by the legislature. It is submitted that despite no courts having yet been designated to specific judges, our judges have competently (and effectively) dealt with the new legislation.[146]

It is submitted that the role of the courts in the development and practical implementation of the Chapter 6 process is vital and necessary. The ability to initiate rescue by way of a section 129 resolution has reduced the need for courts to become involved in a voluntary commencement procedure. As the various judgments and precedents above have evolved, so has the interpretation and implementation of the business rescue process become easier. Low levels of court interference have resulted, in many instances, in successful rescue processes being effected.[147]

It is further submitted that the legislature has provided significant power to the practitioner to avert the need for such practitioner to require the court's involvement in a business rescue process. If required (such as in the section 136(2) process),[148] the practitioner can approach the court for assistance.

7.2.1.4 DEFINITION OF "FINANCIALLY DISTRESSED"

Section 128(1)(f) defines when a company is trading under "financial distress":

> "Financially distressed", in reference to a particular company at any particular time, means that –
>
> (i) it appears to be reasonably unlikely that the company will be able to pay all of its debts as they become due and payable within the immediately ensuing six months; or
>
> (ii) it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months.

146. This can be seen in the quality of judgments that have been handed down by our judges in the interpretation of Chapter 6 of the 2008 Companies Act since May 2011.

147. Although the statistics from the CIPC indicate a low level of success (15 per cent) for business rescues (see http://www.cipc.co.za), it is submitted that this is as a result of the many companies who were not suitable candidates for rescue in the first place applying for business rescue (by way of a section 129 resolution) and to merely attempt to obtain a moratorium from creditors' claims. In the main, and in larger business rescues, they have been successful. It is submitted that when an experienced business rescue practitioner is appointed, the prospects of a successful business rescue is increased. Experienced and competent practitioners will not need to involve the court if they engage with all stakeholders in a transparent manner which promotes the success of the rescue. See Chapter 7, para 7.5 and Chapter 8, para 8.3.3.

148. See other examples above.

The definition of "financial distress" clearly envisages both a cash flow and a balance sheet test to determine whether a company is financially distressed.[149]

The eligibility of entry into rescue is a fundamental international core theme. Only specific companies, which are bordering on insolvency or are financially distressed, should be allowed to file for a formal rescue process and obtain the benefits of the moratorium and the restructuring of its business affairs.[150]

Clearly, the first part of the definition in section 128(1)(f) refers to what has been termed "commercial insolvency" or to what is referred to in the US as the "cash flow test". Can the company pay all of its debts in the ordinary course and as and when they become due and payable (in terms of applicable credit terms in place) in the immediately ensuing six-month period?[151]

The intention of the legislature was clearly to allow directors of companies[152] to "crystal ball gaze" to a degree, by analysing whether or not the company was reasonably likely to run into cash-flow problems in the next six-month period. The six-month period was determined to be a sufficient period of time to allow directors to consider an intervening business rescue process "before it was too late". Hence, if the company found that it fell into the first part of the definition, it was obligated to consider a business rescue process.

Of course, if the company was already in a position where it could not pay all of its debts, then clearly it was insolvent and therefore not a candidate for business rescue, but rather for liquidation.[153]

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149. Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-9–18.10 at para 18.3.5. There is no definition of the word "company". The term must be interpreted as per section 1 of the 2008 Companies Act. This includes a close corporation and does *not* include an "external company" (foreign company) under the 2008 Companies Act. See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-8 at para 18.3.3.

150. See Chapter 5, para 5.5.1.

151. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 450–451, deals with the meaning of financial distress as follows:

> Unfortunately Chapter 6 is silent on the manner in which it should be concluded that the company will be unable to pay all its debts as they fall due in the immediately ensuing six months, or how it is to be decided that the company is likely to become insolvent during the same period. Without well-defined guidelines, it is clear that many tactics will be employed by the management of companies to fudge the lines between solvency and impending insolvency, especially considering the consequences that follow failure by them to pass a resolution placing the company under supervision where the company is clearly in financial distress.

152. Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-1–18.2 at para 18.3.1. Meskin suggests that the business rescue procedure is intended to be used at the earliest possible moment, when a company is experiencing financial difficulties, but has not yet reached the stage of actual insolvency. Under judicial management, it was a requirement that the company had to be insolvent at the time the judicial management order was sought; see section 427(1)(a) of the 1973 Companies Act. Under Chapter 6 of the 2008 Companies Act, only impending or imminent insolvency is required.

153. Chapter 14 of the 1973 Companies Act continues to be applicable to insolvent companies. The Act deals with the winding-up of solvent companies; see sections 79–81. See transitional provisions set out in the 2008 Companies Act, item 9(2) of Schedule 5, with regard to the

Again, our courts have been quick to deem the new business rescue process as being the one which must be considered well in advance of insolvency:

> From the above definitions it is clear that a business rescue plan cannot be invoked where a company is already insolvent. This is one of the aspects differentiating business rescue from judicial management: Proceedings can be started six months in advance when the tell-tale signs are starting to appear. For instance, a company that is trading profitably and is cash positive but does not have the wherewithal to repay a large debt which will become due and payable within the next six months would qualify to be classified as being 'financially distressed', thus being a candidate for business rescue."[154]

It is submitted that the purpose of a business rescue procedure is to ensure that the rescue process is started an early stage – at least six months before cash-flow difficulties emerge. This would give the business rescue practitioner enough time to take control and restructure the company (in terms of the objectives set out in section 128(1)(b)), and not leave the company to reach the stage of full-blown insolvency with the resultant liquidation process.

An inability to pay debts (or creditors) should be of concern to directors. Section 22(1) of the 2008 Companies Act effectively replaces section 424(1) of the 1973 Companies Act[155] (which remains applicable) and prohibits the company (and its directors and management) from carrying on the company's business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose.[156]

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continued application of the 1973 Companies Act to winding-up and liquidation. For a further exposition on the applicability of the 1973 Companies Act to insolvent companies and close corporations and a comparison to the test for financial distress, see *FirstRand Bank Ltd v Lodhi 5 Properties Investment* CC 2013 (3) SA 212 (GNP).

154. *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Limited* 2013 JDR 1019 (GSJ) 4 at para 8.

155. Section 424(1) of the 1973 Companies Act deals with the liability of directors and others for fraudulent conduct of business: "When it appears, whether it be in a winding up, judicial management or otherwise, that any business of the company was or is being carried on recklessly or with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, the Court may, on the application of the Master, the liquidator, the judicial manager, any creditor or member or contributory of the company, declare that any person who was knowingly a party to the carrying on of the business in the manner aforesaid, shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the Court may direct."

156. Initially the draft bill contained the words "and in insolvent circumstances". These words were removed from the final version of the 2008 Companies Act.

It is submitted that, in terms of section 77(3)(b) of the 2008 Companies Act, if any director trades a company in contravention of section 128(1)(f), such director would be liable for any loss, damages or cost sustained by the company as a result of such conduct.[157]

In terms of section 218(2), any person who contravenes any provision of the 2008 Companies Act is liable to any person for any loss or damage suffered by that person as a result of that contravention.[158] Thus, if any director continues to trade the company in contravention of a position of financial distress, this would constitute reckless conduct or conduct calculated to defraud a creditor (especially if such a director continues to incur credit at a time when he or she knows that such credit cannot be repaid as and when that debt becomes due). This could result in such a director being sued by affected creditors for any loss or damage caused by such conduct civilly in terms of section 218(2).[159]

Further, in terms of section 214(1)(c), such a director would be guilty of a criminal offence as a result of conduct where he or she was knowingly a party to an act or omission by a company calculated to defraud a creditor[160] of the company or with another fraudulent purpose.[161]

The second part of the definition provides some difficulties of interpretation. It contemplates a situation where directors of a company believe that in the immediately ensuing six months (from when the determination is made) it is reasonably likely that the company will become "insolvent" in terms of the 2008 Companies Act.

It is submitted that the only reasonable interpretation must be that there is an expectation by the director that the company will become insolvent on its balance sheet (i.e. liabilities

157. Section 76(3)(b) of the 2008 Companies Act states the following: "A director of a company is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having, inter alia, acquiesced in the carrying of the company's business despite knowing that it was being conducted in a manner prohibited by section 22(1).

158. Section 218 of the 2008 Companies Act provides the "catch-all" liability section for parties that suffer damages/loss caused by "any person" who contravenes "any provision" of the 2008 Companies Act.

159. See section 218(2) as read with section 22 of the 2008 Companies Act.

160. Similar wording to section 22(1) of the 2008 Companies Act.

161. Section 216 of the 2008 Companies Act, dealing with penalties, states:

"Any person convicted of an offence in terms of this Act, is liable –

(a) in the case of a contravention of section 213(1) or 214(1), to a fine or to imprisonment for a period not exceeding 10 years, or to both a fine and imprisonment; or

(b) in any other case, to a fine or to imprisonment for a period not exceeding 12 months, or to both a fine and imprisonment."

exceeding assets) in the next six-month period. Again, if the company is already insolvent on its balance sheet, then it might rather be a candidate for liquidation.[162]

The second part of the definition has caused much consternation on the part of directors whose companies are trading on the "cusp" of an insolvent balance sheet.[163] There is no definition of the word "insolvent" in the 2008 Companies Act. The lack of certainty in respect of the meaning of the word "insolvent" has caused confusion.

There has been no court interpretation on the meaning of the second part of the definition and so directors have little guidance in their decision on whether or not their companies are trading within ambit of the second part of the definition. The general view[164] is that the word "insolvent" in its ordinary sense connotes "an excess of liabilities over assets". The test will be whether "liabilities fairly valued would exceed assets fairly valued".[165]

A deliberation must be made by the directors as to whether or not, in the next six months, the balance sheet of the company will be altered, amended and/or restated so as to result in a position where the liabilities of the company will exceed the assets. Such a position could result from numerous events such as an attestation to an agreement in subordination of creditors' claims, a restatement of the value of either the assets or the liabilities of the company, a contingent liability that might become due and payable within the intervening period, or a possible sale of assets of the company at a loss; all of which might result in a negative effect on the company's balance sheet.[166]

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162. What about a start-up company with minimal start-up capital put into the company by its shareholders on loan account? Would this mean that the company is "insolvent" almost immediately after it commences trading in that its liabilities exceed its assets? This could not have been the intention of the legislature. Such a company would have to argue that there is an expectation that in the next six months, such company will become solvent on its balance sheet and thus is not "financially distressed" as defined.

163. Many directors are concerned that they would be opening themselves up to personal liability claims if they ignore the obligations imposed upon them by the 2008 Companies Act and continue to trade their companies in a position of financial distress and in terms of the second part of the definition; see sections referred to above, namely 22(1), 218(2) and 214(1)(c).

164. View shared in a formal opinion by Late Advocate Hiram Slomowitz SC and Advocate Jonathan Blou SC (2 September 2011).

165. See section 4 of the 2008 Companies Act as discussed below.

166. Some guidance from the English courts is available. In *BNY Corporate Trustee Services Limited v Eurosail-UK 2007-3 BL Plc & Others* [2011] EWCA Civ227, the Court of Appeal held that "the balance sheet test of insolvency in section 123(23) of the UK Insolvency Act, 1996 is intended only to apply where a company has reached a point of no return rather than being used as a 'mechanistic, even artificial test for permitting a creditor to present a petition to wind up a company'". The Court noted that a company is not balance sheet insolvent solely because its liabilities exceed its assets. Were this to be the interpretation adopted, many companies would find themselves deemed unable to pay their debts and consequently unable to access investment or credit. The Court pointed out that "the balance sheet test is a useful starting point", but cautioned against simply adopting balance sheet values without keeping a firm eye both on commercial reality and commercial fairness. This judgment was confirmed on appeal (2013 UK SC 28). The English Supreme Court ruled that the balance sheet test is simply a test of whether, on the balance of probabilities, a company has sufficient assets to meet all its liabilities, including prospective and contingent liabilities. For the commencement requirements applicable in the UK, US, Australia and Canada, see Chapter 7, paras 7.2.2 and 7.2.3. All jurisdictions require some level of financial distress or likelihood of insolvency to be the entry point allowing a company to file for a restructuring process.

As set out above, the 2008 Companies Act does not define the word "insolvent". In section 4 of the 2008 Companies Act, the legislature sets out what is termed the "solvency and liquidity test".[167] No attempt, however, is made to define either "solvency" or "liquidity" for the remaining provisions set out in the 2008 Companies Act. Reference is made to a company satisfying the solvency and liquidity test if, considering all reasonably foreseeable financial circumstances of the company at that time, the assets of the company, as fairly valued, equal or exceed the liabilities of the company fairly valued, and it appears that the company will be able to pay its debts as they become due in the ordinary course for a period of twelve months after the date on which the test is considered.

The provisions of section 4 of the 2008 Companies Act are not helpful and should be looked at independently of the deliberations to be made when a company is considering whether or not it is financially distressed in terms of section 128(1)(f). Section 4 assists directors in deciding, *inter alia*, on the provision of financial assistance for the subscription of securities (section 44(3)(b)(i)); loans or other financial assistance to directors (section 45(3)(b)(i)); and distributions (section 46(1)(b) and (c)).

In any event, the period referred to in section 128(1)(f) is six months (not twelve months as set out in section 4(1)) and thus contemplates a shorter and more immediate time frame within which to consider the financial position of the company.

Although Chapter 14 of the 1973 Companies Act remains applicable during the transition period and the 1973 Companies Act (at section 339) incorporates the law relating to

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167. Section 4(1) of the 2008 Companies Act states that a company satisfies the solvency and liquidity test at a particular time if, considering all reasonably foreseeable financial circumstances of the company at that time –

"…

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

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

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

(ii) in the case of a distribution contemplated in para (a) of the definition of "distribution" in section 1, 12 months following that distribution.

(2) For the purposes contemplated in subsection (1) –

(a) any financial information to be considered concerning the company must be based on –

(i) accounting records that satisfy the requirements of section 28; and

(ii) financial statements that satisfy the requirements of section 29;

(b) subject to para (c), the board or any other person applying the solvency and liquidity test to a company –

(i) must consider a fair valuation of the company's assets and liabilities, including any reasonably foreseeable contingent assets and liabilities, irrespective of whether or not arising as a result of the proposed distribution, or otherwise; and

(ii) may consider any other valuation of the company's assets and liabilities that is reasonable in the circumstances; and…"

insolvency, this does not mean that the definition of "insolvent" in the Insolvency Act 24 of 1936 (the Insolvency Act) would be of relevance.[168]

The general definition of the word "insolvent" was applied by Wessels J in *Ohlsson's Cape Breweries Ltd v Totten,*[169] where he stated:

> The word 'insolvent' must be taken to mean that liabilities of the debtor, fairly estimated, exceed the value of his assets, fairly valued.[170]

In *Ex Parte De Villiers and Another*,[171] the Appellate Division confirmed that "factual insolvency" and "commercial insolvency" had been recognised by our law "for many years".[172]

In 2014, the Supreme Court of Appeal (SCA) considered the meaning of "solvent" and "insolvent" in the context of the 2008 Companies Act. In *Boschpoort Ondernemings (Pty) Ltd v Absa Bank Ltd*[173] the court considered the question of what is meant by a "solvent company" in the 2008 Companies Act. The court confirmed that the 2008 Companies Act had not defined the meaning of either a "solvent" company or its converse, an "insolvent" company. The court confirmed that for decades our law had recognised two forms of insolvency: factual insolvency (where a company's liabilities exceed its assets) and commercial insolvency (a position in which a company is unable to pay its debts even though its assets may exceed its liabilities).[174] The court chose not to interfere with a "long established and well settled practice" of the fact that commercial insolvency justifies the liquidation of a company. The SCA found that it must be presumed that the legislature deliberately refrained from defining "solvency". It did so with a view to ensuring that "the well-oiled machine of the courts in matters of company liquidations should not stall". The legislature must have been content that prevailing judicial interpretations of solvency and insolvency respectively should continue to have effect. The meaning of those terms must

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168. There is no definition of "insolvency" in the 2008 Companies Act, nor in the Insolvency Act.
169. *Ohlsson's Cape Breweries Ltd v Totten* 1911 TPD 48.
170. This was followed by the Natal Full Bench in *Ex Parte Harmse* 2005 (1) SA 323 (N) at 325 H. Section 4(1)(a) of the 2008 Companies Act has similar connotations.
171. *Ex Parte De Villiers and Another NNO: In Re: Carbon Developments (Pty) Ltd* 1993 (1) SA 493 (A) at 502 C.
172. Stegman J in his judgment dealt with start-up companies and what it means to be insolvent.
173. *Boschpoort Ondernemings (Pty) Ltd v Absa Bank Ltd* 2014 (2) SA 518 (SCA). See comments by Swart and Lombard "Winding Up of Companies – Back to Basics: *Boschpoort Ondernemings (Pty) Ltd v. ABSA Bank Ltd*" (2015) 78 (2) *THRHR* 356–362.
174. *Boschpoort Ondernemings (Pty) Ltd v Absa Bank Ltd* 2014 (2) SA 518 (SCA) at paras 14–16.

be one that leads to a sensible and business-like result.[175] The SCA went on to comment on the considerations of "solvency" and "insolvency" as set out in Chapter 6 of the 2008 Companies Act, and held that "it is indeed 'business as usual" when it comes to a decision as to whether a commercially insolvency company should be placed into liquidation".[176]

In determining whether the company is in fact "insolvent", it is submitted that the board will have to take advice from its auditors and to establish by way of a formal accounting deliberation whether or not such company is in a position of balance sheet insolvency. A careful analysis of what liabilities (fairly valued) must be taken into account, together with those liabilities that have been finally subordinated in favour of other creditors in order to provide additional working capital for the company should be made. Small start-up companies, with little access to additional finance, would generally be financed by shareholders' loans, which in the normal course would be subordinated. Shareholders would rank behind creditors on insolvency and would only be paid where there is sufficient residue in place to repay such obligations to shareholders.

It is submitted that it could never have been the intention of the legislature (see section 7(b)(iii) and sections 7(g) and 7(h)) to incorporate such a position into the definition of "financial distress" as contemplated by the second part of the definition. Subordinated loans must therefore be ignored as liabilities in this determination.

The other aspect which should be considered is the use of the words "will become" in the second part of the definition. It is submitted that, like the first part of the definition, there is a consideration of a future event, i.e. in the next ensuing six-month period there is a likelihood that the company will become "insolvent", i.e. reflect a balance sheet position where liabilities exceed assets. If a company is already insolvent, then it is not "financially distressed" in accordance with the definition, but rather is a candidate for a liquidation proceeding.[177]

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175. Ibid at paras 18–19.

176. Ibid at para 25. See Locke "The Meaning of 'Solvent' for purposes of The Companies Act 71 of 2008: *Boschpoort Ondernemings (Pty) Ltd v Absa Bank Ltd*" (2015) 27 *SA Merc LJ* 153–162. Also see Wainer "The Insolvency Conundrum in the Companies Act" (2015) *SALJ* 509–512. In this article, the author suggests that the elevation of factual insolvency to meaning that a company is "financially distressed" in terms of section 128 of the 2008 Companies Act is misguided and should be deleted (at 517).

177. For the meaning of a "solvent company" see *FirstRand Bank Ltd v Lodhi 5 Properties Investment* CC 2013 (3) SA 212 (GNP). Also see *FirstRand Bank Ltd v Wayrail Investments (Pty) Ltd* [2013] 2 All SA 295 (KZN) for the meaning of the word "solvent" as employed by items 9(2) of Schedule 5 to the 1973 Companies Act. The concepts of "solvent, insolvent, commercially insolvent and the inability to pay debts" were considered in the context of whether a company is insolvent and liable to be wound up (see p. 7 of judgment). The analysis

It is also submitted that the legislature, in introducing the words "will become insolvent" in section 128(1)(f)(ii) created some level of confusion when one compares the threshold levels of financial distress (in the second part of the definition) with the principles of insolvency law, namely when one is obligated to wind up a company on the basis of it being "insolvent".[178] Loubser states:

> The legislature also seems to have forgotten that this is not a liquidation of the company and that the company is quite possibly not insolvent or unable to pay its debts, and may not even become so. There is a disturbing and inappropriate confusion and mixing of principles of corporate and contractual law, on the one hand, and insolvency law, on the other. The legislature decided to separate corporate rescue from insolvency law and should remain consistent and true to this principle in the provisions regulating corporate rescue proceedings. If the legislature does not have sufficient confidence in the possibility of successful company or business rescues, then business rescue proceedings should be removed from the Companies Act of 2008 and become part of a future consolidated Insolvency Act.
>
> The first bold steps have been taken to provide the framework for a new and more successful rescue procedure for viable companies and their businesses. It will require good faith and trust from all stakeholders, including the legislature, to make this work in practice.[179]

It is further submitted that the concept of "rescue" is very different to that of "insolvency" or "liquidation". The legislation placed Chapter 6 into the 2008 Companies Act, and not the Insolvency Act, for good reason. The message was to be clearly that companies that were "financially distressed" within the context of the six month window period (as set out in section 128(1)(f)) contemplated a company that was not yet insolvent. There was still some viability to the business with a real prospect of it being rescued. As Loubser points out, confusing a company that was already "insolvent" to that which is "financially distressed" was a dangerous mistake.[180]

It is submitted that the financial distress test is one peculiar to the South African legal landscape, particularly when one deals with the deliberations required by boards of South

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includes a debate as to when a company qualifies as a "solvent company" for the purposes of winding up in terms of Section 81 (1)(b) of the 2008 Companies Act.

178. Factual insolvency has always been considered where a company's liabilities exceed its assets and as a result falls to be wound up. See section 134 of the 1973 Companies Act in regard to circumstances where a company may be wound up by the court; Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) and the dicta set out in *Ex Parte De Villiers and Another NNO: In Re: Carbon Developments (Pty) Ltd* 1993 (1) SA 493 (A).

179. Loubser "Some Comparative Aspects of Corporate Rescue in South African Company Law" (LLD thesis, University of South Africa 2010) 381–382. The debate as to whether business rescue should be part of our insolvency law (dealt with in a new Unified Insolvency Act) or remain part of our company legislation (in the 2008 Companies Act) continues.

180. Ibid.

African companies to determine financial distress. Generally, directors wait too long before coming to the realisation that their company is indeed financially distressed, or perhaps even insolvent; thus the imposition of the six-month forward-looking test for financial distress. The legislature clearly intended for directors to apply their minds as early as possible to the test for financial distress and, if necessary, place the company into a business rescue process. The objective of the process would be to maximise recovery for creditors and similarly to benefit employees, shareholders and the debtor company itself. The test is very similar to those used in international jurisdictions (as pointed out above). Commercial insolvency (an inability to pay debts) appears to be a consistent entry point for companies requiring a restructuring intervention and this is generally supported by rescue legislation peculiar to each jurisdiction.

Clearly, the protection of the South African rescue regime is designed for restructuring intervention as early as possible and certainly prior (if possible) to where the company is already insolvent. The earlier the intervention of a rescue process, the higher the probability that the company will be successfully rescued as contemplated by Chapter 6 of the 2008 Companies Act.

Like in other countries, and for good reason, there is no point in allowing a company to file for rescue proceedings when it is already insolvent. Some form of "imminent financial distress" or "insolvency" would (and should) be the catalyst which allows an entity to receive the benefit of a rescue process. As pointed out above, all jurisdictions (including South Africa) recognise that placing a company into a rescue regime must occur as early as possible, and prior to the company already becoming insolvent. If that was not the case, there would be nothing left to save or rescue.

7.2.1.5 DEFINITION OF "INDEPENDENT CREDITOR"

Section 128(1)(g) of the 2008 Companies Act defines an "independent creditor" as a person who –

- is a creditor of the company, including an employee of the company who is a creditor in terms of section 144(2); and
- is not related to the company, a director, or the practitioner, subject to subsection (2).

Section 128(2) states that for the purposes of subsection 1(g), an employee of a company is not related to that company solely as a result of being a member of a trade union that holds securities of that company. An employee who is also a creditor of the company is not related to the company.

Whether or not a creditor is independent is a unique concept and one which features strongly in Chapter 6. The concept of an "independent creditor" becomes important when creditors vote on the acceptance or rejection of a business rescue plan under section 152 of the 2008 Companies Act. While approval of the business rescue plan requires the support of 75 per cent of the voting interests of creditors, there is a further requirement that at least 50 per cent of those votes must be from independent creditors.[181] In terms of section 145(5)(a), the practitioner has the responsibility of determining whether a creditor is independent for the purposes of business rescue proceedings. If a creditor is not satisfied with the determination by the practitioner, an independent creditor can apply to court within five business days of having received the notice of such determination in order to have such determination reviewed.[182] The issue of being "related" to the company is problematic. The question is raised as to whether the mere fact of being a holder of securities of the company, automatically results in a creditor not being regarded as independent.[183]

The requirement of independence of creditors appears to be unique to the South African regime, and would appear to be aimed at voting taking place on a nonbiased and unaffiliated basis. An "unrelated creditor" would serve to ensure that voting takes place with the interests of the company at heart and with its general (independent) body of creditors having the power of the vote. The concept of an "independent creditor" having a meaningful and effective vote is a strong feature of the legislation and certainly diminishes the possibility of bias and a lack of independence.

181. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 451–452.

182. Ibid 448. See Section 145(6)(a) of the 2008 Companies Act. For a full analysis of the determination of an independent creditor in terms of section 145, see Chapter 7, para 7.2.1.5. Also see Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-11–18.12 at para 18.3.7.

183. This issue will be discussed in Chapter 7.6, para 7.6.1, in the context of the practitioner having to determine whether a creditor is independent in terms of section 145(5)(b) of the 2008 Companies Act.

7.2.1.6 DEFINITION OF "VOTING INTEREST"

In terms of section 128(1)(j), a voting interest means an interest as recognised, appraised and valued in terms of section 145(4) to (6). In terms of section 145(4) a secured or unsecured creditor has a voting interest equal to the value of the amount owed to that creditor by the company. There is no determination as to "number", only "value".[184]

7.3 ELIGIBILITY, ENTRY AND DURATION OF BUSINESS RESCUE

There are two entry or commencement points into a business rescue process. The first is by way of company resolution and the second is by way of a formal court application. The Act provides affected persons with the opportunity to object to the company's resolution for business rescue on various grounds.

7.3.1 VOLUNTARY COMMENCEMENT

Section 129 of the 2008 Companies Act provides the boards of financially distressed companies with the opportunity to commence business rescue proceedings on a voluntary basis by passing a resolution.[185]

Thus, in South Africa, the 2008 Companies Act allows the board of a financially distressed company to voluntarily commence business rescue proceedings without the necessity of a court order[186] (voluntary business rescue). If the board has reasonable grounds to believe that the company is financially distressed and there appears to be a reasonable prospect of rescuing the company, it can pass a resolution to commence business rescue.[187] The South African business rescue procedure can also be initiated by affected persons launching a

184. For a full analysis of voting interests and the manner in which such voting interest is determined in terms of section 145, see Chapter 7, para 7.8.1. In most international jurisdictions the ability to enter into a rescue proceeding is provided to the debtor company itself, either by way of resolution filed with the local companies office or by way of application to court. Also see the manner in which business rescue proceedings are commenced in Chapter 7, paras 7.3.1 and 7.3.3.

185. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 453: A resolution adopted by a simple majority would be sufficient. For a synopsis of the voluntary commencement procedure see Van der Walt "A Turnaround Practitioner's View of New Business Rescue Legislation" in Harvey (ed) *Turnaround Management and Corporate Renewal: A South African Perspective* (2011) 154–155; Levenstein "The New Business Rescue Procedure" in Harvey (ed) *Turnaround Management and Corporate Renewal: A South African Perspective* (2011) 9–10. Also see Rushworth "A Critical Analysis of the Business Rescue Regime in the Companies Act 71 of 2008" (2010) *Acta Juridica* 377–380.

186. Section 129(1) of the 2008 Companies Act.

187. South Africa also allows the voluntary liquidation procedure which places a company into winding-up. Voluntary winding-up procedures are brought in terms of Section 349 and 353 of the 1973 Companies Act.

court application in the High Court (compulsory business rescue).[188] Thus there is a dual gateway into the business rescue process.

The section dealing with a "voluntary commencement" for business rescue is section 129(1), which reads as follows:

> 129. Company resolution to begin business rescue proceedings
>
> (1) Subject to subsection (2)(a), the board of a company may resolve that the company voluntarily begin business rescue proceedings and place the company under supervision, if the board has reasonable grounds to believe that –
>
> (a) the company is financially distressed; and
>
> (b) there appears to be a reasonable prospect of rescuing the company.

We have already dealt with the definition of "financial distress" above. The second consideration of determining, at the time of the board deliberation, that there "appears to be a reasonable prospect of rescuing the company" requires analysis.[189]

The legislation does not give any definitive guidance as to what is meant by "reasonable grounds to believe" as set out in section 129(1)(b). Directors will have to consider the company's specific circumstances at the time of deliberation. There will be a subjective (personal view of the director) and an objective element (view of the reasonable director) to the consideration as to whether a company's board has reasonable grounds to believe that the company is both financially distressed and that there appears to be a reasonable prospect of rescuing the company.[190]

It is submitted that any director, when faced with a decision whether or not to place a company into business rescue, will have to deliberate over the peculiar factual matrix that

188. See Chapter 7, para 7.3.3.

189. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 453–454 states that "a company" only includes a company incorporated in terms of the 2008 Companies Act. Thus a foreign or external company (even if such company has operations in South Africa) will not be entitled to apply the provisions of Chapter 6. The test of "reasonable grounds to believe" refers to the company's specific circumstances at the time, which should be well known to the board. This is a subjective test. The test for "reasonable prospect" would be an objective test. See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-13–18-14 at para 18.4.1.1.

190. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 456.

the company faces at the relevant time. There can be no specific guidelines or check lists provided to directors to assist them in making such a decision.[191]

The deliberation over the "reasonable prospect of rescuing the company" must be assessed with the definition of business rescue as set out in section 128(1)(b) in mind. The objective of business rescue does not state as its only objective the rescue of the company, but also the possibility of devising a plan, if the company cannot be rescued, that results in a better return for creditors than the immediate winding-up of the company.[192]

It is submitted that in practice, directors already faced with cash-flow difficulties and a looming insolvent balance sheet position, tend to ignore this important determination. The question is, at this point, whether directors are able (independently) in fact to make this determination without the intervention of an independent third party such as the prospective business rescue practitioner or a suitably qualified turnaround specialist or accountant.

A full ventilation of the term "reasonable prospect" has been dealt with in various matters by the High Court. The term "reasonable prospect" is generally debated by the High Court in the context of section 131 applications (compulsory applications) where the presiding judge is obligated to make a finding on the meaning of such term within the context of the facts relevant to the case before such judge. Many of the decisions pertaining to the meaning of the term "reasonable prospect" have been dealt with by the court when determining whether or not a court should discuss the section 131 application for business rescue and place the company into liquidation in terms of section 131(4)(b), or alternatively grant the business rescue order.[193]

Moreover, when submitting the resolution to the Companies and Intellectual Property Commission ("CIPC"), directors must also submit a "sworn statement of the facts relevant to the grounds on which the board resolution was founded".[194]

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191. See Institute of Directors in Southern Africa *King 3 Code of Corporate Governance for South Africa* (September 2009) Principle 2.15: "The board should consider business rescue proceedings or other turnaround mechanisms as soon as the company is financially distressed."

192. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 456–458.

193. Ibid. For a full analysis of the term "reasonable prospect of rescuing the company"; see Chapter 7, para 7.3.3 for an analysis of section 131.

194. Section 129(3)(a) of the 2008 Companies Act. The resolution has no force and effect until it has been filed in the offices of the CIPC; see section 129(2)(b) of the 2008 Companies Act.

In practice, many directors are taking the conservative approach. They engage with the nominated business rescue practitioner to conduct what is now termed a "pre-assessment" of the affairs, business and prospects of the company so as to be able to satisfy themselves that in fact the company is a proper candidate for business rescue.[195]

It is submitted that where directors do not allow a pre-assessment to be conducted, it would constitute reckless conduct on their part which might result in those directors being held personally liable for damage or loss caused to the company by the filing of an inappropriate resolution in support of business rescue, without due and responsible consideration. What is required by directors is to demonstrate that there are "reasonable grounds to believe" that the company is financially distressed.[196] If there is no reasonable basis to come to this decision and directors proceed to file a section 129 resolution, this could be regarded as reckless conduct as contemplated by section 22 of the 2008 Companies Act.

Once a business rescue resolution has been filed with the CIPC, and the procedure of notification to all affected persons has taken place, the possibility of the liquidation of a company increases dramatically. If the business rescue process fails, the business rescue will in all likelihood end in liquidation proceedings.[197]

It is submitted that the preassessment will entail an investigation (at the instance of the debtor company, creditors or shareholders) into the business, dealings and affairs of the company. In practice, the pre-assessment procedure is becoming necessary and essential to any successful business rescue process. The starting point must be to assess whether or not the company is indeed financially distressed in terms of section 128(1)(f) of the 2008 Companies Act. If so, would there be any merit in the company proceeding to pass a resolution to place the company under supervision? As will be discussed below, an element vital to this investigation will be to establish the availability of post-commencement

195. In a ruling by the CIPC (December 2012) (published in http://www.cipc.co.za), the CIPC confirmed that the involvement of a nominated business rescue practitioner to assess the company's "rescueability" (prior to the form CoR123.1 – notice of the commencement of business rescue proceedings – being filed with the CIPC) does not jeopardise the business rescue practitioner's independence. The suggested period of pre-assessment is 15 to 20 days. The CIPC confirmed that a Practice Note would be prepared in this regard.

196. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) state that "reasonable grounds to believe" refers to the company's specific circumstances at the time and which should be known to the board. This is a partly subjective and partly objective test.

197. Notification of the resolution and the accompanying statement of affairs to all affected persons, including creditors in terms of section 129(3)(a) of the 2008 Companies Act, is notice to the "world" that the company is "financially distressed" and is teetering on the verge of insolvency. In terms of section 132(2)(a), the court can either, on application, set aside the resolution *or* court order that began business rescue proceedings *or* convert the business rescue proceedings into liquidation proceedings.

finance[198] from the existing bank/financier or alternative sources of funding from new financiers such as shareholders or venture capitalists.[199]

The preassessment would also include a careful analysis of the prospects of a business rescue plan and whether it can be developed and implemented, if approved, to ultimately rescue the company or, alternatively, render a better return for creditors or shareholders than would result from the immediate liquidation of the company. During the pre-assessment process, the nominated business rescue practitioner should consult with the management of the company, with its auditors and its existing bankers. If necessary, credit insurers should also be consulted to establish the willingness to provide further credit insurance to the company while it is in business rescue proceedings.

It is highly recommended that creditors be extensively consulted prior to the company filing for business rescue by way of formal resolution. Business rescue practitioners have advised that in practice, if creditors are not consulted, the business rescue practitioner will struggle to obtain the approval of creditors when the business rescue plan is under consideration. A creditor that is confronted "cold" with a business rescue plan may be taken off guard, which results in resistance and a reluctance to engage in meaningful discussions with the business rescue practitioner.[200]

The question may be posed how likely it is that creditors, already concerned about an exposure to the debtor company, would be willing to engage in a pre-assessment discussion, either with the business rescue practitioner or with representatives of the board or management. Such discussions could become highly confrontational and at times quite emotional. In practice, most creditors (especially representatives of the banks) welcome such discussions. Often, banks holding a general notarial bond would be given an

198. Section 135 of the 2008 Companies Act.

199. While there has not yet been a huge upsurge in interest in the provision of post-commencement finance by third-party funders (such as buyers of distressed debt), certain venture capitalists (local, Chinese, from the UK and the US) are keeping a careful watch on this space, particularly where they foresee taking an upside in providing post-commencement finance in return for an equity stake in the financially distressed company where there is significant advantage in the potential value available in the company; for example, a mining company that has significant cash-flow issues and is unable to successfully exploit valuable mining rights belonging to the company.

200. In *Gormley v West City Precinct Properties* (Pty) Ltd 2013 JDR 1895 (WCC), Traverso J stressed the importance of the need to conduct a pre-assessment with major creditors (in this case the intervening bank). Traverso J stated: "The practitioner can only prepare the plan once he/she has consulted, inter alia, the creditors. The Bank has made it clear that it will not be party to a plan where the remaining assets are to be sold over a period spanning 3–5 years." The Judge pointed out that the application to court must contain facts which show that "if the intended resuscitation of the company should fail, the creditors will not be worse off". At para 22, the Judge went on to conclude that the Bank (holding more than 75 per cent of the creditors' voting interest) had made it clear that it would not approve the envisaged business rescue plan: "In any event, it appears that this application is an exercise in futility." Traverso J placed the company into provisional liquidation in the exercise of her discretion.

opportunity, by consent, to perfect such general notarial bond by application to court, prior to the commencement of business rescue proceedings.[201]

Creditors are beginning to understand the need for business rescue proceedings and would not necessarily react adversely to the interests of the company by rushing off to court with a liquidation application. Creditors, if properly advised, would understand that a hastily brought liquidation application could always be "headed off" by an application to intervene in that application in terms of a business rescue application brought in terms of section 131.

An issue which has been debated amongst business rescue practitioners is whether or not a business rescue practitioner who has been engaged to conduct a pre-assessment would remain independent once appointed. Section 138(1)(e) of the 2008 Companies Act states the following:

> 138. Qualifications of practitioners
>
> A person may be appointed as the business rescue practitioner of a company only if the person –
>
> …
>
> (e) 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; …

Section 130(1)(b) and section 139(2)(e) make provision for the removal of a business rescue practitioner who is not independent of the company or its management, who has a conflict of interest or lacks independence.

The words "conflict of interest" or "independence" are not defined in the 2008 Companies Act.[202]

In *African Bank Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Limited and Others*, the court held that the practitioner must act objectively and impartially

201. Section 133 of the 2008 Companies Act disallows such application to be brought post the commencement of business rescue proceedings as these actions would constitute "legal proceedings".

202. Regulation 126(4)(a) to the 2008 Companies Act refers to the criterion that an applicant for appointment as a business rescue practitioner must be "of good character and integrity".

in the conduct of the business rescue proceedings.[203] It is submitted that prior consultation with the company is necessary and does not prevent the business rescue practitioner, who has been engaged to conduct a pre-assessment, from taking an appointment at a later stage and in the same company as business rescue practitioner. The intention of the legislature is to preclude persons who lack independence *or* who "are close to" the company or its management.[204]

There has been some debate in respect of whether a shareholders agreement can restrict or qualify the power of a board to initiate a voluntary business rescue in terms of section 129(1). In *De Bruyn v Conradie and Others*[205] the court considered a provision in a shareholders agreement concluded before the Act came into operation that provided that any decision by the directors or by the shareholders of the company relating to "an arrangement or a compromise generally with the company's creditors or any proposal that the company be wound up or liquidated or placed under judicial management, whether provisionally or finally, as the case may be", required the approval of all shareholders (i.e. unanimous consent). No mention of business rescue was made in the relevant provision of the agreement.

The court held that the provision will preclude the directors from taking a decision on their own to place the company under business rescue, due to the fact that it is unlikely that the parties would have excluded business rescue if it had existed as a process at the time of signing the agreement due to the fact that there is potentially no judicial oversight to protect minority shareholders' interests if compared to a process such as judicial management as mentioned in the shareholders agreement.[206] The court held that on the argument that the power to take the resolution vests exclusively with the board, that if the legislature intended it to be subject to shareholders' approval, it would have stated it as such. On the basis that the shareholders agreement falls foul of section 15(7) of the Act[207]

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203. *African Bank Corporation of Botswana Limited and Kariba Furniture Manufacturers (Pty) Ltd and Others* (228/2014) [2015] ZASCA 69 (20 May 2015) at para 38.

204. Examples of business rescue practitioners who lack independence or who are conflicted would be a nonexecutive director, a turnaround specialist engaged for a long period of time by the management of the company and the audit partner (accountant) engaged by the company. The fact that the company has also paid fees to such an individual might also impact on that individual's independence.

205. *De Bruyn v Conradie and Others* (18679/11 and 4455/14) [2014] ZAWCHC (31 March 2014).

206. Ibid at paras 23–24.

207. Section 15(7) of the 2008 Companies Act states that "the shareholders of a company may enter into any agreement with one another concerning any matter relating to the company, but any such agreement must be consistent with this Act and the company's Memorandum of Incorporation, and any provision of such an agreement that is inconsistent with this Act or the company's Memorandum of Incorporation is void to the extent of the inconsistency".

which voids any provision in the agreement that is inconsistent with the 2008 Companies Act, the court found that the shareholders agreement merely adds another "layer" of decision making and is therefore not in conflict with section 129.[208]

Section 129(2)(a) prohibits any resolution from being adopted if liquidation proceedings have been initiated by or against the company. The reason for this is to prevent the board thwarting an application to liquidate the company by adopting a business rescue resolution.[209]

Sections 129(3) and (4) (as read with regulation 123) set out the publication and notification requirements for the resolution once it has been passed by the board.[210]

In terms of section 129(5)(a):

> If a company fails to comply with any provision of subsection (3) or (4) –
>
> (a) its resolution to begin business rescue proceedings and place the company under supervision lapses and is a nullity; …

In *Advanced Technologies and Engineering Company (Pty) Ltd (in business rescue) v Aeronautique et Technologies Embarquees SAS and 4 Others*,[211] Fabricius J considered

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208. *De Bruyn v Conradie and Others* (18679/11 and 4455/14) [2014] ZAWCHC (31 March 2014).

209. See Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 458. As to the meaning of "initiated", see *FirstRand Bank Limited v Imperial Crown Trading 143 (Pty) Ltd* 2012 (4) SA 266 (KZD) at para 18: "It should be noted that section 131(6) refers to liquidation proceedings having 'been commenced by or against the company' at the time application is made for an order placing the company under supervision and commencing business rescue proceedings in terms of section 131(1) of the 2008 Companies Act". Henochsberg is of the view that due regard being had to the fact that the provisions of the 1973 Companies Act continue to be applicable to the winding up of companies, the word "initiated" must be intended to have the same meaning as the word "commenced" in the applicable sections – see 458.

210. Section 129(3) of the 2008 Companies Act states:

> Within five business days after a company has adopted and filed a resolution, as contemplated in subsection (1), or such longer time as the Commission, on application by the company, may allow, the company must –
>
> (a) publish a notice of the resolution, and its effective date, in the prescribed manner to every affected person, including with the notice a sworn statement of the facts relevant to the grounds on which the board resolution was founded; and
>
> (b) appoint a business rescue practitioner who satisfies the requirements of section 138, and who has consented in writing to accept the appointment.

"Business days" are defined in section 5(3) of the 2008 Companies Act. In practice, a sworn statement (sworn to by the directors) must be included with the resolution when it is filed with the CIPC. Such sworn statement is published by the company and sent to every affected person within a period of five days from the date that the section 129 resolution has been adopted and filed. For an analysis of the content and import of the sworn statement, see *FirstRand Bank Ltd v Deoland Investments (Pty) Ltd* (18125/13) (4 April 2014) (WCC) 19. See also comments by Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-14–18-20 at para 18.4.1.2; Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 458–461. Henochsberg comments on notification requirements in section 129(3). Once the section 129 resolution has been filed at the CIPC, the company is required to appoint a suitably qualified business rescue practitioner within a period of five business days. The nominated business rescue practitioner is required to consent to the appointment in writing. Within two business days of having appointed a business rescue practitioner, the company is required to file a notice of the appointment with the CIPC and publish a copy of the notice to each affected person within two business days after the filing of the notice. See CIPC Practice Note 3 of 2014 for details required for the section 129 business rescue filing procedure.

211. *Advanced Technologies and Engineering Company (Pty) Ltd (in business rescue) v Aeronautique et Technologies Embarquees SAS and 4 Others* Case No. 72522/11, North Gauteng High Court, Pretoria, June 2012 (unreported) 28.

whether or not the provisions of section 129(5) were applicable and that the resolution adopted by the company could be set aside on the basis that it had lapsed and was a nullity.

Fabricius J held as follows:

> It is clear from the relevant sections contained in chapter 6 that a substantial degree of urgency is envisaged once a company has decided to adopt the relevant resolution beginning business rescue proceedings. The purpose of s 129(5) is very plain and blunt. There can be no argument that substantial compliance can ever be sufficient in the given context. If there is non-compliance with s129(3) or (4) the relevant resolution lapses and is a nullity. There is no other way out, and no question of any condonation or argument pertaining to "substantial compliance". The requirements contained in the relevant sub-sections were either complied with or they were not. In this case they were not, for the reasons stated herein above.

Fabricius J ordered that the applicant's resolution to commence business rescue proceedings had lapsed and had become a nullity in terms of section 129(5) of the 2008 Companies Act and as a result of the company failing to comply with the provisions of sections 129(3) and/or 129(4) of the 2008 Companies Act. Fabricius J declared the proceedings to have lapsed and the resolution to be a nullity with effect from the date of failure to comply with sections 129(3) and (4).[212]

Section 129(5) has been the subject matter of further debate in our courts. The question that concerns all stakeholders is that the failure to serve the business rescue publication requirements in respect of certain creditors, who at the date of commencement could be unknown to the company (and where later it transpires that such a creditor was indeed a creditor at the date of commencement), can later result in the entire business rescue collapsing as a result of the resolution being ruled a "nullity".[213] Does the lapsing of the business rescue proceedings occur immediately upon the failure to publish to that particular "creditor"? Fabricius J ruled that such lapsing occurred at the date of the failure to comply.

212. See Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 1 (2010) 3 *TSAR* 503–504; Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-22–18.24(1) at para 18.4.1.4. In this case, application had been made by the business rescue practitioner under section 153(1)(a) to have the votes of the shareholders against the adoption of the business rescue plan declared inappropriate. The end result was an order by the court declaring that the business rescue resolution had lapsed and was a nullity, thereby terminating the business rescue proceedings, even at that late stage of the process. The end result suited the shareholders, as they had voted against the adoption of the business rescue plan at the meeting to determine the future of the company. See Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 460–461.

213. In the early days of the legislation, post-2011, many applications were brought on fairly "technical grounds" in order to attack the lawfulness of business rescue orders in an effort to convert them into liquidations. See certain examples below.

This can have dire consequences, as actions taken by the practitioner during the business rescue proceedings will need to be unravelled and would occur at great prejudice to the company. The lapse of its business rescue proceedings could result in all post-commencement finance[214] losing its preferential status and, if the company is placed in liquidation, becoming a concurrent claim in such liquidation. Further, what would occur if after the business rescue plan has been adopted,[215] the resolution is then set aside? Would the plan itself become a nullity?

In the *Ex Parte* application of *Ex Parte Van Den Steen NO and Another (Credit Suisse Group AG and Another Intervening)*,[216] Rautenbach AJ had cause to consider section 129(5) of the 2008 Companies Act. In that matter, there had been a *prima facie* failure to comply with section 129(13)(a) in that the practitioner had not served a copy of the section 129 resolution on an affected person, namely, to certain noteholders who were in fact creditors of the company at the time. The issue that the Judge had to determine was whether or not the company had in fact complied with its notification requirement in terms of section 129(3), failing which the business rescue resolution could be set aside as a result of it being a nullity in terms of section 129(5)(a).

In his judgment, Rautenbach AJ distinguished the decision in *Advanced Technologies and Engineering Company (Pty) Ltd (in business rescue) v Aeronautique et Technologies Embarquees SAS and 4 Others*[217] which had dealt with a failure to appoint a business rescue practitioner within the specified time frame, and not with the notification requirements of section 129(3). The Court concluded that section 6(9) of the 2008 Companies Act enabled it to find that there had been substantial compliance with the notification requirements if all affected persons had full knowledge of the notice and its contents. The purpose of section 129(3) and (4) was to protect the rights of affected persons by informing them of the business rescue resolution and to enable them to exercise their rights in terms of section 130 (by applying to have the business rescue resolution, or the appointment of a business rescue practitioner, set aside). Since the noteholders had

214. Section 135 of the 2008 Companies Act.
215. Section 152 of the 2008 Companies Act.
216. *Ex Parte Van Den Steen NO and Another (Credit Suisse Group AG and Another Intervening)* 2014 (6) SA 29 (GJ) 15–17 at paras 20–26.
217. *Advanced Technologies and Engineering Company (Pty) Ltd (in business rescue) v Aeronautique et Technologies Embarquees SAS and 4 Others* Case No. 72522/11, North Gauteng High Court, Pretoria, June 2012 (unreported) 28.

become aware of the business rescue proceedings and supported the application, there had been substantial compliance with section 129(3) and (4).[218]

Further deliberation on the lapsing of the resolution for failure to comply with section 129(3) have been considered in various matters.[219] Henochsberg highlights the uncertainty of section 129(3). It remains unclear as to exactly how such "lapsing" is to occur and who should determine that the formal requirements have not been met, other than by way of an application to court. Automatic lapsing of the resolution is problematic, especially if the original intention of the company was to gain a moratorium on claims for a brief period. Practically, this could have unanticipated consequences where non-compliance has been minor and unintentional, such as where a specific affected person did not receive notice of the resolution. It remains unclear if this means that the resolution lapses and becomes a nullity, even if the plan has already been adopted and is in the process of being implemented.[220]

The SCA has finally determined the position in respect of the effect that noncompliance with section 129(3) and (4) has on business rescue proceedings. In *Panamo Properties (Pty) Ltd and Another v Nel NO and Others*,[221] the court held that such noncompliance does not automatically result in the proceedings becoming a nullity, notwithstanding the provisions of section 129(5) of the 2008 Companies Act. Thus, business rescue proceedings only come to an end when a court order specifically sets aside a resolution or court order that began those proceedings in terms of section 132(2)(a)(i). This decision therefore overrules the judgment of Fabricius and the further cases that followed Fabricius' ruling in *Advanced Technologies and Engineering Company (Pty) Ltd (in business rescue) v Aeronautique et Technologies Embarquees SAS and 4 Others*.[222]

218. Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-22–18.24(1) at para 18.4.1.4. From a practical perspective, abuse of these provisions may occur where there is intentional noncompliance with the provisions of section 129(3) and (4) of the 2008 Companies Act by the company in order to gain the protection of Chapter 6 for a brief period of time, only to exit the procedure due to the resolution lapsing and becoming a nullity at a later date.

219 See cases mentioned in Meskin et al. *Henochsberg on the Companies Act 71 of 2009* (2011+) 458–459.

220 Ibid 460–461. In the matter of *Newton Global Trading (Pty) Ltd v De Corte and Another* 2015 (3) SA 466 (GP), it was held that the nullity resulting from failure to comply with section 129(5) is *ex tunc* and there is no provision that a further resolution, rectifying the original resolution, can be filed (para 12).

221. *Panamo Properties (Pty) Ltd and Another v Nel NO and Others* 2015 (5) SA 63 (SCA). See comments by Elliot and Weyers "Hot off the business rescue press" *Without Prejudice* (2015) 10–11.

222. *Advanced Technologies and Engineering Company (Pty) Ltd (in business rescue) v Aeronautique et Technologies Embarquees SAS and 4 Others* Case No. 72522/11, North Gauteng High Court, Pretoria, June 2012 (unreported) 28.

Thus, any party that seeks an order setting aside a resolution or court order that commenced business rescue proceedings must bring an application to court in terms of section 130. Noncompliance with time periods will not therefore result in a termination of business rescue proceedings and a proper ventilation by the court (in its discretion) will determine termination of business rescue proceedings.

Section 129(5)(b) of the 2008 Companies Act reads as follows:

> If a company fails to comply with any provision of subsection (3) or (4) the company may not file a further resolution contemplated in subsection (1) for a period of three months after the date on which the lapsed resolution was adopted, unless a Court, on good cause shown on an ex parte application, approves the company filing a further resolution.[223]

This has serious consequences for the company. It has already informed all affected persons that it is financially distressed.[224] It is now in a very invidious position. Either it applies to court for an order allowing the court to consent to it filing a further resolution (on good cause shown) or it will be left with no alternative but to apply to court for its own voluntary liquidation. It cannot be practical or probable for such a company to continue to trade and if it does so, the directors are exposing themselves to personal liability.

The other issue which arises in the context of compliance with section 129(4)(b) is whether the company must recognise a "contingent creditor" for publication purposes. Does a contingent creditor qualify as a "creditor" for purposes of business rescue proceedings? Section 128(1)(a)(i) does not define a "creditor", only including such parties as "affected persons". If a company has, for example, signed a guarantee for the obligations due by its holding company to a third party, would such third party, in whose favour the guarantee was given, be a creditor in the business rescue proceedings of the company? The third party would be a "contingent" or "conditional" creditor on the occurrence of the non-performance of the holding company. The Act does not deal at all with the status of a contingent creditor.

223. In the *Ex Parte Application of A G* Petzetakis, Case No. 53915/12 (unreported), the Court granted the airline company the opportunity to file a further section 129 resolution in terms of section 129(5)(b) of the 2008 Companies Act, after an initial resolution had lapsed and had become a nullity.

224. Section 129(3)(a) of the 2008 Companies Act.

The position of a "contingent creditor" was dealt with in *Absa Bank Limited v Etienne Jacques Naude NO and 2 Others*.[225] The practitioner construed the applicant's claim as being "contingent", thereby not entitling it to a voting interest for such a claim. The practitioner relied on the proposition set out in *Milman and Another NNO v Masterbond Participation Bond Trust Managers (Pty) Ltd (under Curatorship) and Others*,[226] where it was held that the liability of a surety and co-principal debtor is not contingent unless the principal debt is contingent.

It is submitted that a guarantee would impose a primary liability and would not be accessory in nature, as would a suretyship. The third party would and should be recognised as a "creditor", and not as a "contingent" or "conditional" creditor. Insofar as actual "contingent creditors" are concerned, such as the third party in whose favour a suretyship was given for the obligations of the company's holding company, it is submitted that inasmuch as conditional creditors are recognised as creditors who may prove claims under section 148 of the Insolvency Act, by analogy such creditors should also be recognised as creditors whose rights, albeit contingent, may be substantially affected by business rescue proceedings.

Thus, contingent creditors who have suretyship undertakings from a company should in any event qualify as creditors when the company is placed in business rescue. These creditors must, importantly, also be notified of the commencement of business rescue proceedings as well as of the appointment of the business rescue practitioner in terms of section 129(3) and (4) of the 2008 Companies Act.

This leads to another very important enquiry on the part of directors. Section 129(7) states:

> (7) If the board of a company has reasonable grounds to believe that the company is financially distressed, but the board has not adopted a resolution contemplated in this section, the board must deliver a written notice to each affected person, setting out the criteria referred to in section 128(1)(f) that are applicable to the company, and its reasons for not adopting a resolution contemplated in this section.

225. *Absa Bank Limited v Etienne Jacques Naude NO and 2 Others* (GNP) Case No. 66088/2012 (24 January 2014).

226. *Milman and Another NNO v Masterbank Participation Bond Trust Managers (Pty) Ltd (under curatorship) and Others* 1997 (1) SA 113 (C). For the meaning of a "contingent creditor" in an application for the winding up of a company, see *Gillis-Mason Construction Co (Pty) Ltd v Overvaal Crushers (Pty) Ltd* 1971 (1) SA 524 (T). The court held that a "contingent creditor" is a creditor "who by reason of some existing *vinculum juris* has a claim against a company which may ripen into an enforceable debt on the happening of some future event or on some future date". Also see *Holzman NO and Another v Knights Engineering and Precision Works (Pty) Ltd* 1979 (2) SA 784 (W).

The section provides directors with an early opportunity to assess whether or not a company is "financially distressed" in terms of section 128(1)(f) and, if so, to deliberate as to whether or not the company should pass a resolution to place the company under supervision in terms of section 129 of the 2008 Companies Act.

The provision makes no mention of the other requirement for a board resolution, namely that there must be a reasonable prospect of rescuing the company. This means that the required notice must be sent even if the board believes that there is no such prospect and that liquidation is the only option.[227]

The section 129(7) notice is one which has certainly focused the minds of many directors on the issue of determining financial distress. Again, when this notice is sent out, the company will be informing all of its creditors that the company is financially distressed and that creditors that continue to deal with the company (including loan financiers and suppliers) do so at their own risk. Receipt of such a notification by a creditor could result in a termination of a contract by virtue of an event of default.[228] Loubser points out that the delivery of the notice will have damaging consequences for the company. Claims will be accelerated, overdrafts called up and suppliers will insist on payment in cash. It appears to be irresponsible to insist that the board send out such a notice despite the possibility that the expected insolvency may not occur. This further inhibits the directors from attempting to agree a pre-packaged plan with creditors.[229]

The other likely consequence of a creditor receiving such a notice, and where there are considerable debts overdue to such creditors, is the launch of recovery proceedings which

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227. Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 1 (2010) 3 *TSAR* 504. It should be clear that a notice published in terms of section 129(7) may very well prompt an affected person to bring an application for the compulsory business rescue proceedings in terms of section 131. Such a person would already have proof that the company is financially distressed, although such person would still have to prove to the court that there is a reasonable prospect of rescuing the company. See Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 461–462.

228. Many suppliers of loan finance and goods have amended their contracts to include provisions which state that the receipt of a section 129(7) notice would constitute an "event of default", thus entitling such party to terminate such contract forthwith, or an entitlement to switch over supply from a credit to cash basis. See Marcus "South Africa Reforms Business Rescue Laws: New Objectives, New Opportunities" (30 September 2013), where he states:

> Declaring financial distress remains a daunting step. While the new Act caters for early warning signs of financial ill health – boards have to assess the future viability of their companies continuously – it is a brave group of directors (especially in owner-managed businesses) that would take the plunge to declare the company to be in financial distress. By doing so they would hand over control with the knowledge that if the company is not rescued it will be liquidated. Self-interest, like love, is often blind!

229. Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 1 (2010) 3 *TSAR* 504–505.

might include an application brought by an affected person in terms of section 131 for a business rescue order or a possible application for such company's liquidation.[230]

Certainly in a start-up company, with subordinated debt, it is submitted that there could never have been an intention for such a company (in its start-up infancy phase) to issue such a notice. Directors trading start-up companies can take comfort in the fact that section 128(1)(f) of the 2008 Companies Act uses the phrase "will become" and thus a section 129(7) notice would not be necessary in such an instance.

The interpretation of "financial distress" will be critical for directors when considering whether or not to send out a section 129(7) notice. The first part of the definition of "financial distress" is fairly straightforward, that is, if it appears to be reasonably unlikely that the company will be able to pay all of its debts as they become due and payable within the immediately ensuing six months, such company would be financially distressed in terms of section 128(1)(f)(i). It is the second part of section 128(1)(f) that is more problematic. Section 128(1)(f)(ii) states that a company will be financially distressed if it appears to be reasonably likely that the company *will become insolvent* within the immediately ensuing six months.[231]

Section 128(1)(f) starts off by referring to a particular company at a *particular time*. There is reference to a frozen point in time, that is, the present, and this would be the time period within which directors must make the determination of financial distress. This is in contradistinction to the fact that directors are to look to the future when making such determination, i.e. "will be able" and "will become". It is submitted that directors, at the date of their relevant board meeting (the particular time), are to make a determination as to what the future might hold in respect of the company becoming financially distressed in the future (in the next six-month period). To understand what is meant by the term "insolvent", reference is made to the discussion above.[232]

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230. Section 131 of the 2008 Companies Act allows an affected person (defined in section 128(1)(a)) to include any shareholder or creditor of the company, any registered trade union representing employees of the company and employees themselves if not represented by a trade union) to apply to a Court at any time for an order placing the company under supervision and commencing business rescue proceedings – dealt with below. Also see Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-18–18.24(1) at para 18.4.1.6. Considering the consequences of delivering such a notice to affected persons, it appears that very few, if any, company boards will be prepared to issue such a notice in the normal course of events, even if they are financially distressed as envisaged by section 128(1)(f) of the 2008 Companies Act.

231. See previous discussion in Chapter 7, para 7.2.1.4 on section 128(1)(f)(ii) of the 2008 Companies Act.

232. See Chapter 5, para 5.5

The other issue for directors is to determine the consequences of failing to send out a section 129(7) notice, and whether such failure results in personal liability for such directors as contemplated by section 22(1) of the 2008 Companies Act.[233]

It is submitted that the failure by directors to warn creditors of the fact that the company is indeed financially distressed, by failing to send out the section 129(7) notice, could result in directors being held personally liable for such conduct on the basis that such conduct is reckless and could be seen to be conduct with intent to defraud the creditors of the company, i.e. continuing to accept the supply of goods on credit knowing that the company will not be in a position to pay as and when such credit terms require settlement by payment.

Furthermore, a person would be guilty of an offence in terms of section 214(1)(c) of the 2008 Companies Act if such person was "knowingly a party to an act or omission by a company calculated to defraud a creditor … or with another fraudulent purpose". Thus, the failure by a director to send out the section 129(7) notice could result in criminal liability (including a fine or imprisonment not exceeding 10 years or to both such fine and imprisonment – see section 216(a)).

Additionally, a director could be sued personally on a civil basis by a creditor in terms of section 218(2) of the 2008 Companies Act should a director cause loss or damage to such creditor as a result of any contravention of the 2008 Companies Act.[234]

As long as directors carefully deliberate over whether or not their companies are indeed financially distressed and choose not to send out the notice in good faith,[235] they would have a defence to any civil claims in terms of section 22(1) or 218(2) or a criminal charge in terms of section 214(1)(c).

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233. Section 22(1) of the 2008 Companies Act states the following:

> 22. Reckless trading prohibited
>
> (1) A company must not carry on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose.

234. See Levenstein "Director's Obligation to Notify Creditors of Financial Distress" (November 2011) *Without Prejudice* 21–22; Dorning "Beware of Drowning on a Sinking Ship" (February 2015) *Without Prejudice* 18–19.

235. Section 77(2)(a) of the 2008 Companies Act states:

> A director of a company may be held liable –
>
> (a) in accordance with the principles of the common law relating to breach of a fiduciary duty, for any loss, damages or costs sustained by the company as a consequence of any breach by the director of a duty contemplated in section 75, 76(2) or 76(3)(a) or (b);or ….

The great majority of business rescue proceedings commence with a resolution in terms of section 129 of the 2008 Companies Act.[236] Directors generally would meet with the prospective practitioner before the resolution is passed and ascertain whether or not their particular company was indeed a candidate for business rescue or, alternatively, should go into liquidation. It is submitted that the abovementioned pre-assessment procedure assists in this discussion and the ultimate decision to pass a resolution in terms of section 129 of the 2008 Companies Act.

In South Africa, business rescue legislation is confined to companies and close corporations.[237] The working document on the Unofficial Draft Unified Insolvency Bill ("UIB") provides for the application of the new business rescue legislation to other entities. Business entities such as business trusts, universities or clubs, incorporated associations or entities such as a sole trader as well as individuals and partnerships are currently under consideration. It has been proposed that individuals who encounter financial difficulties should also be considered for the protection of business rescue and especially the moratorium on claims. The proposed UIB might very well include these additional entities and individuals into a new restructuring and business rescue regime.[238]

It is submitted that there is a marked distinction between commercial/business entities and individuals. Whether it is correct to allow individuals to become subject to a restructuring process is a moot question. The extensive provisions of the NCA[239] already allow a comprehensive debt restructuring opportunity for individuals who may require it.

Rajak and Henning, however, express a strong view that individual debtors who conduct business should also have the opportunity to enter into a formal rescue proceeding:

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236. 90 per cent of filings for business rescue have been voluntary findings by directors by way of resolutions by the board and 10 per cent of filings are by court applications – see http://www.cipc.co.za/files/4714/2866/7900/ReportNumber3Amended 31 at para 4.1.2. Up-to-date statistics have not been provided since August 2012.

237. See item 6, Schedule 3 to the 2008 Companies Act which states that the provisions of Chapter 6 apply to a close corporation, and that a reference in Chapter 6 to a "company" must be regarded as a reference to a "corporation" and a reference to a "shareholder" of a company or the holder of securities issued by a company must be read as a reference to a member of a corporation.

238. At a workshop conducted at the University of Pretoria on 12 July 2013, Mr Marthinus Cronje (ex-Department of Justice) advised that the Draft Uniform Insolvency Bill provides for the application of business rescue to debtors (other than a company or close corporation) who carry on business with 10 or more employees. The latest version of the Unofficial Draft Unified Insolvency Bill was published in 2015 and is available from mcronje@justice.gov.za.

239. The National Credit Act 34 of 2005 is a comprehensive piece of legislation which allows individual debtors to apply for a debt moratorium whilst a debt counsellor makes a proposal to such debtor's creditors. The aim of the legislation is, *inter alia*, to reduce the provision of reckless credit to individual consumers.

> A distinction between business and consumer debtors is, in our view, sensible and workable. South African courts are well used to the issue of defining the meaning of "business", and any difficulty occasioned thereby will be a small price for the smooth efficiency which should result from a single business rescue regime for all debtors.[240]

At this stage, all other entities, and individuals other than companies and close corporations have been left unaffected by the provisions of Chapter 6.

It is further submitted that the ease of entry into a business rescue process by way of a section 129 resolution must support the contention that business rescue is a viable and serious option available to companies in financial distress. As is the position in foreign jurisdictions, ease of entry will encourage directors to address financial distress at an early stage with less cost and while averting court processes. In South Africa, the option of a board resolution placing the company into business rescue is being utilised and often results in a successful rescue. Of course, abuse of the process must be avoided, and those directors that pass section 129 resolutions merely to obtain the benefits of a moratorium on claims from creditors, will find their companies having to be placed into liquidation soon after the resolution has been filed with the CIPC.

The requirements of reporting to affected persons (at an early stage) of potential financial distress aligns with the requirements of international best practice. When directors are faced with the prospect of personal liability where they do not report or do not proceed to place the financially distressed entity into a rescue process, it clearly supports a rescue regime aimed at commencement as early as possible and which would result in a higher percentage of companies being rescued. Maintaining the "value" of the entity would of course be the result of the early intervention of the rescue process. Ease of entry by way of the section 129 resolution follows international commencement standards such as those found in international jurisdictions.

240. Rajak and Henning "Business Rescue for South Africa" (1999) *SALJ* 273.

7.3.2 OBJECTION TO COMPANY RESOLUTION

Due to the fact that the initiation of voluntary business rescue proceedings by a company is open to potential abuse, the legislature has sought to protect affected persons by making provision for them to approach the court for protection in appropriate circumstances.[241]

In terms of section 130(1), at any time after the adoption of a resolution in terms of section 129, until the adoption of a business rescue plan in terms of section 152, an affected person can apply to court for an order:

> (a) setting aside the resolution, on the grounds that –
>
> > (i) there is no reasonable basis for believing that the company is financially distressed;
> >
> > (ii) there is no reasonable prospect for rescuing the company; or
> >
> > (iii) the company has failed to satisfy the procedural requirements set out in section 129;
>
> (b) setting aside the appointment of the practitioner, on the grounds that the practitioner –
>
> > (i) does not satisfy the requirements of section 138;
> >
> > (ii) is not independent of the company or its management; or
> >
> > (iii) lacks the necessary skills, having regard to the company's circumstances; …

This section thus guards against potential abuse by directors who might pass a section 129 resolution that is ill-founded and which constitutes an abuse of process. It protects affected persons, who can come to court and potentially have the resolution set aside in appropriate circumstances.[242] However, it does remain a heavy burden for any applicant in terms of this section to bring an application to set aside the section 129 resolution. In addition to making out a case in terms of the provisions of section 130(1), the legislation requires the applicant to notify all affected persons (all creditors, shareholders, registered trade unions and employees) and the CIPC of the application and to do so in the prescribed manner.[243]

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241. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 462(2).

242. For grounds to set aside the section 129 resolution, see Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 1 (2010(3) *TSAR* 505–507. See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-27–18-30 at para 18.4.2.3.

243. See service requirements set out in section 130(3) of the 2008 Companies Act.

The applicant (if adverse to the company) will not necessarily have access to all the detail necessary to allow it to comply with the service requirements. Further, information about the extent of the company's position of financial distress and information relevant to there not being a prospect of rescuing the company might also not be available to the applicant. It is submitted that this makes the application in terms of section 130(1) difficult.

Further, in terms of section 130(1)(a)(ii), a court will set aside a resolution passed when in fact there was no reasonable prospect of rescuing the company.

Directors need to be aware that the legislature goes so far as to punish those directors who supported a business rescue resolution when there was clearly no merit in doing so. In terms of section 130(1)(a)(i), if the court finds that there were no reasonable grounds for believing that the company would be unlikely to be able to pay all of its debts as they become due and payable, i.e. that the company was not financially distressed in terms of the first part of the definition, then the court will set aside such resolution. Any director of a company who voted in favour of a resolution for business rescue in such circumstances would be ordered to pay the costs of the application launched to set aside such resolution. The court would not make such an order if it found that the director acted in good faith and on the basis of information provided and that the director was entitled to rely on such information in terms of section 76(4) and (5). This would constitute a defence against an order to pay the costs of such application.

In practice, directors are now accepting that they must be circumspect when passing a resolution as they may face a personal costs order. In many instances, directors focus their attention on the fact that the company is financially distressed and, by passing the section 129 resolution, they obtain the benefits of the moratorium on claims offered by section 133 of the 2008 Companies Act. They do not, at their own risk, focus on the true outcome of the business rescue process, namely that there must be a reasonable prospect that the company will be rescued and placed in a solvent position to allow it to continue trading into the future.

Although we have not yet seen any cost orders against directors, there is no doubt that this will occur in the near future. The abuse of the Chapter 6 process by boards of directors and the postponing of the inevitable liquidation of the company will be brought to an end by our courts in due course.

In *Climax Concrete Products CC t/a Climax Concrete Products CC v Evening Flame Trading 449 (Pty) Ltd and Others*[244] Judge Beshe dealt with an urgent application brought by a creditor to set aside a resolution for business rescue in terms of section 130 of the 2008 Companies Act. A counterapplication had been brought by the respondent company to seek the court's approval to file a further resolution in terms of section 129(5) of the 2008 Companies Act. The Judge ruled that there was a reasonable apprehension that, *inter alia*, the resolution to commence business rescue proceedings by the respondent company, coupled with their failure to comply with the provisions of section 129 of the 2008 Companies Act, was an indication that the respondent intended to avoid payment of the amount due to the applicant. The counterapplication was postponed. The court set aside the section 129 resolution and the resolution to appoint the business rescue practitioner.

Any creditor who believes that the resolution has been ill-considered by the board of directors could apply to court to set aside the section 129 resolution on the abovementioned grounds. It would be difficult for a creditor to show that the company is not financially distressed.[245] Creditors would, however, have seen the sworn statement of facts setting out the grounds on which the board resolution was founded.[246] Creditors would certainly be able to attack the grounds of the board resolution if it appears that there is no reasonable prospect of rescuing the company.

The test for "reasonable prospect" has been dealt with extensively by our courts.

In *Johan Theron v Erf 2343 Houghton Estate Limited, Private SA DVD Distribution (FirstRand Bank intervening)*[247] Berridge J stated "there must be a 'reasonable probability' of the process succeeding".[248]

According to Berridge J:

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244. *Climax Concrete Products CC t/a Climax Concrete Products CC v Evening Flame Trading 449 (Pty) Ltd and Others* (812/2012) [2012] ZAECPEHC 39 (21 June 2012) 7 at para 17.

245. Access to the financial statements of the company by a creditor is prohibited in our law. However, in terms of section 31(3) of the 2008 Companies Act, trade unions can, through the CIPC, and under conditions as determined by the CIPC, be given access to company financial statements for purposes of initiating a business rescue process. Furthermore, a judgment creditor, in terms of section 31(2), if informed by the Sheriff of the High Court that there appears to be insufficient disposable property to satisfy that judgment, is entitled to demand a copy of the most recent annual financial statements of the company.

246. Section 129(3)(a) of the 2008 Companies Act.

247. *Johan Theron v Erf 2343 Houghton Estate Limited, Private SA DVD Distribution (FirstRand Bank intervening)*, Case No. 2011/28187, South Gauteng High Court, Johannesburg (14 June 2012) (unreported).

248. Berridge AJ analysed the meaning of "a reasonable prospect" with reference to section 131(4) of the 2008 Companies Act. Although the Judge was not considering the identical wording found in section 130(1)(a)(ii), it is submitted that our courts, when determining the meaning of the section, will adopt a similar approach.

> [t]he concept of there being a "prospect" is, according to ordinary grammatical meaning, something less than a "probability". The Oxford English Dictionary defines a "prospect" as "the possibility or likelihood of some future event occurring".

Berridge AJ confirmed that:

> despite the lower threshold for which the 2008 Act provides, an applicant for the commencement of business rescue proceedings still has to satisfy the Court that there is a reasonable prospect of rescuing the business of the company.

Berridge AJ was critical of the attempts made by the applicant to "simply regurgitate the wording of the 2008 Act when attempting to demonstrate the benefits which may result from business rescue". The application for business rescue was dismissed and the Court ordered the winding-up of the close corporation.[249]

Thus, in order to set aside a section 129 resolution, a creditor would have to challenge the allegations set out in the sworn statement and place facts before the court supporting the conclusion that the company is not in fact a candidate for business rescue and that such company should rather be placed into liquidation.

In terms of section 130(4), any affected person has a right to participate in the hearing of an application in terms of section 130.[250] This would include trade unions who could intervene to insist on the company remaining in the business rescue process.[251]

The setting aside of a section 129 resolution is dealt with in terms of section 130(5) as follows:

> When considering an application in terms of subsection (1)(a) to set aside the company's resolution, the Court may –
>
> (a) set aside the resolution –
>
> (i) on any grounds set out in subsection (1); or

249. Berridge AJ further set out the manner in which parties could intervene in an application in terms of section 131 of the 2008 Companies Act. In this matter, FirstRand Bank Limited intervened and relied on section 130(4) of the 2008 Companies Act. Berridge AJ ruled that although the reliance on such section was misplaced (as no resolution had been passed by the relevant company), this did not preclude FirstRand Bank Limited from relying on section 131(1) of the 2008 Companies Act to intervene in the business rescue proceedings. Section 131(3) of the Act states that each affected person has the right to participate in the hearing of an application in terms of section 131.

250. See *Engen Petroleum Ltd v Multi Waste (Pty) Ltd* 2012 (5) SA 596 (GNP) 26–27 at para 46.

251. Trade unions would be motivated to ensure that a company remains under business rescue (rather than being placed in liquidation by the court) as, in terms of section 135, employees are ranked as "post-commencement financiers". They are elevated to "superpriority" creditors in a business rescue and would be paid before any other creditor in business rescue, save for the business rescue practitioner.

(ii) if, having regard to all of the evidence, the Court considers that it is otherwise just and equitable to do so;

(b) afford the practitioner sufficient time to form an opinion whether or not –

(i) the company appears to be financially distressed; or

(ii) there is a reasonable prospect of rescuing the company,

and after receiving a report from the practitioner, may set aside the company's resolution if the Court concludes that the company is not financially distressed, or there is no reasonable prospect of rescuing the company; and

(c) if it makes an order under paragraph (a) or (b) setting aside the company's resolution, may make any further necessary and appropriate order, including–

(i) an order placing the company under liquidation; or

(ii) if the Court has found that there were no reasonable grounds for believing that the company would be unlikely to pay all of its debts as they became due and payable, an order of costs against any director who voted in favour of the resolution to commence business rescue proceedings, unless the Court is satisfied that the director acted in good faith and on the basis of information that the director was entitled to rely upon in terms of section 76(4) and (5).

The court can, in the course of hearing a section 130 application, place the company into liquidation,[252] or order a director to pay the costs of the setting aside section 130 application if the court finds that there were never any reasonable grounds to support a conclusion that the company was financially distressed.[253]

A further ground to set aside a resolution would be if the practitioner appointed did not satisfy the requirements of section 138, was not independent or lacked the necessary skills, having regard to the company's circumstances. This further ground is a repetition of what is found in section 138(1)(e), which refers to the fact that a practitioner will not be appointed if he or she has a relationship with the company that compromises such practitioner's impartiality or objectivity. These are therefore already grounds for the practitioner's removal provided for in section 138(1)(e). In any event, a practitioner's lack of independence is also a ground to set aside the section 129 resolution.

252. Section 130(5)(c)(i) of the 2008 Companies Act.

253. For an analysis of a section 130 application setting aside a section 129 resolution, see *FirstRand Bank Ltd v Deoland Investments (Pty) Ltd* (18125/13) (4 April 2014) (WCC).

Section 130(1)(c) allows an affected person to apply to court to order that the practitioner puts up security, in an amount and on terms and conditions that the court considers necessary, to secure the interests of the company and any affected persons. Strangely, it is only the practitioner nominated in terms of a section 129 resolution who may be required to put up security upon application to court brought by an affected person. A court-appointed practitioner does not have to put up security. Whether this was an oversight on the part of the legislature is unknown.[254]

In the matter of *Absa Bank Ltd v Golden Dividend 339 (Pty) Ltd*, *Etienne Naude NO, Companies and Intellectual Property Commission*[255] the court had to consider, *inter alia*, an application to set aside a section 129 resolution in terms of section 130(1)(a)(ii), alternatively section 130(5)(a)(ii). The applicant further sought an order declaring that the business rescue proceedings had terminated and that the company be placed in liquidation in the hands of the Master. The court had to deal with various issues, *inter alia*, whether creditors of the company had to be joined in the proceedings, extensions of time for meetings, the contents of the business rescue plan, the validity of the adoption of the plan and the veracity of the business rescue practitioner's remuneration. Having considered all of these compliance issues, the court set aside the section 129 resolution, terminated the company's business rescue proceedings, placed the company into final liquidation and declared the agreement dealing with the practitioner's remuneration to be invalid.

In *DH Brothers Industries (Pty) Ltd v Gribnitz NO and Others*[256] the court considered the grounds provided by section 130(1)(a) which would support a basis to set aside a section 129 resolution. The court held that each of these grounds must be evaluated at the time of considering the application, rather than at the time the resolution was taken. This is because the first two grounds are formulated in the present tense and the third ground is based on procedural requirements. The procedural requirements relate mostly to actions to be taken after the date of the resolution within specified time periods. These include filing

254. See Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 1 (2010) 3 *TSAR* 508–509; Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-31– 8-32 at para 18.4.2.3. The curious aspect of this provision is that it is only the practitioner who has been nominated by the board of directors (section 129) who has to put up security. If this aspect is not challenged under a voluntary business rescue proceeding, the practitioner may never be required to furnish security for the proper performance of his or her duties. A practitioner appointed in terms of a compulsory business rescue will never be required to furnish security for the proper performance of his duties.

255. *Absa Bank Limited v Golden Dividend 339 (Pty) Ltd and Others* 2015 (5) SA 272 GP.; *Absa Bank Limited v Naude NO (Louis Pasteur Holdings (Pty) Limited Affected Party)* 2015 (5) SA 272 (GP). These cases are useful in that it deals with a number of practical and statutory compliance issues which, if not met, could result in a company being placed into liquidation.

256. *DH Brothers Industries (Pty) Ltd v Gribnitz NO and Others* 2014 (1) SA 103 (KZP).

the resolution, publishing the resolution to affected persons, appointing a business rescue practitioner, filing a notice of appointment and publishing a copy of the appointment to each affected person. The application is therefore not based on whether there was an adequate basis to take the resolution at the time it was taken.[257]

Additionally, the court held that a court could not set aside a resolution "having regard to all of the evidence" if the court believes that it is otherwise just and equitable to do so. Thus, the court is empowered to set aside a resolution on the four grounds set out in section 130(1), but an applicant is only entitled to base an application on one or more of three grounds. In other words, an application cannot be based on the fourth ground of being "just and equitable" because the application would not qualify as one brought in terms of section 130(1)(a).[258]

In the *DH Brothers* case, the court held that in order "to avoid an absurdity" the just and equitable basis should be construed as one additional ground to the three listed in section 130(1)(a). Thus, the just and equitable basis can be used to set aside a resolution as a fourth ground or cause of action for relief in an application brought under that section.[259] However, this view was overruled in *Panamo Properties (Pty) Ltd v Nel and Another NNO*,[260] where the court ruled that noncompliance by a company with the requirements of subsections 129(3) and (4) of the 2008 Companies Act does not automatically result in the business rescue being terminated. Such noncompliance is, however, a ground for bringing an application to court to set aside the resolution in terms of section 130(1)(a)(iii) on the ground that it is just and equitable to do so in terms of section 130(5).

In *Resource Washing (Pty) Ltd v Zululand Coal Reclaimers Proprietary Limited and Others*[261] the meaning of "just and equitable" as set out in section 130(5)(a)(ii) was also considered:

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257. Ibid 7–8 at paras 11–12. For an analysis of the grounds set out in section 130(1)(a) see pp. 8–22 at paras 13–14. Also see *Finance Factors CC v Jayesem (Pty) Ltd and Others* (5304/2013) [2013] ZAKZDHC 45 (22 August 2013) for section 130 (1)(a) grounds to set aside a resolution on the grounds that there is no reasonable basis for believing that the company is financially distressed, that there is no reasonable prospect of rescuing the company or that the company has not satisfied the procedural requirements set out in section 129. Also see *De Bruyn v Conradie and Others* (18679/11 and 4455/14) [2014] ZAWCHC (31 March 2014).

258. *DH Brothers Industries (Pty) Ltd v Gribnitz NO and Others* 2014 (1) SA 103 (KZP) 11 at para 17.

259. Ibid 12 at para 18.

260. *Panamo Properties (Pty) Ltd and Another v Nel NO and Others* 2015 (5) SA 63 (SCA).

261. *Resource Washing (Pty) Ltd v Zululand Coal Reclaimers Proprietary Limited and Others* (10862/14) [2015] ZAKZPHC 21 (20 March 2015).

> DH Brothers highlights difficulties in interpreting and applying the 'just and equitable' discretion of the court in s 130(5)(a)(ii). Challengingly at this nascent stage of the development of the Act the 'just and equitable' power that s 130(5)(a)(ii) confers on courts injects a degree of flexibility necessary to cater for the numerous circumstances that can arise to justify or not justify setting aside the resolution. A just and equitable power can work in favour of or against the company in business rescue. As the court is so empowered anyone seeking to invoke such power must lay the factual and legal basis for invoking it. I doubt that any litigant who sets out a compelling basis for invoking the court's just and equitable powers can justifiably suffer the striking off of its pleadings.[262]

In *Absa Bank Ltd v Naude NO*,[263] the SCA ruled that creditors of a company under business rescue must be joined in an application for an order that the decision taken at the meeting of creditors approving the business rescue plan for the company was lawful and valid. The creditor (Absa Bank Ltd) argued that notice of the application had to be given to all affected parties as is required in terms of section 130(3)(a) and (b) of the 2008 Companies Act.[264]

It is submitted that directors must be cognisant of the high duty of good faith set by the court when they consider passing a resolution in terms of section 129(1) of the 2008 Companies Act for business rescue. Section 130(5)(c) requires an element of "good faith" on the part of directors where it is expected that directors have a legitimate business purpose in resolving to place the company under business rescue. In *Griessel and Another v Lizemore and Others*,[265] the requirement of good faith was considered in the context of an application brought in terms of section 130(5) as read with section 130(1)(a).[266] Section 130(5)(a)(ii) states that the court may set aside the resolution, firstly on any grounds set out in section 130(1)(a) or, having regard to all the evidence, if the court considers that it is otherwise "just and equitable" to do so. The court considered the "good faith" requirement

262. Ibid at para 64. Similarly in liquidation applications where the presiding judge has a discretion to order a winding up, judges hearing business rescue applications should also be given some leeway (discretion) by implementing the concept of "just and equitable" deliberations in exercising their discretion in granting a business rescue order.

263. *Absa Bank Ltd v Naude NO* 20264/2014 [2015] ZASCA 97 (1 June 2015).

264. In terms of section 130(3)(a) and (b), when any application is brought in terms of section 130(1) a copy of the application must be served on the company and the Commission, and further each affected person must be notified of the application in the prescribed manner. If creditors were not joined their rights would be materially prejudiced. The court ruled that the reasons for insisting on joinder of all creditors was that the setting aside of such a plan would require each creditor to return all monies that were paid to it pursuant to such plan.

265. *Griessel and Another v Lizemore and Others* 2015 (4) ALL SA 433 (GJ).

266. Section 130(5) of the 2008 Companies Act, sets out what must be considered in an application brought in terms of section 130(1)(a) in setting aside a resolution for business rescue.

that must be implicit in the scheme of Chapter 6 which seeks to balance the interests of affected parties including creditors and employees.[267]

In terms of section 130(5)(c)(ii), if directors pass a resolution where there were no reasonable grounds for believing that the company would be unlikely to pay all of its debts as they became due and payable, then in such an instance, the court would order costs against any director who voted in favour of such a resolution, unless the court is satisfied that the director acted in good faith and on the basis of information that the director was entitled to reply upon in terms of sections 76(4)(and (5). Section 76(4), *inter alia*, sets out the basis upon which a director is expected to take "reasonably diligent steps to become informed about the matter". Section 76(5) sets out the basis upon which a director is entitled to rely on employees of the company when providing him/her with information about the company; as well as upon information provided by legal counsel, accountants, or other professional persons.[268]

Thus the "good faith" element on the part of directors must be taken into account when the court considers the need to set aside a resolution in terms of the "just and equitable" requirement set out in section 130(5)(a)(ii).[269] The court found that the director had taken the resolution "behind the backs" of the shareholders when the director knew that they, as majority shareholders, were entitled to have a director on the board and who clearly would not have supported business rescue.[270] The court also found that there was no concrete evidence to demonstrate that the company would be unable to pay all of its debts when they became due within a period of six months, particularly as it was in the process of obtaining funding from its bankers.[271] In this instance, the court found that it was "just and equitable' to set aside the resolution under section 130(5)(a)(ii).[272]

It is further submitted that section 130 provides a protection mechanism in a situation where directors seek to abuse the section 129 resolution entry into business rescue. Many

267. *Griessel and Another v Lizemore and Others* 2015 (4) ALL SA 433 (GJ) 453–454.

268. See section 76 of the 2008 Companies Act and comments by Meskin et al *Henochsberg on the Companies Act 71 of 2008* (2011+) 298(4) –298(6).

269. See discussion in *Griessel and Another v Lizemore and Others* 2015 (4) ALL SA 433 (GJ) 453–454.

270. Ibid 461.

271. Ibid 459. Also see *Commissioner of South African Revenue Service v The Business Zone 983 CC* 9673/2015 [2015] WCC (7 September 2015) (unreported). Here the court held that where a business rescue process is abused and it does not support a genuine attempt to achieve the efficient rescue and recovery of a financially distressed company in a manner that balances the rights and interests of all relevant stakeholders, it is just and equitable that the resolution be set aside in terms of section 130(5)(a).

272. *Griessel and Another v Lizemore and Others* 2015 (4) ALL SA 433 (GJ) 115–131.

directors pass section 129 resolutions merely to obtain the benefits of the moratorium provided by section 133. Many of these directors do not give cognisance to the fact that in addition to the recognition that a company is financially distressed, the board also needs to consider the proposition that there must be a reasonable prospect of rescuing the company. It is this latter requirement that would generally be the subject matter of the section 130 application, specifically where the company cannot realistically be rescued and when such company should in fact be placed into liquidation.

7.3.3 COMPULSORY COMMENCEMENT

In terms of section 131(1), unless a company has adopted a resolution in terms of section 129, an affected person may apply to court at any time for an order placing the company under supervision and commencing business rescue proceedings.[273] Each affected person has a right to participate in the hearing of an application in terms of this section.[274]

Since the date of the commencement of the 2008 Companies Act on 1 May 2011, the great majority of court applications for business rescue have been in terms of section 131(1) of the 2008 Companies Act which have been dealt with by our courts. It is necessary to examine the manner in which the courts have considered the threshold of entry into the business rescue process in order to appreciate the extent of the contribution that the judiciary has made to the development of business rescue precedent from 2011 to date. Such an analysis appears below.

Generally, applications for intervention (mostly by the banks) have resulted in applications for business rescue failing, and an order being granted by the court for a liquidation (either provisional or final winding-up).[275] Certainly, many applications for intervention have also been brought by affected persons where the company is the subject of a liquidation

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273. In respect of a court's jurisdiction to hear a business rescue application, see *De Bruyn v Conradie and Others* (18679/11 and 4455/14) [2014] ZAWCHC (31 March 2014). Here the court concurred with the judgment of Binns-Ward J in *Sibakhulu Corporation (Pty) Ltd v Wedgewood Village Golf Country Estate (Pty) Ltd (Nedbank Ltd intervening)* 2013 (1) SA 191 (WCC), where the question of the jurisdiction of the High Court came under scrutiny. The court held that it would have jurisdiction to determine the liquidation or business rescue application of a company whose principal place of business and/or registered office is situated in its area of jurisdiction. Also see *Lonsdale Commercial Corporation v Kimberley West Diamond Mining* (312/2012) [2013] ZANCHC 11 (17 May 2013) and *Philippus Johannes de Bruyn v Grandselect 101 (Pty) Ltd and 1 Other* (NCK) Case No. 1961/2013.

274. Section 131(4)(b) of the 2008 Companies Act. For a synopsis of compulsory commencement see Van der Walt "A Turnaround Practitioner's View of New Business Rescue Legislation" in Harvey (ed) *Turnaround Management and Corporate Renewal: A South African Perspective* (2011) 156. Also see Rushworth "A Critical Analysis of the Business Rescue Regime in the Companies Act 71 of 2008" (2010) *Acta Juridica* 380–382.

275. Section 131(4)(b) of the 2008 Companies Act: the Court can dismiss the application for business rescue and place the company under liquidation.

application and the affected person intervenes and moves for an order staying the liquidation proceedings while business rescue proceedings are introduced in terms of the provisions of Chapter 6.[276]

Neither the company nor the directors (in their capacity as such) are authorised to apply for a business rescue order. The exclusion of both the board and individual directors from applying for a business rescue order is regrettable since no board resolution to commence rescue proceedings may be taken after liquidation proceedings have been initiated, even if the board is convinced that the company can be rescued.[277]

What makes it even more difficult for directors is that if a director believes that the company is financially distressed and should be placed under business rescue, but is outvoted by other directors, such a director will not be able to apply to court in his or her capacity as a director for a business rescue order.[278]

Since a director can be held personally liable to the company for damages because he or she "acquiesced" in the company's trading recklessly or with intent to defraud creditors, the risk of the personal liability of directors increases.[279]

In a ground-setting case,[280] *Cape Point Vineyards (Pty) Ltd v Pinnacle Point Group Ltd and Another (Advantage Projects Managers (Pty) Ltd Intervening)*, Rogers AJ dealt with section 131(3) and confirmed that each affected person has a right to participate in the hearing of an application in terms of section 131. Dealing with whether or not it was necessary for an affected party to have to bring an application for leave to intervene, the Judge stated:

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276. Section 131(4)(b) of the 2008 Companies Act. If liquidation proceedings have already been commenced by or against the company at the time an application is made in terms of subsection (1), the application will suspend those liquidation proceedings until the Court has adjudicated upon the application (for business rescue proceedings in terms of section 131(1)); or the business rescue proceedings end if the Court makes the order applied for (for liquidation).

277. See section 129(2)(a) of the 2008 Companies Act. See Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions (Part 1)" (2010) 3 *TSAR* 509. Section 131(1) of the 2008 Companies Act provides that an affected person may apply to court at any time for an order placing a company under business rescue. In the matter of *Richter NO v Bloempro CC and Others* 2014 (6) SA 38 (GP), the court considered whether such an application could be brought after final liquidation. The court held that business rescue proceedings and final liquidation were incompatible concepts requiring different considerations. The legislature intended for the former to commence before the latter was ordered. It follows that a business rescue application was not in law possible after a final liquidation order had been made unless that order was set aside on appeal, and that the "liquidation proceedings" (that a business rescue order would suspend) referred to section 131(6), did not include a final liquidation order.

278. Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 1 (2010) 3 *TSAR* 509.

279. Ibid.

280. *Cape Point Vineyards (Pty) Ltd v Pinnacle Point Group Ltd and Another (Advantage Projects Managers (Pty) Ltd Intervening)* 2011 (5) SA 600 (WCC).

> I do not think the legislature contemplated that an affected party would have to apply for leave to intervene in the proceedings. If the person is an 'affected person', such person has a right to participate in the hearing. If the person wishes to file affidavits, the Court will obviously need to regulate the procedure to be followed to ensure fairness to all concerned.[281]

Generally, affected persons (despite Rogers AJ's judgment) continue to make application for leave to intervene in applications either for the winding-up of the company, in an attempt to convert these proceedings into a business rescue proceeding[282] or, alternatively, bringing an application to intervene in a business rescue application, in an attempt to obtain an order for such company's winding-up.[283]

In terms of section 131(4), after considering an application in terms of subsection (1), the court may –

> (a) make an order placing the company under supervision and commencing business rescue proceedings, if the Court is satisfied that –
>
> (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.

Section 131(4) sets out the basis of the court's discretion in dealing with applications for business rescue.[284] Clearly, if the company is financially distressed in terms of section 128(1)(f), it is a candidate for a business rescue order. Failure to pay monies in terms of public regulation or contract is a fairly vague reference and one which has not yet been interpreted by our courts. "Public regulation" may be a reference to municipal services such as water, electricity and other utility services. A failure to pay an amount in terms of a "contract" is very vague and left open for interpretation by the court. The failure

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281. Ibid 606 at para 2.1.
282. Section 131(6) of the 2008 Companies Act.
283. Section 131(4)(b) of the 2008 Companies Act.
284. For a critical analysis of section 131(4), see 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, University of Johannesburg 2013, available at https://ujdigispace.uj.ac.za 20–40. The author concludes (pp. 41–42) that our courts have shown a willingness to engage the new business rescue procedure and exercise its discretion in appropriate circumstances. As a general rule, the company going into business rescue should present objectively ascertainable details showing that the company has a reasonable prospect of being rescued successfully.

to pay amounts due in terms of "employment-related matters" must refer to unpaid wages or salaries in the employment context. This is a clear opening for trade unions and employees to make applications for compulsory business rescue proceedings in circumstances where they do not have information relating to whether or not the company is financially distressed. The provisions of section 31(3) of the 2008 Companies Act specifically allow trade unions, through the CIPC, and under conditions as determined by the CIPC, to be given access to company financial statements for purposes of initiating a business rescue process.

At all times, the court must be persuaded that "there is a reasonable prospect of rescuing the company". Failure to do so will result in the court dismissing the application, together with any further necessary and appropriate order, including an order placing the company into liquidation.

Section 131(4)(a)(ii) refers to the ground of a business rescue order being granted if "it is otherwise just and equitable to do so for financial reasons". Again, the 2008 Companies Act does not provide us with any guidelines to what is meant by this phrase. If a company is financially distressed, it would appear that the addition of the "just and equitable" ground is tautologous. In *Panamo Properties (Pty) Ltd v Nel and Another NNO*[285] the court ruled that it had a discretion to consider on the grounds of equity and justice in the light of all the evidence, as to whether the resolution should be set aside on a just and equitable basis and in terms of section 130(5)(a)(ii) of the 2008 Companies Act.[286]

The guiding principle always appears to come back to the catch-all phrase that there is a *reasonable prospect* of rescuing the company. In this regard, our courts have carefully analysed what is meant by this terminology.

It is submitted that our courts have made a remarkable contribution in considering business rescue (intervention) applications where our judges have been called upon to opine on the mechanisms and level of entry (burden of proof) required in a section 131 application. Our judges have, in this regard, assisted us dramatically in developing the law and setting the

285. *Panamo Properties (Pty) Ltd and Another v Nel NO and Others* 2015 (5) SA 63 (SCA). See Elliot and Weyers "Hot off the business rescue press" (July 2015) *Without Prejudice* 10–11.

286. *Panamo Properties (Pty) Ltd and Another v Nel NO and Others* 2015 (5) SA 63 (SCA) paras 30–31.

thresholds for entry into a business rescue process. A careful interpretation of the standards set by section 131(4) is required.

In one of the very first judgments dealing with section 131(4)(a), *Swart v Beagles Run Investments 25 (Pty) Ltd (four creditors intervening)*,[287] Makgoba J dealt with the grounds of section 131(4) and whether the intervening creditor, FirstRand Bank Limited, should be granted its order for the winding-up of the company. The Judge compared the provisions of section 131(4) to those of section 427(1) of the 1973 Companies Act and stated that what must be reasonably probable is that the company is viable and capable of ultimate solvency and that it will, within a reasonable time, become a successful concern.[288]

The Judge analysed the evidence placed before him in the court papers and stated that it was required of him to exercise his discretion as to whether to order business rescue and whether the requirements set out in section 131(4)(a)(i) to (iii) of the 2008 Companies Act had been fulfilled.[289] He went on to say:

> Where an application for business rescue, as was the case in applications for judicial management, entails the weighing up of the interests of the creditors and the company … the interests of the creditors should carry the day.[290]

The Judge concluded that there was no basis for contending that the company would be able to carry on business on a solvent basis and that, in his view, there was no prospect of that occurring. The Judge held that no case had been made out for the granting of a business rescue where such a process would place creditors in a better position than they would be in the case of a winding-up.[291]

The Judge went on to state:

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287. *Swart v Beagles Run Investments 25 (Pty) Ltd (four creditors intervening)* 2011 (5) SA 422 (GNP). See Tselane *The Requirements for Business Rescue Proceedings Under the Companies Act 71 of 2008, as discussed in Swart v Beagle Run Investments 25 (Pty) Ltd (four creditors intervening) 2011 (5) SA 422 GNP* (LLB article, University of South Africa 2012, available at http://www.unisa.ac.za.

288. *Swart v Beagles Run Investments 25 (Pty) Ltd (four creditors intervening)* 2011 (5) SA 422 (GNP) 428 at para 23.

289. Ibid 431 at para 37.

290. Ibid. The Judge's statement is, with respect, somewhat controversial. It is submitted that the whole purpose of business rescue is, in fact, to focus on the company and its ability to be rescued. If creditors have to have their claims compromised, then that should occur. In fact, it is submitted that, as in the US, where the interests of the debtor company are paramount, such a mind-shift in the minds of our judiciary should become prevalent. Clearly the court in this matter continued to cling to the pro-creditor culture prevalent in South Africa in the period pre-2011. See discussion in Chapter 5, para 5.4.

291. Ibid para 42.

> I cannot and do not accept that, if there was a genuine and bona fide intention to rescue the entities … no steps whatsoever have been taken to reduce or even curtail that indebtedness which continues to mount.[292]

In the judgment of *Southern Palace Investments 256 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd*,[293] Eloff AJ compared the provisions of section 42 (judicial management) of the 1973 Companies Act to the new business rescue procedure. Section 427 referred to "reasonable probability", while section 131(4) of the 2008 Companies Act refers to "a reasonable prospect". In dealing with the difference between the two sections, the Acting Judge stated that the language used in section 131(4) indicates something less is required than that the recovery should be a reasonable probability. In the judicial management application, an order would only be granted in exceptional circumstances; in business rescue it is the opposite – business rescue is preferred to liquidation. Notwithstanding, the court still has a discretion not to grant the order. The court should avoid the mindset (from the earlier judicial management regime) that a creditor is entitled *ex debito justitiae* to be paid or to have the company liquidated.[294]

Eloff AJ considered the term "reasonable prospect" as referred to in section 131(4) and referred to section 427(1) of the 1973 Companies Act as a "rather cumbersome and ineffective procedure … provided for reviving ailing companies".[295] The Judge contrasted the words "reasonable prospect" found in section 131(4) with "reasonable probability" found in section 427(1) of the 1973 Act.

Eloff AJ was not convinced that the applicant had set out a "concrete plan" for consideration. He referred to "vague and undetailed information" which did not support "any prospect of the business of the respondent being restored to a successful one".[296]

Eloff AJ was of the view that every case should be considered on its own merits. The objective is to propose a business rescue plan that will have a reasonable prospect of success and should deal with the cause of the demise of the company's business and offer a remedy that has a reasonable prospect of being sustainable. One should avoid prolonging

292. Ibid para 24.
293. See *Southern Palace Investments 256 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd* 2012 (2) SA 423 (WCC).
294. Ibid 431 at paras 21–22.
295. Ibid.
296. Ibid.

the agony by substituting one debt for the other, and one should provide "concrete and objectively ascertainable detail going beyond mere speculation". This should include:[297]

- the likely costs of rendering the company able to commence with its intended business, or to resume the conduct of its core business;
- the likely availability of the necessary cash resource in order to enable the ailing company to meet its day-to-day expenditure, once its trading operations commence or are resumed. If the company will be reliant on loan capital or other facilities, one would expect to be given some concrete indication of the extent thereof and the basis or terms upon which it will be available;
- the availability of any other necessary resource, such as raw materials and human capital;
- the reasons why it is suggested that the proposed business plan will have a reasonable prospect of success.

The application for business rescue was thus dismissed. Clearly, due care must be taken to include all relevant detail when preparing the plan relevant to the restructuring of the company in business rescue. Failure to do so could result in a dismissal of the application.

A distinction must be drawn between the position where the board adopts a resolution to place the company under supervision under section 129(1) and that where an affected person brings an application to place the company under supervision in terms of section 131. In the case of a voluntary business rescue resolution, the board will have full knowledge of the company's financial situation, what it is capable of achieving and what would reasonably be required to rescue the company. This is in contrast to the knowledge of the company's affairs that an affected person may have when an application is brought under section 131(4). Such a person (i.e. an employee, creditor or shareholder) would not necessarily have the information required to meet the requirements laid down by the court in the *Southern Palace Investments* case.[298]

The *dicta* of Eloff AJ have been followed in numerous subsequent cases.

In *Koen and Another v Wedgewood Village Golf & Country Estate (Pty) Ltd*,[299] Binns-Ward J compared the elements that had been historically required to support an application

297. Ibid 432 at paras 24–24.4.
298. Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-34 at para 18.4.3.
299. *Koen and Another v Wedgewood Village Golf & Country Estate (Pty) Ltd & Others* 2012 (2) SA 378 (WCC) 382–383.

for judicial management as opposed to that for business rescue. He commented that the requirements for a business rescue order were materially different to those which were applicable in a judicial management. The "collateral damage" of a liquidation was something to be avoided and it was in the public interest to avoid the socioeconomic consequences that would occur. Business rescue should be a process which serves the public interest by providing a remedy to avoid the deleterious consequences of liquidations in cases where there was a prospect of salvaging the business of a company in financial distress or by providing a better return to creditors that would probably be achieved in a liquidation.[300]

The court confirmed that a section 131(4) application required supporting and cogent evidence that reflected that there was a reasonable prospect that the subject company could be rescued. While a practitioner is obligated to ultimately draw up a business rescue plan, the founding papers must contain sufficient factual detail to enable the court to determine whether the practitioner will have a viable basis, after investigation, to undertake the rescue. Vague and speculative averments in the founding papers will not suffice.[301]

As is evident from the judgment of Binns-Ward, it is submitted that our courts have adopted the modern (international) corporate rescue approach of focusing on whether or not the entity would continue to have value as a going concern if it were to be rescued and when compared to the recovery in a liquidation.

In *AG Petzetakis International Holdings Limited v Petzetakis Africa and 5 Others (Marley Pipe Systems (Pty) Ltd, NUMSA intervening)*,[302] Coetzee AJ dealt with an application to intervene by affected parties (including a trade union) into an application for the winding-up of Petzetakis Africa (Pty) Ltd.[303] The Judge confirmed that the requirement for a reasonable prospect in section 131(4)(a) of rescuing the company *must be present*. This must be the case for all three of the subsections to 131(4)(a).[304]

300. Ibid 382.
301. Ibid 385.
302. *AG Petzetakis International Holdings Ltd v Petzetakis Africa (Pty) Ltd and Others (Marley Pipe Systems (Pty) Ltd and Another Intervening) 2012 (5) SA 515 (GSJ) Absa Bank Limited v Caine NO, In Re; Absa Bank Limited v Caine NO and Another* (3813/2013, 3915/2013) [2014] ZAFSHC 46 (2 April 2014).
303. Ibid at para 14.
304. Ibid 521 at para 17. The Judge was of the view that the intention of the legislature was to ensure that in order for a section 131 rescue order to be made, the company under consideration must have a reasonable prospect of recovery. Once a company is under business

Coetzee AJ concurred with the *dictum* of Eloff AJ in *Southern Palace Investments*[305] and confirmed that the alternative purpose may be sufficient at the time of the section 131 application, but should be dealt with in the founding papers.[306]

In dismissing the application for business rescue, the learned Judge stated that the court papers did not demonstrate the existence of a reasonable prospect that the company could successfully be rescued.[307] On the contrary, the founding papers reflected a company which was beyond rescue unless it received a "financial injection" and it appeared that this was not a reasonable probability. The Judge went on to state that it did not appear that there was a reasonable prospect that the company would be saved or that the alternative object of providing a better return to creditors than in a liquidation could be achieved.[308]

A leading case on the topic of section 131 is *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others; Farm Bothasfontein (Kyalami) (Pty) Ltd v Kyalami Events and Exhibitions (Pty) Ltd and others*.[309] Before delving into the test for what is meant by "a reasonable prospect for rescuing the company" (section 131(4)), Claassen J dealt with what is meant by the phrase "it is otherwise just and equitable to do so for financial reasons"[310] and stated that the words used were extremely vague:

> The immediate question arises: "for financial reasons" of whom, the company, the creditors, shareholders or the employees? Since the company cannot apply to Court for a business order, as it is not an "affected person", one can immediately say that the financial reasons of the company are not referred to. However, that would render this provision absurd as it is primarily the financial health of the company which is at stake. I have little doubt that the Legislature never intended such absurdity. I would, therefore, hold that financial reasons relating to all the stakeholders, except that of the

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rescue, its rescue plan may be aimed then at the alternative object, namely, a better return than the return of immediate liquidation (the second part of the definition).

305. *Southern Palace Investments 256 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd* 2012 (2) SA 423 (WCC).

306. *AG Petzetakis International Holdings Ltd v Petzetakis Africa (Pty) Ltd and Others (Marley Pipe Systems (Pty) Ltd and Another Intervening)* 2012 (5) SA 515 (GSJ) *Absa Bank Limited v Caine NO, In Re; Absa Bank Limited v Caine NO and Another* (3813/2013, 3915/2013) [2014] ZAFSHC 46 (2 April 2014) at para 18.

307. Ibid 520 at para 12.

308. Ibid 521 at para 23.

309. *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others; Farm Bothasfontein (Kyalami) (Pty) Ltd v Kyalami Events and Exhibitions (Pty) Ltd and others* 2012 (3) SA 273 (GSJ).

310. Ibid 281 at para 17.

> practitioner, contemplated in the business rescue provisions, are to be considered by the Court when applying this provision.[311]

The Judge then dealt with the meaning of "reasonable prospect for rescuing the company" and concurred with the views of Eloff AJ in *Southern Palace Investments 256 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd*[312] in that "something less is required than that the recovery should be a reasonable probability". The Judge added that, in his view, a section 131 order should be granted if the facts indicate a "reasonable possibility of a company being rescued". The Judge referred to Loubser[313] where she stated that the use of the judicial management test of "reasonable probability" would be disastrous if used in the new business rescue procedure.

The Judge stated the following:

> The philosophy underlining the grant of a business rescue order contemplates that the Court cannot 'second guess' the rescue plan which will ultimately be approved by the creditors' meetings. It would seem to me that this conclusion is in line with the intention of the Legislature to prevent the negative impact on economic and social affairs by rescuing companies rather than liquidating companies. I would respectfully agree with Eloff AJ that the intention was to legislate for business rescue as a 'preferred' solution to companies in distress. Each case will, however, have to be adjudicated on its own facts.[314]

The matter was heard by the SCA on appeal. In *Oakdene Square Properties (Pty) Limited and 3 Others v Farm Bothasfontein (Kyalami) (Pty) Limited and 2 Others*,[315] the SCA (judgment was delivered by Brand JA with four judges concurring) handed down a seminal judgment dealing with, *inter alia*, the requirements for an applicant to satisfy the requirement of a "reasonable prospect for rescuing the company" as set out in section 131 of the 2008 Companies Act.

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311. Ibid.
312. *Southern Palace Investments 256 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd* 2012 (2) SA 423 (WCC).
313. Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 1 (2010) 3 *TSAR* 506.
314. *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others; Farm Bothasfontein (Kyalami) (Pty) Ltd v Kyalami Events and Exhibitions (Pty) Ltd and others* 2012 (3) SA 273 (GSJ) 441 at para 19.
315. *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others* 2013 (4) SA 539 (SCA) confirmed on appeal. Also see the grounds for bringing a counterapplication for business rescue: *Kalahari Resources (Pty) Ltd v Arcelormittal SA and Others* [2012] 3 All SA 555 (GSJ) 571–578.

The Judges of Appeal referred to many of the judgments referred to above in their deliberations. The SCA ruled that a "reasonable prospect" must refer to a prospect based on reasonable grounds. A mere speculative suggestion is not enough:

> Self-evidently it will be neither practical nor prudent to be prescriptive about the way in which the appellant must show a reasonable prospect in every case. Some reported decisions laid down, however, that the applicant must provide a reasonable measure of detail about the proposed plan to satisfy this requirement.

Further it was stated that:

> The development of a plan cannot be a goal in itself. It can only be the means to an end. That end, as I see it, must be either to restore the company to a solvent going concern, or at least to facilitate a better deal for creditors and shareholders than they would secure from a liquidation process. I have indicated my agreement with the statement in Prospec that the applicant is not required to set out a detailed plan. That can be left to the business rescue practitioner after proper investigation in terms of s 141. But the applicant must establish grounds for the reasonable prospect of achieving one of the two grounds in s 128(1)(b).[316]

Clearly the court was of the view that a reasonable prospect needs to be dealt with in the application to court up to a point. The actual detail and workings of the business rescue which would deal with all of the mechanisms being proposed to restructure the company need not be specified in significant detail in the application, but should be left to the practitioner to deal with in the business rescue plan itself.

In the matter of *Nedbank Ltd v Bestvest 153 (Pty) Ltd; Essa & Another v Bestvest 153 (Pty) Ltd and Another (Companies and Intellectual Property Commission and Another intervening)*,[317] Gamble J had to deal with affected persons intervening in an application

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316. *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others* 2013 (4) SA 539 (SCA) 553. For an analysis of the term "reasonable prospect" as set out in section 131(1) of the 2008 Companies Act, see Joubert "'Reasonable possibility' versus 'reasonable prospect': Did business rescue succeed in creating a better test than judicial management?" (2013) 76 *THRHR* 550–563 where he states as follows:

> It is clear from the discussion above that the single most problematic factor that stands in the way of granting the business rescue orders, if the uncertainty experienced by the courts regarding the meaning of "reasonable prospect". It is submitted that one major reason for this uncertainty is the high bar that has been set by Eloff AJ in Southern Palace. Ever since, every decision dealing with a business rescue application where it was common cause that the company was financially distressed and the issue involved was whether there was a reasonable prospect that the company can be rescued, the guidelines as discussed by Eloff AJ were referred to. The reference made by Eloff AJ to the business rescue plan at that early commencement stage seems to have stuck in the minds of almost all later judges and that resulted in a threshold that is too high. One must remember that a similar high threshold, even though not exactly the same, caused judicial management to fail as a successful corporate rescue mechanism. It is submitted that the reasonableness approach that was started by Van der Merwe J in the *Propspec* decision and confirmed in the appeal case can be seen as a constructive approach to the many difficulties encountered in proving the recovery requirement. Even though a clear definition of the recovery requirement has not yet been developed by the courts, the bar has been lowered and a more versatile approach has been advocated that will surely enable the courts in future business rescue applications to deal with the recovery requirement in a swift and easy manner without placing the bar too high.

317. *Nedbank Ltd v Bestvest 153 (Pty) Ltd; Essa & Another v Bestvest 153 (Pty) Ltd and Another (Companies and Intellectual Property Commission and Another intervening)* [2012] 4 All SA 103 (WCC).

for the winding-up of a company. The affected persons moved for an order to place the company into business rescue in terms of section 131 of the 2008 Companies Act.

Gamble J confirmed his preference for interpreting the test for the successful granting of an order for business rescue to be that found by Eloff AJ in *Southern Palace*,[318] rather than that postulated by Makgoba J in *Swart v Beagles Run Investments 25 (Pty) Ltd*.[319] Gamble J emphasised the fact that judicial management had not been retained in the new dispensation.[320] As a result, the legislature has "signalled a deliberate intention to break from the past and abandon that earlier limited form of corporate rescue".

The Judge referred to various cases in interpreting the meaning of "reasonable prospect of success" and ruled that:

> A Court should not set the bar at such a height that the applicant for business rescue has little chance of clearing it and persuading the Court to exercise its discretion to grant supervision. As I have said, the test under section 427(1) of the old Companies Act for the granting of judicial management was more onerous since an applicant was required to persuade a Court that there was a "reasonable probability" that if placed under judicial management the company would be able to pay its debts, meet its obligations and ultimately become a successful business.[321]

Counsel for the intervening applicant for business rescue further argued that the papers must contain a summary of the proposed business rescue plan.[322] Counsel contended that only once this was set out in the papers, could a court decide whether there was a reasonable prospect of the company being saved from insolvency. The Judge disagreed with this contention:[323]

> It should be left up to the business rescue practitioner to formulate the rescue package once he/she has had an opportunity to properly assess the company, its prospects going forward and, most importantly, the reasons for its commercial distress.

318. *Southern Palace Investments 256 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd* 2012 (2) SA 423 (WCC) 431 at paras 20–22.
319. *Swart v Beagles Run Investments 25 (Pty) Ltd (four creditors intervening)* 2011 (5) SA 422 (GNP) 428 at paras 24–25.
320. While the extensive winding-up provisions of Chapter XIV of the 1973 Companies Act have been retained, the provisions of Chapter XV relating to judicial management have not.
321. *Nedbank Ltd v Bestvest 153 (Pty) Ltd; Essa & Another v Bestvest 153 (Pty) Ltd and Another (Companies and Intellectual Property Commission and Another intervening)* [2012] 4 All SA 103 (WCC) 111 at para 38.
322. Ibid 110–113.
323. Ibid 112 at para 40.

The Judge was firm in his view that this did not mean that an affected person can merely approach the court on "flimsy grounds", hoping that the duly appointed business rescue practitioner will provide a solution to the company's problems:

> The application must set out sufficient facts, if necessary augmented by documentary evidence, from which a Court would be able to assess the prospects before exercising its discretion.[324]

The Judge, having regard to all of the facts and circumstances, was not persuaded that there was a reasonable prospect of the company being rescued by the appointment of a business rescue practitioner, nor that it is just and equitable to do so for financial reasons.[325] The application for business rescue failed and the company was placed under provisional winding-up.

In *Johan Theron v Erf 2343 Houghton Estate CC (FirstRand Bank Limited intervening)*,[326] Berridge AJ dealt with an intervening application by FirstRand Bank Limited. Mr Theron had applied for the close corporation to be placed under supervision in terms of section 131 of the 2008 Companies Act. FirstRand Bank Limited moved for an order for the winding-up of the close corporation.

Berridge AJ deliberated over the concept of "a reasonable prospect for rescuing the company".[327] The Judge referred to previous cases and judgments and confirmed that the approach taken in the matters of *Southern Palace*, *Oakdene Square Properties* and *Koen* was correct and ought to be followed.[328]

In *Lidino Trading 580 CC v Cross Point Trading (Pty) Ltd , In re: Mabe v Cross Point Trading 215 (Pty) Ltd*,[329] Kruger J stated that in the case of a deadlock on the board of directors, liquidation is more appropriate than business rescue.[330] The Judge also noted that "no concrete plan [was] put forward".[331] As a result, a business rescue order was not

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324. Ibid 112 at paras 40–41.
325. Ibid 117 at para 60.
326. *Johan Theron v Erf 2343 Houghton Estate Limited, Private SA DVD Distribution (FirstRand Bank intervening)*, Case No. 2011/28187, South Gauteng High Court, Johannesburg (14 June 2012) (unreported) 4–5.
327. Ibid 18 at para 34.
328. Ibid 22 at para 39.
329. *Lidino Trading 580 CC v Cross Point Trading (Pty) Ltd , In re: Mabe v Cross Point Trading 215 (Pty) Ltd* (2130/2012) [2012] ZAFSHC 155 (23 August 2012).
330. Ibid 14 at para 20. Followed *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others; Farm Bothasfontein (Kyalami) (Pty) Ltd v Kyalami Events and Exhibitions (Pty) Ltd and others* 2012 (3) SA 273 (GSJ) 448 at para 49.
331. Ibid 16–17.

granted. The Judge also considered the prospects of post-commencement finance[332] and stated:

> The purpose of a business rescue plan is to grant an essential breathing space while a business rescue plan is being implemented (*Southern Palace,* para 3). In this case there is no question of a breathing space needed or the implementation of a business rescue plan. In this case a business plan will simply prolong the agony (*Southern Palace*, para 24). There is no indication of the likely cost of the business rescue, and where the money to pay the business rescue practitioner will come from.[333]

The company was placed into liquidation and the business rescue application dismissed. The court in this case emphasised the need to deal with the source and identification of post-commencement finance to ensure that expenses (including that of the practitioner) be paid, failing which there was no need for the company to be placed into business rescue.

In *Zoneska Investments (Pty) Ltd t/a Bonatla Properties (Pty) Ltd v Midnight Storm Investments 386 Ltd and Others (FirstRand Bank Limited as intervening creditor),*[334] Stelzner AJ considered section 128(1)(b)(iii) and section 131(4) of the 2008 Companies Act. The Judge held that in his view, "prospect" should be interpreted to mean "possibility".[335] In this matter, the applicant had argued that the test set out by Eloff AJ in *Southern Palace Investments 265 (Pty) Ltd*[336] "set the bar too high". The applicant for business rescue should *not* have to provide concrete details at the level indicated by the court in *Southern Palace*. The Judge held in *Southern Palace* that what was required were facts to be placed before the court as opposed to mere "speculative suggestions".[337]

Stelzner AJ stated as follows:[338]

> Each plan will need to be evaluated, based on the facts placed before the Court, as to the potential of the plan being workable and whether there is a reasonable possibility that the objectives contained in section 128 can be met.[339]

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332. Section 135 of the 2008 Companies Act.
333. *Lidino Trading 580 CC v Cross Point Trading (Pty) Ltd , In re: Mabe v Cross Point Trading 215 (Pty) Ltd* (2130/2012) [2012] ZAFSHC 155 (23 August 2012) 16.
334. *Zoneska Investments (Pty) Ltd t/a Bonatla Properties (Pty) Ltd v Midnight Storm Investments 386 Ltd and Others (FirstRand Bank Limited as intervening creditor)* [2012] 4 All SA 590 (WCC).
335. Ibid 598 at para 40.
336. *Southern Palace Investments 256 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd* 2012 (2) SA 423 (WCC).
337. Ibid 432 at para 25.
338. *Zoneska Investments (Pty) Ltd t/a Bonatla Properties (Pty) Ltd v Midnight Storm Investments 386 Ltd and Others (FirstRand Bank Limited as intervening creditor)* [2012] 4 All SA 590 (WCC).
339. Ibid 601 at para 54.

Judge Stelzner was of the view that the correct approach was to consider "whether there was a reasonable possibility of a greater return being achieved for creditors in terms of the plan".[340] He went on to analyse the various cases that had, at that time, already been considered by the various South African courts in the different jurisdictions.[341] The Judge ruled that ultimately there was no reasonable prospect of the proposed plan being for the benefit of creditors and dismissed the application for business rescue.

In *Employees of Solar Spectrum Trading 83 (Pty) Ltd v Afgri Operations Ltd and Solar Spectrum Trading 83 (Pty) Ltd Re: Afgri Operations Ltd v Solar Spectrum Trading 83 (Pty) Ltd*[342] Judge Kollapen deliberated over an application brought by the employees of a company as an affected party. The company had previously been under a judicial management order and Afgri had applied to intervene in order to have the company liquidated. The court held that it was not a prerequisite to set out in the application the details of a business rescue plan. The responsibility for developing a business rescue plan rests with the business rescue practitioner.[343]

In *Van Niekerk v Seriso 321 CC and Another*,[344] Judge Gangen considered an application to place a bed-and-breakfast business under business rescue proceedings. FirstRand Bank opposed the application, arguing that the application was an abuse and further that there was no detail of a plan. The court held that this was a case for business rescue and stated its belief that because the tourism industry was so important to the South African economy, the business should be placed under supervision.[345] The Judge believed that FirstRand

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340. Ibid 600 at para 50.

341. The judgment by Judge Stelzner is a leading case on business rescue and provides an excellent overview of all the leading cases which had been heard to that date.

342. *Employees of Solar Spectrum Trading 83 (Pty) Limited v Afgri Operations Limited and Another, In Re; Afgri Operations Limited v Solar Spectrum Trading 83 (Pty) Ltd* (6418/2011, 18624/2011, 66226/2011, 666226/2011, 66226A/2011) [2012] ZAGPPHC 359 (16 May 2012). For comments on this case, see Swart "Business Rescue: Do employees have better (reasonable prospects) of success? Commentary on employees of Solar Spectrum Trading 83 (Pty) Limited v Afgri Operations Limited (North Gauteng High Court, Pretoria (unreported) 2012 – Case No 6418/20111, 18624/2011, 66226/2011, 66226A/11" (2014) *Obiter* 406–420. The judgment in this case provides some direction on how the judgment in *Southern Palace Investments (supra)* should be understood in respect of the nature of the information an affected person must present to a court in an application for business rescue. The court held that the test to determine a "reasonable prospect for rescuing the company", is the same in all applications for business rescue, irrespective of who brings the application. The level of detail will be determined by the facts of each case and the court will make a determination by way of a "value judgment" on the merits – see Swart's commentary 419–420.

343. Ibid 12 at para 19.

344. *Van Niekerk v Seriso 321 CC and Another* (952/11, 23929/11) [2012] ZAWCHC 63 (20 March 2012).

345. Ibid paras 22 and 26.

Bank would not be prejudiced as the bank, as creditor, had sufficient security in place for its debts.[346] The Judge held:

> In weighing up the interests of creditors, the applicant and the respondent, one has to consider the potential prejudice to stakeholders if the application to commence business rescue proceedings is granted.[347]

In *Propsec Investments (Pty) Ltd v Pacific Court Investments 97 Ltd and Another,*[348] the court disagreed with the *Southern Palace* judgment and held that the court had indeed "placed the bar too high". Judge Van der Merwe was of the view that "reasonable prospect" meant "reasonable expectation". The need to place concrete details in the court papers evidencing details of the likely costs of rendering the company able to trade and the availability of cash resources to meet day-to-day expenses was not necessary, since this was tantamount to requiring "proof of a probability". Judge Van der Merwe was of the view that:

> "reasonable prospect" means 'no more than a possibility that rests on an objectively reasonable ground or grounds.[349]

The *Propsec* case was followed by Judge Kruger in *Lidino Trading 580 CC v Cross Point Trading (Pty) Ltd , In re: Mabe v Cross Point Trading 215 (Pty) Ltd*.[350] The Judge set out the law on business applications[351] and summarised the position as follows:

> Before granting a business rescue application, the Court must be satisfied that there is a reasonable prospect for rescuing the company (section 131(4)(a)(iii), apart from the other requirements listed in section 131(4)(a)). It has been held that a prospect here means an expectation, which in turn signifies a possibility. A possibility is reasonable if it rests on a ground that is objectively reasonable – per Van der Merwe J, in *Propsec Investments (Pty) Ltd and Another v Pacific Coast Investments 97 Ltd* (supra) par [12].[352]

Procedural irregularities in the application brought for business rescue will generally result in a dismissal of the application. Judge Boruchowitz in *Engen Petroleum Limited v Multi-*

346. Ibid paras 32–33.
347. Ibid para 27. The impact of the business rescue order should not be underestimated. The affect that the imposition of a business rescue order has on all affected persons needs to be carefully considered.
348. *Propsec Investments (Pty) Ltd v Pacific Coast Coast Investments 97 Ltd and Another* 2013 (1) SA 542 (FB).
349. Ibid 7 at para 12.
350. *Lidino Trading 580 CC v Cross Point Trading (Pty) Ltd , In re: Mabe v Cross Point Trading 215 (Pty) Ltd* (2130/2012) [2012] ZAFSHC 155 (23 August 2012) 13 at para 18.
351. Ibid 11–12 at para 17.
352. Ibid 13 at para 18.

Waste (Pty) Ltd[353] dismissed an application brought by a shareholder and director of Multi-Waste. The court held in favour of the intervening creditor, Engen Petroleum, and placed the company into liquidation. The intervening creditor raised serious allegations relevant to the impropriety of management in disposing of its assets and the transferring of substantial funds from the company's bank account. The court held the following:

> The business rescue application is bristling with procedural irregularities. The most glaring of the irregularities pertain to the use of the short form notice of motion (Form 2 of the First Schedule to the Uniform Rules) and the failure to comply with the service and notice requirements laid down in the Act.

The court believed that it was essential for a winding-up order to be granted "so as to enable a liquidator to take control of the affairs of both Multi-Fleet and Multi-Waste".[354]

Clearly, with reference to the abovementioned cases, our courts require a proper motivation of the "reasonable prospect" test. Proper objective facts, supported by affidavits of persons having actual knowledge of the facts, is required. The bar has been set fairly high and it is not adequate merely to go through the motions of an unsubstantiated motivation when it comes to the "reasonable prospect" test. Mere regurgitation of the 2008 Companies Act, and particularly what is stated in section 128(1)(b)(iii) is not sufficient.[355]

Section 131(4)(a)(iii) refers to the possibility of placing a company into business rescue if "it is otherwise just and equitable to do so for financial reasons". This appears to give a court a very wide discretion in considering whether to grant a business rescue order. In the case of *Mfazwe v AN Gadi Property Investments (Pty) Ltd*[356] the court considered what was meant by "just and equitable" and "for financial reasons" with reference to section 131(4)(a)(iii) and stated the following:

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353. *Engen Petroleum Ltd v Multi Waste (Pty) Ltd* 2012 (5) SA 596 (GNP).

354. Ibid 599 at para 11.

355. See analysis of cases in Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-32–18-50(3) at para 18.4.3. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 474–478(1) makes submissions on what is meant by "a reasonable prospect of rescuing the company" as set out in section 131(4)(a) and is particularly critical of the *Southern Palace* case.

> As already indicated above in the discussion of the Court's interpretation of the term "reasonable prospect", the applicant for a business rescue order should not have to provide concrete details at the level indicated by the Court. As has already been pointed out above, most applicants will not have this information at their disposal, and it is unreasonable to expect them to have. If it is not possible to rescue the company by adopting and implementing a workable business rescue plan, it would still be to the benefit of the creditors if, eg, the company's business was to be sold as a going concern. While this would not rescue the company, it would certainly offer a better return to the company's creditors, and would also ensure that some or all of the employees retain their employment.

356. *Mfazwe v AN Gadi Property Investments (Pty) Ltd* (CA192/2014) [2015] ZAECGHC 24 (7 April 2015); *Blignaut v Stalcor (Pty) Ltd* 2014 (6) SA 398 (FB).

> Absa's alleged moral blameworthiness in failing to exercise whatever rights it may have had in terms of the cession is irrelevant to the issue of whether it is "just and equitable" for an order to be granted in terms of section 131(4)(a)(iii) "for financial reasons".

The court held that the fact that Absa Bank Ltd had not collected on its cession of rentals prior to the commencement of the business rescue proceedings did not justify them now seeking the winding-up of the respondent company. Absa had been "the author of its own misfortune". Thus, the court was supportive of the fact that such a "prejudice" did not influence the deliberation in terms of section 131(4)(a)(iii).

In terms of section 344(4) of the 1973 Companies Act, a court could wind up a company if it "appears to the court that it is *just and equitable* that the company should be wound up" (emphasis added). The courts reaching the conclusion in interpreting grounds for winding-up on a just and equitable basis involves the exercise not of a discretion, but of a judgment on the facts found by the court to be relevant. Once such conclusion is reached, however, the making of an order for the winding-up does involve the exercise of a discretion.[357] Whether a similar approach will be adopted by our courts will become apparent once this issue is properly considered by our courts. It is submitted that, in all likelihood, judges will look at each particular company and limit their discretion to the status of the financial position of the company at the relevant time.

Section 131(5) raises an interesting issue. It states:

> If the Court makes an order in terms of subsection (4)(a), the Court may make a further order appointing as interim practitioner a person who satisfies the requirements of section 138, and who has been nominated by the affected person who applied in terms of subsection (1), subject to ratification by the holders of a majority of the independent creditors' voting interests at the first meeting of creditors, as contemplated in section 147.

It appears that the appointment of a business rescue practitioner by the court (in terms of section 131(5)) requires "ratification by the holders of a majority of the independent creditor's voting interests at the first meeting of creditors".[358] What is strange is that the

357. *Cunninghame and Another v First Ready Development 249 (Association Incorporated in terms of Section 21)* [2010] 1 All SA 473 (SCA) 41–42. In *Registrar of Banks v Dafel and Others* [2015] JOL 32711 (GP), the court exercised its discretion and held that business rescue proceedings cannot apply to a company conducting an unlawful business such as a Ponzi scheme. Such a company should be placed into liquidation so that an enquiry into the financial affairs of the entities could be investigated.

358. In terms of section 147(1) of the 2008 Companies Act, within ten business days after being appointed, the practitioner must convene and preside over a first meeting of creditors. Independent creditors are those creditors who are not related to the company in terms of section 2 of the 2008 Companies Act and who are not related to the company, a director or the practitioner.

presiding judge would have already appointed the business rescue practitioner by way of court order in terms of section 131(5). Why then would such an appointment have to be "ratified" at the first creditors' meeting?

The business rescue practitioner nominated in the section 129 resolution would be appointed by the CIPC, provided that such business rescue practitioner, duly nominated, satisfies the requirements of section 138 of the 2008 Companies Act.[359] One would have thought that such an appointment (duly made by the directors of the company), without any input from any affected persons, including creditors, should require his or her appointment to be ratified at the first meeting of creditors. This is not the case.

The courts have dealt with the case where an application for business rescue was considered to be an abuse or manipulation of the business rescue process. An analysis of this point is dealt with below.

In *Absa Bank Ltd v Newcity Group (Pty) Ltd, Cohen v Newcity Group and Absa Bank Ltd*[360] Judge Sutherland considered a business rescue application instituted by the sole shareholder and director of Newcity, Chaim Cohen, for an order to intervene in the provisional liquidation of the company. The Judge held that the application launched for business rescue was not "genuine" but a "ruse".[361] The court held that:

> Notwithstanding the prima facie merits, the business rescue application must be branded an abuse and refused.

In the matter of *Kalahari Resources (Pty) Ltd v Arcelormittal SA and Others*,[362] Judge Coppin considered a counterapplication for business rescue in terms of section 131 of the 2008 Companies Act. Kalahari Resources, a mining operation, was financially distressed, and brought an application on the grounds that it was "just and equitable" for the company to have a practitioner appointed. The Judge dealt extensively with the requirements of sections 130(3)(h) and 131(2)(b) in respect of the need for notification to all affected

359. In terms of section 138(1), a person would be appointed as a business rescue practitioner of a company only if the person, *inter alia*, is a member in good standing of a legal, accounting or business management profession accredited by the CIPC.

360. *Absa Bank Ltd v Newcity Group (Pty) Ltd and Another Related Matter* [2013] 3 All SA 146 (GSJ).

361. Ibid 10 at para 22. The Judge followed the ruling in *Southern Palace*, where the presiding judge cautioned "against the possible abuse of business rescue proceedings, by rendering the company temporarily immune to actions by creditors so as to enable the directors or other stakeholders to pursue their own ends".

362. *Kalahari Resources (Pty) Ltd v Arcelormittal SA and Others* [2012] 3 All SA 555 (GSJ).

persons that an application had been made to court.[363] The Judge went further and considered the meaning of "just and equitable" in section 131(4)(iii) of the 2008 Companies Act:

> There is ample authority that an applicant who relies on the ground that it was just and equitable to liquidate a company (i.e. under the previous Companies Act), must come to Court with clean hands. In other words, it must not itself have been wrongfully responsible for, or have connived at bringing about the state of affairs, which it asserts results in it being just and equitable to wind up the company. There is no reason why the same principle cannot also apply in the case of business rescue proceedings.[364]

The Judge struck the business rescue application from the roll.

In *Cardinet (Pty) Ltd v Wedgewood Golf and Country Estate (Pty) Ltd (in liquidation) and 2 Others*[365] Nyman AJ had to determine whether there was a reasonable prospect of rescuing a golf estate named Wedgewood. The Judge followed the ruling in *AG Petzetakis International Holdings Ltd v Petzetakis Africa (Pty) Ltd and Others*[366] that the requirement of "a reasonable prospect of rescuing the company must be present".[367] The Judge considered the object of the business rescue plan, including the prospect of the largest creditor, Nedbank, receiving a possibly better return than would result from the immediate liquidation of Wedgewood. The Judge stated:

> Nevertheless, I am mindful that in ascertaining whether the applicant has placed before me a cogent evidential foundation, that this bar should not be raised too high to serve as a barrier to business rescues. In my view, the introduction of the business rescue provisions into our company laws, is indicative of the legislature's intention of utilising it as a substantial measure to promote the development of the South African economy and to encourage 'entrepreneurship and enterprise efficiency' as stipulated in sub-section 7(b)(i) of the Act.[368]

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363. Ibid 571–575 at paras 53–67, where an excellent summary of the service requirements set out in the 2008 Companies Act is provided.
364. Ibid 577 at para 72. Similar to the cases supporting just and equitable winding up of companies in the 1973 Companies Act, an applicant will not get the support of a court if it comes to the court with "dirty hands" in an application for the business rescue of the company.
365. *Cardinet (Pty) Ltd v Wedgewood Golf and Country Estate (Pty) Ltd (in liquidation) and 2 Others* Case No. 19599/2012, Western Cape High Court, Cape Town (30 January 2013) (unreported).
366. *AG Petzetakis International Holdings Ltd v Petzetakis Africa (Pty) Ltd and Others (Marley Pipe Systems (Pty) Ltd and Another Intervening) 2012 (5) SA 515 (GSJ) Absa Bank Limited v Caine NO, In Re; Absa Bank Limited v Caine NO and Another* (3813/2013, 3915/2013) [2014] ZAFSHC 46 (2 April 2014) 521 at para 14.
367. *Cardinet (Pty) Ltd v Wedgewood Golf and Country Estate (Pty) Ltd (in liquidation) and 2 Others* Case No. 19599/2012, Western Cape High Court, Cape Town (30 January 2013) (unreported).
368. Ibid 14 at para 42.

The Judge followed the judgment of Eloff AJ in *Southern Palace*[369] and confirmed the sentiments set out in subsection 7(k) of the 2008 Companies Act.[370] The company was placed under supervision.

In a further case, *Breedt v P G Breedt Boorkontrakteurs CC and Others*,[371] Hughes J considered an application for business rescue in terms of section 131 of the 2008 Companies Act. The applicant attached a proposed business rescue plan to the court papers based on future cash flows emanating from new contracts. The Judge was not convinced that enough detail had been placed before the court to convince him that there was a reasonable prospect of the company being rescued. No credible plan was forthcoming and he was of the view that the "application was a delay tactic to stall the inevitable". The application was dismissed.

In *New City Group (Pty) Ltd v Pellow NO and Others*,[372] five judges in the SCA deliberated over what is meant by a "reasonable prospect" of rescue as contemplated in section 131(4)(a) of the 2008 Companies Act. The court dismissed the business rescue and placed the relevant company into final liquidation.

The court held that a company can only be rescued if there is a reasonable prospect that either the company can continue in existence on a solvent basis, or if this is not possible, results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company. This must be established on the basis of facts, not speculation. If, seen objectively, there is a reasonable possibility or likelihood of those uncertain future events occurring, the jurisdictional requirements have been satisfied and the court can exercise its discretion. The test should be flexible and the circumstances of each case will determine whether the available facts give rise to a reasonable prospect or not.[373]

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369. *Southern Palace Investments 256 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd* 2012 (2) SA 423 (WCC).
370. Subsection 7(k) of the 2008 Companies Act: 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".
371. *Breedt v P G Breedt Boorkontrakteurs CC and Others* (10581 / 2012) [2013] ZAGPPHC 17 (4 February 2013). Also see *Eveleigh v Dowmont Snacks (Pty) Ltd and* Others (11982/2013) [2014] ZAKZPHC 1 (22 January 2014). Judge Vahed considered the meaning of a "reasonable prospect of rescue"; see pp. 10–11.
372. *New City Group (Pty) Ltd v Pellow NO and Others* (577/2013) [2014] ZASCA 162 (1 October 2014). This judgment sets out a useful history of the various courts' deliberations on the topic.
373. Ibid at paras 13–14.

The tests set out in section 131(4) were considered:

> It is plain from the wording of these provisions that a court may not grant an application for business rescue unless there is a reasonable prospect for rescuing the company i.e. facilitating its rehabilitation so that it continues on a solvent basis or, if that is not possible, yields a better return for its creditors and shareholders than what they would receive through liquidation. In deciding the question the court exercises a discretion in the wide sense – it makes a value judgment – and if a court of appeal should disagree with the conclusion, it is bound to interfere.[374]

The judges on appeal considered the various "expressions of interest" that had been made and concluded that such "offers were not capable of yielding any concrete funding". The court agreed with the judgment in the *Oakdene* case, that the "mere savings on the costs of the winding up process in accordance with the existing liquidation provisions can hardly justify the separate institution of just business rescue". Thus, it is not good enough to show that the costs of liquidation would exceed those incurred in a business rescue.[375]

The court found, on the facts, that not one of the two objectives of business rescue was present. There was no viable business rescue plan – one had to still be developed. The passing of a year without any solution rendered the reasonable prospect of a plan being developed to be remote. It appeared that the reasonable prospects of rescuing the company had become exhausted.[376]

Business rescue proceedings are often initiated as a counter to a liquidation application. In practice, a creditor (often a financial institution) would launch an application for the winding-up of the company based on an unpaid debt.[377]

Once such an application is brought, the debtor company would struggle to provide sufficient opposition to such an application as the debt was indeed due and payable with no defence to the claim. Chapter 6 now allows an alternative. Any affected person (often the shareholder on loan account) can now intervene in such a liquidation application and

374. Ibid 11 at para 15. Reference was made to *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others* 2013 (4) SA 539 (SCA) at para 21.

375. Ibid 13–14 at paras 20–22).

376. Ibid para 25.

377. In many instances directors of companies in financial distress have applied for business rescue merely to avoid liquidation and the inquisitive focus of the liquidator on the conduct of directors prior to the liquidation application. Directors remain wary of the potential for being found personally liable for the debts of the company under section 424 of the 1973 Companies Act (which remains applicable) as read with section 22 of the 2008 Companies Act (the prohibition on reckless trading). Section 345 of the 1973 Companies Act (which remains applicable) deems a company to be insolvent if it is proved to the court that the company cannot pay its debts in the ordinary course of business as and when such debts fall due. Section 345 is often a basis (or ground) for the launch of a company's winding-up.

request the court to suspend such liquidation proceedings and grant an order for business rescue proceedings instead.

Section 131(6) deals with the suspension of liquidation proceedings when a business rescue application is brought:

> If liquidation proceedings have already been commenced by or against the company at the time an application is made in terms of subsection (1), the application will suspend those liquidation proceedings until –
>
> (a) the Court has adjudicated upon the application; or
>
> (b) the business rescue proceedings end, if the Court makes the order applied for.

Thus, a liquidation proceeding can be converted into a business rescue proceeding. The question posed is at what point in the "liquidation proceedings" can one apply to court (as an affected person) to convert the proceedings into business rescue proceedings. Initially the interpretation by practitioners was that an affected person could only apply to convert the liquidation proceedings into business rescue proceedings up until the date of a final order of liquidation was granted by the High Court.

In the judgment of *Van Staden v Angel Ozone Products CC*,[378] Legodi J ruled that the 2008 Companies Act contemplates the conversion of a liquidation into business rescue proceedings no matter how far the liquidation and winding-up proceedings might have progressed and certainly well after a liquidator has been appointed to administer the company in liquidation.[379]

The Judge stated:[380]

> One of the objects of the Act is to provide for the efficient and [*sic*] recovery of financially distressed companies, in a manner that protects the rights and interests of all relevant stakeholders (see section 7(k)). In terms of the repealed Act, the liquidation proceedings' major stakeholders are the creditors. Liquidation proceedings are meant to ensure that no one particular stakeholder (creditor) gains an

378. *Van Staden v Angel Ozone Products CC* 2013 (4) SA 630 (GNP).

379. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 471. For the difficulties posed by applications for business rescue after liquidation proceedings have commenced, see Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 1 (2010) 3 *TSAR* 511–512.

380. *Van Staden v Angel Ozone Products CC* 2013 (4) SA 630 (GNP) at para 31. In *Commissioner of South African Revenue Services v Beginsel NO and Others* 2013 (1) SA 307 (WCC), the court held conversely that if business rescue proceedings were well advanced, it would be impractical to convert such proceedings into a winding-up. Also see Braatvedt "Positive and Negative Effects of a Business Rescue Order after Liquidation" (7 March 2013) *Hogan Lovells* available at http://www.hoganlovells.com.

> advantage over other creditors. Now, if the rescue proceedings are a better option than the liquidation proceedings, I see no reason why such liquidation proceedings cannot be converted into supervision and rescue proceedings irrespective of how far advanced the liquidation or the winding-up proceedings might be.

It is submitted that the ruling is problematic in the sense that liquidators having sold portions of a business as a going concern, disposed of or realised assets and having drawn up a liquidation and distribution account, might still be faced with the possible conversion of the liquidation proceedings to business rescue. The counter to this of course is that the court will (and must) take cognisance of the interests of all stakeholders and whether the conversion to business rescue will in fact result in the outcomes envisaged by section 128(1)(b).[381]

The question is posed as to what would happen to a partially implemented business rescue plan if the company ends up in liquidation. Are all transactions actioned by the practitioner void or voidable? Can they be reversed by a liquidator once he or she is appointed? Actions (such as payments to creditors or sales of assets) taken by a practitioner (if done in good faith and in the best interests of the company) cannot be overturned by a liquidator. The practitioner would have taken action in terms of the provisions of Chapter 6 and would thus be protected. The possibility of having voidable transaction provisions applied (sections 26, 21 and 30) would not be likely.

Once a winding-up or liquidation of a company is suspended in terms of section 131(6), the liquidator becomes *functus officio* for the period of the suspension.[382]

Section 131(6) is silent on the consequences of a stay of "liquidation proceedings". The practical position is that suspension of the liquidation proceeding renders the actual continuation of the liquidation (on any basis) to be held in abeyance and includes the powers of a liquidator as set out in Chapter 14 of the 1973 Companies Act. The company

381. Section 128(1)(b) of the 2008 Companies Act states:

"Business Rescue" means proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for –

(i) the temporary supervision of the company, and of 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; 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 maximises 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;

382. Section 354(1) of the 1973 Companies Act entitles a Court to stay the winding-up of a company provided the Court is satisfied that there are grounds for such suspension. Such stay can only occur if an application to Court is made in support of such stay. The effect of section 131(6) is, on the other hand, automatic and becomes operative as soon as the application for business rescue is lodged (application is made).

"in liquidation" remains in limbo whilst the application for business rescue is being determined. This can take a considerable period of time with the exchanges of opposing affidavits prior to the matter being argued before the High Court.[383] The company continues to trade with suppliers, customers and creditors in this interim period. The fact that the company is in fact rudderless is a major concern for all stakeholders. If the company ultimately is placed under a business rescue process, the chances of it being rescued on a "reasonable prospect of success" basis are severely diminished.

In *Absa Bank Limited v Summer Lodge (Pty) Ltd* the court held that the words "liquidation proceedings" in section 131(6) are confined to the actual process of winding up a company following an order of winding-up having been issued by a court. Such a process is the actual process followed in a winding-up which is overseen by the liquidators and the Master of the High Court. The words "liquidation proceedings" do not include the legal proceedings taken by a creditor for the purposes of obtaining an order that a company be wound up.[384]

In *Jansen van Rensburg NO v Cardio-Fitness Properties (Pty) Ltd and 4 Others*[385] Judge Kgomo again considered the effect the suspension of liquidation proceedings would have on the assets of the company pending the appointment of a business rescue practitioner in terms of a pending business rescue application. Once a provisional winding-up order is granted, directors no longer have any control over the company's property. The suspension of liquidation proceedings in terms of section 131(6) does not suspend the appointment of the joint liquidators. However, section 131(6) is silent as to whether their powers are affected. Had the legislature intended that provisional liquidators were to be relieved of control before a business rescue practitioner is appointed, it would have said so clearly and unambiguously:[386]

> Until the business rescue application is finalised or a final liquidator is appointed, the provisional liquidators are liable for everything. As such, it should only be prudent that they remain in charge until the court pronounces on the business rescue application. If it succeeds, a practitioner would be appointed and he could take over

383. Once an application is heard and an order for business rescue granted, further delays can occur if the order is taken on appeal to the SCA in Bloemfontein. This can cause considerable delay with SCA hearings often being set down some 18 months after leave to appeal is granted.

384. *Absa Bank Limited v Summer Lodge (Pty) Limited* 2013 (5) SA 444 (GNP) 445 at para 5.

385. *Van Rensburg NO and Another v Cardio-Fitness Properties (Pty) Ltd and Others* (46194/13) [2014] ZAGPJHC 40 (4 March 2014).

386. Ibid 19, para 52.

> the affairs of this company in financial distress. If it fails, a final liquidator(s) would be appointed and the suspension of winding-up lifted.[387]

The Judge went on further to state:

> It is my finding that it was not the intention of the legislature that the first respondent at any stage be a rudderless ship or a ship without a captain. If the respondent's contentions are anything to go by, the suspension of the liquidation proceedings means the forthwith departure of the applicants. As no business rescue practitioner has not [*sic*] yet been appointed (as at date of argument hereof) then the first respondent would remain without anybody to control and protect its assets and safeguard its takings.

The judge agreed that the interpretation of section 131(6) should lean towards supporting the contention that the provisional liquidators are temporarily restrained from disposing of assets or doing any act that resulted in a continuation of the winding up until the business rescue application is finalised. However, due to the peculiar circumstances of the matter, the judge held that section 131(6) did not affect the appointment of the provisional liquidators who were obligated to perform their duties in terms of section 386(1) of the 1973 Companies Act. To allow the previous directors to step back into control of the business would be a travesty of justice.[388]

The stay of proceedings is permanent until the court has adjudicated upon the application (and granted a supervision order) or if the business rescue proceedings come to an end.

The effect of the stay provided for in terms of section 131(6) must mean that the administration conducted by the duly appointed liquidator is also immediately suspended. He or she is effectively deprived of all powers and authority as set out in the 1973 Companies Act.

If there is protracted and lengthy opposition to the application for business rescue (brought in terms of section 131), what happens to the administration of the company in the hiatus period, i.e. between the lodgement of the application for business rescue and the ultimate appointment of the business rescue practitioner?

387. Ibid 20, para 55.
388. Ibid 21 at paras 56–58.

In *Rhett Justin Christopher Molyneux and one other v Mohammed Ismail Patel and 5 others*,[389] Rogers J dealt with the effect of section 131(6) on pending liquidation proceedings. Once a winding-up order is granted, the administration of the liquidation cannot be properly regarded as something by or against the company. Proceedings contemplated in terms of section 131(6) are legal proceedings by a company, or by a shareholder or creditor against the company for a liquidation order. The judge held that there were practical considerations in favour of that view. Any counterview would mean that a company would be effectively left rudderless from the moment the business rescue application is served until it has been determined. *Ex hypothesi* there would not, pending the determination of the business rescue application, be a practitioner to guide the affairs of the company. For that reason, the business rescue application must be determined prior to a pending liquidation application, though often they may end up being adjudicated together. The court held that the mere delivery of the business rescue application cannot suspend the powers of a liquidator pursuant to the final order of liquidation.[390]

In *Richter v Absa Bank Limited*[391] the SCA held that there is no sensible justification for drawing the proverbial "line in the sand" between pre- and post-final liquidation in circumstances where the prospects of success of business rescue exist. The legislature did not do so, and to restrict business rescue to those cases in which a final winding-up order has not been granted is inimical to the Act. It is clear that a proper interpretation of "liquidation proceedings" in relation to section 131(6) of the Act includes proceedings that occur after the occurrence of a winding-up order to liquidate the assets and account to the creditors, up to the deregistration of a company. Thus an application in terms of section 131 to place a company under business rescue can be made after the date of a final liquidation order.[392]

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389. *Rhett Justin Christopher Molyneux and one other v Mohammed Ismail Patel and 5 others* High Court, Western Cape Division, Cape Town, Case No. 14618/2014, unreported, 27 November 2014.

390. Ibid 12–14.

391. *Richter v Absa Bank Limited* (20181/2014) [2015] ZASCA 100 (1 June 2014) at paras 17–18. Also see comments in *Knipe and Another v Noordman NO and Others* 2015 (4) SA 338 (NCK). In this matter the court held that the liquidator had a duty and responsibility to look after the assets and affairs of the company in liquidation. The legislature did not intend to create a situation where provisional liquidators would be disempowered to carry out their responsibilities (para 24).

392. See Van Niekerk "Launching business rescue applications in liquidation proceedings – (successfully) flogging a dead horse?" (2015) *De Rebus* 50–51. The author submits that the judgment might very well offend the insolvency practitioner as surely it could not have been the intention of the legislature to allow applications for business rescue to be made at any time before the dissolution of the company? Also see MacKay-Davidson and Crystal "Saving graces: Liquidation, compromise or business rescue?" (2015) *Without Prejudice* 18–19.

In *Van Der Merwe and Others v Zonnekus Mansion (Pty) Ltd and Others*[393] the court followed the finding in the *Richter* case and held that it is competent to commence business rescue proceedings in terms of section 131(1) of the 2008 Companies Act, when a company is in final liquidation. In *Van Der Merwe and Others v Zonnekus Mansion (Pty) Ltd and Others*,[394] the judge disagreed with the decision by the SCA in the *Richter* case but held that it was still bound to it.

In *Burmeister and Another v Spitskop Village Properties Ltd and Others (Commissioner for the South African Revenue Service intervening)*,[395] the judge considered, in his discretion, whether to place a company into business rescue after it had been in final liquidation for a lengthy period of time. Relying on the judgment in New City Group (supra),[396] and where the court was faced with the choice of liquidation and business rescue in such circumstances, the court found that there can be no reasonable prospect of rescuing the company. The court held that liquidation would be far more advantageous to creditors than the proposed business rescue supervision and that the opposition by SARS to the proposed business rescue plan was both reasonable and bona fide.

In the case of *Rentekor (Pty) Ltd & Others v Rheeder and Berman NNO and Others*,[397] Judge Kriegler dealt with the suspension of a winding-up order caused by the noting of an appeal in terms of Rule 49(11) of the High Court Rules of South Africa. Judge Kriegler stated:

> The liquidators' appointment and their powers and duties were suspended, as were all the other consequences of winding up. Suspended means lifted, removed but subject to possible future re-imposition.[398]

The judge further stated the following:

> Once the operation of the winding up order had been suspended, no meetings of creditors could be held nor could the Master preside at any such meeting, hear any

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393. *Van Der Merwe and Others v Zonnekus Mansion (Pty) Ltd and Others* (4653/2015) [2015] ZAWCHC 90; [2015] 3 All SA 659 (WCC) (10 June 2015).
394. *Van Der Merwe and Others v Zonnekus Mansion (Pty) Ltd and Others* (4653/2015B) [2016] ZAWCHC 11 (18 February 2016).
395. *Burmeister and Another v Spitskop Village Properties Ltd and Others (Commissioner for the South African Revenue Service intervening)* (76408/2013) [2016] ZAGPPHC 72 (22 January 2016).
396. *New City Group (Pty) Ltd v Pellow NO and Others* (577/2013) [2014] ZASCA 162 (1 October 2014).
397. *Rentekor (Pty) Ltd & Others v Rheeder and Berman NNO and Others* 1988 (4) SA 469 (T).
398. Ibid 504 at D–H.

> ingenious argument or make any rulings. His hands and the hands of the liquidator had been lifted.[399]

The stay of liquidation proceedings where a liquidator has dealt with creditors, estate assets, claims and the like, makes it extremely difficult for such liquidator to put all of this "on ice", pending either the appointment of the business rescue practitioner or the dismissal of the application for business rescue, resulting in the lifting of the suspension:

> The position appears even more paradoxical within the context of a stay achieved without the exercise of a judicial discretion to support it. One must, however, have regard to the imperative in the New Companies Act of attempting, where possible, to save companies and consequently employment opportunities. The lengthy employment preamble to the New Companies Act includes "… to provide for efficient rescue of financially distressed companies…".[400]

The court has been given a very wide discretion to consider placing a company under business rescue while it is considering either liquidation proceedings or proceedings to enforce security against the company.

Section 131(7) deals with the ability of the court to place the company into business rescue during the course of either liquidation proceedings or proceedings to enforce any security against the company:

> In addition to the powers of a Court on an application contemplated in this section, a Court may make an order contemplated in subsection (4), or (5) if applicable, at any time during the course of any liquidation proceedings or proceedings to enforce any security against the company.

A court can place a company under business rescue, *mero motu*, when it considers the merits of liquidation proceedings or proceedings to enforce security against the company. A typical example would be an application for the perfection of a general notarial bond ("GNB") registered in the Deeds Office over all the assets (generally movable) of the company.[401] Thus, creditors who seek perfection orders over movable assets or to perfect a cession of debtors could find that their application to court results in a business rescue order, thus staying any attempt to perfect their security as a result of the automatic stay of all legal proceedings set out in section 133 of the 2008 Companies Act.

399. Ibid 505 at C–D.
400. Opinion by John Suttner SC (26 March 2012) on section 131(6) of the 2008 Companies Act.
401. A GNB must be converted into a pledge over movables and by way of court order.

In *Investec Bank Ltd v Bruyns*[402] the court distinguished section 131(6) and (7). Both sections deal with a court's ability to grant an order placing a company under compulsory business rescue in circumstances where liquidation proceedings are present. Section 131(6) states that "liquidation proceedings have already been commenced by or against the company at the time an application [for an order placing the company under business rescue] is made, while subsection (7) states that the court may make an order contemplated in subsection (4) or (5) at any time during the course of any liquidation proceedings or proceedings to enforce any security against the company. The question that arises is whether the term "at any time during the course of any liquidation proceedings" in subsection (7) refers only to the time during which an application for the liquidation of the company is before the court, i.e. prior to a final liquidation order, *or* does it refer to collective proceedings of the actual winding-up which includes the administration proceedings which could already be at an advanced stage? Can one at that stage bring an application for business rescue proceedings? Rogers J ruled that business rescue proceedings could only be brought prior to a final liquidation order being granted, i.e. while a court is still considering an application for the winding-up of a company.[403]

The question as to whether a company can adopt a resolution in support of a winding up, while such company is under business rescue, is dealt with in section 131(8) as follows:

> A company that has been placed under supervision in terms of this section –

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402. *Investec Bank Ltd v Bruyns* 2012 (5) SA 430 (WCC).

403. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 478–478(1). Henochsberg has a different view:

> S 136 (4) states that if liquidation proceedings have been converted into business rescue proceedings, the liquidator is a creditor of the company to the extent of any outstanding claim by the liquidator for any remuneration due for work performed, or compensation for expenses incurred, before the business rescue proceedings commenced. It seems unlikely that s 136(4) caters for the fees and expenses incurred by a provisional liquidator prior to a final liquidation order being granted by the Court since there are hardly likely to be any, and in any event if the legislature had intended to refer to the costs of a provisional liquidator it is likely to have said so in clear terms. It appears far more likely that this provision contemplates the conversion of a liquidation, however far advanced, to a business rescue procedure. Although the *Bruyns* decision seems to suggest otherwise, this appears to be the most likely interpretation of the relevant provisions. However, it is submitted that compelling reasons would have to be placed before the Court before it would be likely to take such drastic action.

Also see *Van Zyl v Engelbrecht NO* 2014 (5) SA 312 (FB). A liquidator sued a director for the company's debts. An intervening application was successfully brought for the company's business rescue. The question was who was liable for the attendant costs of the litigation. Since liquidation proceedings (in terms of section 131(6)) are suspended by an application for business rescue, the question was whether the liquidator's action against the director qualified as a step in the liquidation proceedings. The liquidator argued that he could not be liable under section 131(6) for costs incurred after the business rescue application. The director argued that section 136(1) did not suspend proceedings, such as the liquidator's action against him, that were for the benefit of the company. The court held as follows:

> The liquidator's action was a claim for the recovery of a debt due to the company and therefore qualified as a step in the liquidation process that was hit by s 131(6). Suspension of the liquidation proceedings entailed the suspension of the office of the liquidator. The director's contention, that claims for the company were exempt from s 131(6) because they stood to benefit the company and, as such, served to resuscitate it, was without merit because the legislature would have said as much. Therefore steps taken by the liquidator after a business rescue application lacked legal consequence, although they could be ratified by him – or possibly the business rescue practitioner – at the end of the suspension period.

Investec Bank Ltd v Bruyns 2012 (5) SA 430 (WCC) 434 at para 15.

(a) may not adopt a resolution placing itself in liquidation until the business rescue proceedings have ended as determined in accordance with section 132(2); and

(b) must notify each affected person of the order within five business days after the date of the order.

A company under business rescue supervision thus cannot adopt a resolution in support of its winding-up.

Consequently, once a business rescue proceeding has commenced, no conversion into a liquidation can occur on the part of the company placing itself into liquidation. The company must give the business rescue practitioner a proper opportunity to investigate the prospects of a business rescue plan in terms of the provisions of the 2008 Companies Act, and all resolutions for winding-up of the company must be placed on hold.

It is submitted that entry into business rescue by way of a section 131 court application is far more difficult than by way of the section 129 resolution commencement. An application to court will have to be carefully motivated if judges are to be persuaded that a business rescue order is to be granted. As is seen above, the standards set by current precedent on what is meant by a "reasonable prospect", will result in many business rescue applications being dismissed, with the strong likelihood of liquidation.

As is evident from the various judgments referred to above, South African business rescue precedent is beginning to develop. The courts are clearly sifting through the opportunistic business rescue applications and are settling on those that truly support the intention and motivation behind business rescue, namely, saving companies that are candidates for rescue, as contemplated by the legislation.

It is clear that our courts have carefully analysed whether placing a company into business rescue will result in a more favourable outcome for all stakeholders (particularly creditors) than would occur in a liquidation. Courts have to carefully balance the needs of creditors with the needs of the debtor company (and all of its stakeholders). It is submitted that in line with legislation set in foreign jurisdictions, our courts have come to a stage where there is clear recognition of the need to save the company as a going concern (trading out on a solvent basis) as opposed to the values delivered in a liquidation.

As in foreign jurisdictions, the entry into a rescue procedure by way of a court application should be available as an alternative to entry by way of resolution and a filing with the relevant authorities. Creditors and other stakeholders must always have the opportunity to approach a court when their interests might be prejudiced if they were prohibited from doing so. The judicial discretion is sometimes required to consider and protect the needs of stakeholders in a situation of financial distress and where a restructuring could result in a better outcome than liquidation. Of course, like in offshore jurisdictions, the better option will always be the quickest, least expensive entry into the rescue process without having to go by way of formal court intervention.

South African courts have set a high standard for entry into the business rescue process, where there has been a clear recognition that not every company is a candidate for business rescue and, if need be, companies must be placed into liquidation, if rescue is not a feasible option.

7.3.4 DURATION OF BUSINESS RESCUE PROCEEDINGS

Once business rescue has commenced, it is important to identify the length (duration) of the rescue process. As referred to above,[404] rescue is a process that should not drag on indefinitely. The value in the rescue process is to ensure that the restructuring is completed within short time frames so as to preserve the business of the debtor company and its ongoing relationship with customers, suppliers and creditors.

In terms of section 132(1), business rescue proceedings begin when:

(a) the company –

(i) files a resolution to place itself under supervision in terms of section 129(3); or

(ii) applies to the Court for consent to file a resolution in terms of section 129(5)(b);

(iii) an affected person applies to the Court for an order placing the company under supervision in terms of section 131(1); or

(iv) a Court makes an order placing a company under supervision during the course of liquidation proceedings, or proceedings to enforce a security interest, as contemplated in section 131(7).

404. See Chapter 5, para 5.5.1.

In terms of section 348 of the 1973 Companies Act:

> A winding-up of a company by the Court shall be deemed to commence at the time of the presentation to the Court of the application for the winding-up.[405]

Thus, a winding up would, once granted, be deemed to apply retrospectively to the date of the presentation of the application for winding up. The purpose was to ensure that any dispositions in the intervening period could be set aside by a liquidator appointed in due course. It is submitted that under a business rescue proceeding, there is no *concursus creditorum* and therefore these disposition sections do not apply.[406]

The "filing" of a resolution in terms of section 132(1)(a)(i) refers to the physical delivery of the resolution to the CIPC. In terms of section 129(3), the date stamp on Form CoR 128.1 would be the commencement date of the business rescue proceeding in a voluntary business rescue.

Section 132(1)(b) is more problematic. It refers to the commencement date of a compulsory business rescue brought by way of an application to court (in terms of section 131(1)) being the date upon which the affected person "applies to the court for an order placing the company under supervision in terms of section 131(1))". The issue is whether, like section 348 of the 1973 Companies Act, the actual commencement date also backdates retrospectively from the date of the grant of the business rescue order, to the date of the launch of the application.[407]

There are two schools of thought.[408] The first is that the legislature did not intend a section 348 scenario, i.e. the commencement date can never backdate retrospectively to the issue date of the application. There is no need for this retrospective effect as there is no *concursus*. The business rescue practitioner is not faced with the need to set aside

405. Section 348 of the 1973 Companies Act. The reason for making the date of liquidation retrospective was because of the fact that upon liquidation of a company, a *concursus creditorum* would be effective from the commencement date of liquidation. This would assist a liquidator (and creditors) in applying the "disposition sections" of the Insolvency Act. See sections 29–31 of the Insolvency Act 24 of 1936.

406. However, in terms of section 141(1)(c) of the 2008 Companies Act, a business rescue practitioner is obligated to establish if, prior to the commencement of business rescue proceedings, there is evidence of "voidable transactions". If these voidable transactions are established, the business rescue practitioner must take "any necessary steps" to rectify the matter and may direct the management to take appropriate steps.

407. Many applications brought for business rescue in terms of section 131(1) are opposed. Thus the issue date of the application is usually followed by weeks (if not months) of delay while affidavits are being exchanged in the course of the opposed application. Eventually the application would be heard, argued and a business rescue order made. It should be noted that such an order is also appealable to a Higher Court. See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-50(3)–18-50(4) at para 18.5.1.

408. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 478(2)–478(4) concede that the issue is problematic and will have to be determined by the Court.

dispositions, like in Insolvency Law. The absurdity of such an interpretation would mean that all business conducted by the company would retrospectively fall within the parameters of Chapter 6 of the 2008 Companies Act. Any contravention of Chapter 6 would have to be unravelled (retrospectively) by a business rescue practitioner, once appointed.

The other school of thought is simply that which takes a strict interpretation of the relevant section. The words are plain and simple. Commencement date of a business rescue proceeding occurs when an affected person *applies* to the court. "Applies" can only mean the issue (filing) date of the application. This would mean that once he or she is appointed, the business rescue practitioner would have to interrogate every transaction, action, resolution and decision made by management and the board, during the period from the issue date of the court application to the date of the court order for business rescue. To what end? The result would mean that companies would shut down and go into liquidation in the interim period. Which suppliers would want to transact with a company facing a business rescue order, where there is a likelihood of such transaction being upset, once a business rescue practitioner is appointed?[409]

It is for this reason that it is submitted that business rescue must commence from the date the business rescue order is granted and the business rescue practitioner appointed.[410]

Our courts have faced the issue of the date of commencement of business rescue in several matters.

In *FirstRand Bank Limited v Imperial Crown Trading 143 (Pty) Ltd*[411] the court held that the word "commenced" in section 131(6) has the same meaning as the word "initiated" in section 129(2)(a). A section 129 resolution may not be adopted if liquidation proceedings

409. Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 1 (2010) 3 *TSAR* 9:

> Serious complications could arise if business rescue proceedings commence before an order to this effect has been issued and all the legal consequences of such an order come into force, which is what this provision implies. It would, for example, mean that the general moratorium on legal proceedings that applies "during" the proceedings comes into effect and the directors' authority and powers to manage the company are curbed, but without a practitioner to take over these duties. The obvious further question then is what happens if the Court refuses to grant an order for business rescue proceedings after the process has already started! This must surely rank as one of the most ill-considered or badly drafted provisions in the act.

410. In *Investec Bank Ltd v Bruyns* 2012 (5) SA 430 (WCC) the Court acknowledged that the question whether any business rescue proceedings commenced at the date of launching the application or only when and if an order was made by Court, was a problem which would have to be determined by a court in due course. In that case, it was not necessary to decide the question. The Court pointed out that if it was held that the proceedings began when the application was launched, it would also have to decide whether the effect of the proceedings ensued immediately or only retrospectively after the Court order was made.

411. *FirstRand Bank Limited v Imperial Crown Trading 143 (Pty) Ltd* 2012 (4) SA 266 (KZD)

have been "initiated" by or against the company. Proceedings only commence once an order is granted, retrospectively backdated to the date of the filing of the liquidation application. However, the court has to consider the effect of a liquidation application which had been brought but where no liquidation order had yet been granted. The court held that where a company had not yet adopted a resolution in terms of section 129, an affected person was well entitled to approach the court at any time for an order placing the company under business rescue proceedings. This would result in any liquidation proceedings pending against the company to be suspended in terms of section 131(6), until the ultimate conclusion of the business rescue proceedings in terms of section 132(2).

In *Absa Bank Limited v Summer Lodge (Pty) Ltd*[412] the court followed a similar approach to the *FirstRand Bank* case. The court held that section 131(6) means that once liquidation proceedings have commenced by the granting of a liquidation order, whether provisional or final, the mere issue and service of a business rescue application would suspend the liquidation process. The liquidation order is not set aside or discharged by the issue of a business rescue application, but rather it is suspended so as to delay the implementation of the order and it can also not have the effect that the company be precluded from carrying on business. The company remains to be finally or provisionally liquidated, as the case may be, until such time as the business rescue proceedings have been finalised.

In *Taboo Trading (Pty) Limited v Pro Wreck Scrap Metal CC and Others*[413] the court held that a business rescue application only commences once the application is lodged with the Registrar, duly issued and a copy served on the CIPC and each affected person.

In *Blue Star Holdings (Pty) Limited v West Coast Oyster Growers CC*[414] Gamble J considered section 131(6) and the suspension of liquidation proceedings at the time an application for business rescue is "made". The court held that a "functional approach" should be taken and that the lodging of the application with the Registrar for the issue thereof constituted the "making" of the application and the commencement of proceedings to place the company under business rescue (as opposed to the commencement of business

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412. *Absa Bank Limited v Makunu Farm CC* (2012/28972) [2013] ZAGPJHC 318 (30 August 2013), where Boruchowitz J concurs with the finding in *Absa Bank Limited v Summer Lodge (Pty) Limited* 2013 (5) SA 444 (GNP).

413. *Taboo Trading (Pty) Limited v Pro Wreck Scrap Metal CC and Others* 2013 (6) SA 141 (KZP) at para 11.4. Also see *Absa Bank Ltd v Cardio-Fitness Properties (Pty) Ltd t/a Aloe Ridge Hotel (in liquidation)*(GSJ) Case No. 2012/2008 (unreported); Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-50(3)–18-50(4) at para 18.5.1.

414. *Blue Star Holdings (Pty) Ltd v West Coast Oyster Growers CC* 2013 (6) SA 540 (WCC).

rescue proceedings *per se*).[415] The Judge pointed out that to suggest that the application for business rescue only commences when it is called "some day in open court" would lead to impractical and even absurd consequences. It would mean that the court which considers the winding-up application could continue with its work and notionally even grant a final order of liquidation before the business rescue application is heard.[416]

Although section 132(1)(c) provides for a court to place a company under supervision during the course of liquidation proceedings or proceedings to enforce a security interest (such as a perfection of a general notarial bond), there have been no judgments on this topic.[417] In practice, an application to perfect a general notarial bond could result in the court (it appears *mero motu* – in its discretion) to place the company under supervision.

In terms of section 132(2), business rescue proceedings end when:

(a) the Court –

(i) sets aside the resolution or order that began those proceedings; or

(ii) has converted the proceedings to liquidation proceedings;

(b) the practitioner has filed with the CIPC a notice of the termination of business rescue proceedings; or

(c) a business rescue plan has been –

(i) proposed and rejected in terms of Part D of this Chapter, and no affected person has acted to extend the proceedings in any manner contemplated in section 153; or

(ii) adopted in terms of Part D of this Chapter, and the practitioner has subsequently filed a notice of substantial implementation of that plan.

Business rescue proceedings may terminate at the instance of the business rescue practitioner in two instances. This is done by the practitioner simply filing a notice to that effect with the CIPC.[418]

The first instance is where the business rescue proceedings were initiated by a resolution of the board of directors and the practitioner concludes that there are no longer reasonable

415. Ibid 546 at para 29.

416. Ibid. See Braatvedt "Positive and Negative Effects of a Business Rescue Order after Liquidation" (7 March 2013) *Hogan Lovells* available at www.hoganlovells.com. Also see comments by Rushworth "A Critical Analysis of the Business Rescue Regime in the Companies Act 71 of 2008" (2010) *Acta Juridica* 382–383.

417. Section 131(7) of the 2008 Companies Act further allows a Court to place a company under supervision at any time during the course of liquidation proceedings or proceedings to enforce a security interest.

418. Section 132(2)(b) of the 2008 Companies Act.

grounds to believe that the company is financially distressed.[419] Once filed, it is assumed that the company will return to its situation prior to business rescue without any further formalities. Hopefully there will be some directors left who can resume the management of the company.[420]

The second possibility applies to all business rescue proceedings if a business rescue plan has been rejected by the creditors or shareholders and none of the possible actions provided by section 153(1) have been taken by either the practitioner or any affected person. If this occurs, the practitioner must promptly file a notice of termination of the business rescue proceedings with the CIPC.[421]

The problem is that section 132(2)(c)(i) also provides for this possibility by stating that rejection of the plan and failure by any affected person to use the options provided by section 153 will terminate business rescue proceedings. These two provisions not only regulate exactly the same situation, but contradict each other. According to section 132(2)(b), the business rescue proceedings are terminated by the filing of the notice of termination, while in terms of section 132(2)(c)(i), they are terminated by the mere inaction of the affected persons.[422]

In *Artio Investments (Pty) Ltd v Absa Bank Limited*[423] the court held that in terms of section 132(2)(c)(i), business rescue proceedings came to an end when the bank voted against the business rescue plan. As a result, the court wound up the company.

The situation is further complicated unnecessarily by section 81(1)(c)(i), which provides for the liquidation of a (solvent) company by the court on application by one or more of the company's creditors. The grounds stipulated in this subsection for the order are that business rescue proceedings have been terminated in terms of section 132(2)(b) or (c)(i), which refer to the above two instances where a practitioner may file a notice of

419. Section 141(2)(b)(ii) of the 2008 Companies Act.

420. Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 2 (2010) 4 *TSAR* 700.

421. Ibid.

422. If no action is taken after a rescue plan has been rejected, it is probable that there is no reasonable prospect for the company to be rescued. In such a case, the practitioner is surely still under the obligation to apply to court for an order discontinuing the rescue proceedings and placing the company into liquidation. The requirement that the practitioner must merely file a notice of termination in these circumstances is in conflict with this obligation. See Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions (Part 2)" (2010) 4 *TSAR* 700; Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-50(4) 18-50(7) at para 18.5.2.

423. *Artio Investments (Pty) Limited v Absa Bank Limited and Others* (7562/2014) [2014] ZAGPPHC 689 (8 September 2014).

termination, and it appears to the court that it is just and equitable in the circumstances for the company to be wound up.[424]

It is understandable that provision should be made for the liquidation of a company if the business rescue plan has been rejected and nobody has taken any steps to resolve the deadlock. What is not clear, however, is why the termination of business rescue proceedings because the company is no longer in financial distress should also expose the company to the risk of being liquidated on the application of creditors. The effect of this provision is that even a successful rescue of the company could lead to its liquidation, and it provides another reason why directors would hesitate before commencing business rescue proceedings. The additional requirement that it must appear just and equitable to the court for the company to be wound up may act as some safeguard, but considering the historical approach of the courts in favouring creditors, it is uncertain to what extent a company will be protected. The reference to section 132(2)(b) is thus not only unnecessary but could result in unfair and unintended consequences for the company.[425]

In *Landosec (Pty) Ltd t/a Lasertech and One Other v Raymond Edward McClaren and One Other*,[426] the crisp issue which was considered was whether the business rescue practitioner became *functus officio* after the business rescue proceedings had ceased in terms of section 132(2)(c)(i). The applicants contended that the practitioner's appointment terminated immediately after he issued the notice of termination of the business rescue proceedings in terms of section 153(5). The respondent contended, to the contrary, that the notice of termination in terms of section 153(5) did not have the effect of terminating the appointment of the practitioner. The practitioner is enjoined to apply to court for an order discontinuing the business rescue proceedings and placing the company into liquidation.

The court strongly disagreed with the first respondent's contentions. Section 153 spells out the clear obligations of a practitioner where a business rescue plan has been proposed and rejected. Once the business rescue proceedings come to an end in terms of section 132(2)(c)(i), with the filing of the notice of termination, so too does the role and function

424. Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 2 (2010) 4 *TSAR* 700.
425. Ibid.
426. Ibid. See *Landosec (Pty) Ltd t/a Lasertech and One Other v Raymond Edward McClaren and One Other* (ECP) (unreported case no 2231/2015) (3 November 2015).

of the practitioner – he becomes *functus officio*. Any subsequent decisions taken by the practitioner thereafter are null and void.[427]

In the matter of *Ex Parte Nel NO and Others*,[428] the High Court considered when a business rescue proceeding should end after a court had set aside a section 129(a) (commencement) resolution and placed the company into liquidation, and where that ruling had been taken on appeal.

A notice of an application for leave to appeal against the order setting aside the section 129(a) resolution was pending, despite the fact that the court had granted a liquidation order placing the company under final liquidation. The application for leave to appeal was being delayed and thus had unfortunate consequences for the administration of justice. A dispute had arisen between the erstwhile business rescue practitioner (whose status remained dependent on an appeal) and the liquidator appointed to administer the winding-up, as to who should take precedence in the running of the company through either the business rescue process or the winding-up.

In terms of section 130(5)(c)(i), if the court makes an order setting aside the company's resolution, it may make any further necessary and appropriate order, including an order placing the company under liquidation. The court pointed out that the power to undo the rescue process and place the company into liquidation is an essential counterweight to address the mischief caused by a company to its creditors, particularly where there is no reasonable prospect of the company being rescued from its financial distress, but has achieved an undeserved moratorium by a stroke of the company pen in the passing and filing of a section 129(a) resolution. The court deliberated over the meaning of section 132(2)(a)(i) which provides that business rescue proceedings end when the court sets aside the resolution or order that began those proceedings.

427. Ibid at paras 12–13.

428. *Ex Parte Nel NO and Others* (GNP) Case No. 45279/14 (28 July 2014) (unreported). Also dealt with in *Van Rensburg NO and Another v Cardio-Fitness Properties (Pty) Ltd and Others* (46194/13) [2014] ZAGPJHC 40 (4 March 2014); *Ellerine Brothers (Pty) Limited v McCarthy Limited* 2014 (4) SA 22 (SCA) and *Employees of Solar Spectrum Trading 83 (Pty) Limited v Afgri Operations Limited and Another, In Re; Afgri Operations Limited v Solar Spectrum Trading 83 (Pty) Ltd* (6418/2011, 18624/2011, 66226/2011, 666226/2011, 66226A/2011) [2012] ZAGPPHC 359 (16 May 2012). In *Engen Petroleum Ltd v Multi Waste (Pty) Ltd* 2012 (5) SA 596 (GNP), the court issued a declaration that the joint provisional liquidators were to continue the trading activities of the company in terms of section 386(4) of the 2008 Companies Act pending the outcome of the court's decision whether or not to place the company under the supervision of a business rescue practitioner.

Section 18(1) of the Superior Courts Act, 10 of 2013 reads that the operation and execution of a decision which is the subject of an application for leave to appeal or of an appeal, is suspended pending the decision of the application or appeal.

The court ruled that notwithstanding the application for leave to appeal lodged against the order setting aside the section 129(a) order, the provisions of the Insolvency Act and Chapter 14 of the 1973 Companies Act apply and operate as if no application for leave to appeal had been made and whether or not any appeal pursuant to any application for leave to appeal against such order is in due course noted and prosecuted.

Thus, the court ruled, the assets of the company would fall under the control of the joint liquidators of the company and would remain so controlled unless the order is set aside or varied on appeal.

In a further determination of the effect that a business rescue application has on ongoing legal proceedings, the court held that all legal proceedings instituted by a liquidator in ongoing liquidation proceedings which are pending as at the date when an application for business rescue proceedings is made against a company in liquidation, are automatically suspended when such an application is made.[429]

The notice of termination of business rescue proceedings[430] should be distinguished from a notice of substantial implementation.[431]

The business rescue practitioner would file a notice of termination if there were reasonable grounds to believe that the company is no longer financially distressed.[432] This would occur if the business rescue proceeding had commenced by way of a resolution filed in terms of section 129(1). If the business rescue proceedings had commenced by way of an

429. See *Van Zyl v Engelbrecht NO* 2014 (5) SA 312 (FB).

430. Form CoR 125.2 – Regulation 125(4), section 141(2)(b)(ii) to the 2008 Companies Act.

431. Form CoR 125.3 – Regulation 125(5), section 152(8) to the 2008 Companies Act. For an analysis of the various ways a business rescue proceeding can terminate see Van Staden "Cutting the Lifeline: The Termination of Business Rescue Proceedings" (December 2013) *De Rebus* 14–17.

432. Section 141(2)(b)(ii) of the 2008 Companies Act.

application to court in terms of section 131, the business rescue practitioner must apply to court to discharge the company from the business rescue proceeding.[433]

The business rescue practitioner would only file a notice of substantial implementation when a business rescue plan has been adopted[434] and the plan implemented as contemplated by the terms of the plan.[435] This might be filed shortly after the plan has been approved[436] or months later, depending on the timing and details of the implementation of the plan.

Business rescue proceedings should effectively take no longer than three months. It is submitted that the three-month period is relatively short when one takes into account the requirements of the practitioner to hold meetings with the various stakeholders, consult on the development of a business rescue plan, hold a meeting to decide the future of the company, and implement the business rescue plan if one has been approved. This is a very brief period of time within which to conduct the rescue of a company. Although it is unlikely that most successful business rescues will be completed within this brief time frame, the advantage of having such a short turnaround time is that it does not allow any of the creditors to hold out on the approval of a plan in the hope that they can improve their position by negotiating a higher return in terms of the business rescue plan. Creditors will be compelled to buy into the process within the allotted time, otherwise they may find themselves facing the alternative of a liquidation procedure where they will likely receive a lower return on their claims.[437]

In the case of *Absa Bank Ltd and John Frederick Kneale Caine NO and One Other*[438] the court ruled that business rescue proceedings cannot go on indefinitely. It was not the intention of the legislature that creditors could be held ransom and be prevented from exercising their normal contractual rights for an extraordinary long period of time.

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433. Section 141(2)(b)(i) of the 2008 Companies Act. See the judgment in *The Commissioner of the South African Revenue Services (intervening creditor)* in *Ex Parte Nel and Others NNO* 2014 (6) SA 545 (GP). This judgment compares the provisions and obligations of the practitioner in terms of section 132(a)(ii) with section 141(2)(b)(ii) of the 2008 Companies Act.
434. Part D of Chapter 6 of the 2008 Companies Act.
435. Section 132(2)(c)(ii) of the 2008 Companies Act.
436. Section 152 of the 2008 Companies Act.
437. See Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 478(2).
438. *Absa Bank Limited v Caine NO, In Re; Absa Bank Limited v Caine NO and Another* (3813/2013, 3915/2013) [2014] ZAFSHC 46 (2 April 2014) at para 48.

If business rescue proceedings take longer than three months, then there are certain reporting requirements that must be adhered to by the business practitioner.

The duration of business rescue proceedings is dealt with in section 132(3)as follows:

> If a company's business rescue proceedings have not ended within three months after the start of those proceedings, or such longer time as the Court, on application by the practitioner, may allow, the practitioner must –
>
> (a) prepare a report on the progress of the business rescue proceedings, and update it at the end of each subsequent month until the end of those proceedings; and
>
> (b) deliver the report and each update in the prescribed manner to each affected person, and to the –
>
> (i) Court, if the proceedings have been the subject of a Court order; or
>
> (ii) the CIPC, in any other case.

When designing the business rescue procedure the legislature realised that the achievement of a successful rescue will in many cases not be achieved with the three-month time frame provided for, and consequently provision has been made for the business rescue practitioner to extend this time frame by approaching the Court. Although the business rescue practitioner has the option of extending the time frames, the reporting requirements in order to do so are considerably onerous. In practice it is likely that business rescue practitioners will endeavour to complete the process as quickly as possible, in order to avoid the onerous reporting provisions provided for under this section.[439]

Once a business rescue plan has been approved, the business rescue practitioner must implement the plan. The size of the company, the complexity of its business, its divisions, number of subsidiaries, employees and creditors, will impact on the complexity of the plan. If the business rescue plan falls into the first part of the definition of business rescue, namely a formal rescue of the company over a period of time by the restructuring of debt, conversion of debt to equity, selling off of loss-making divisions, rationalisation of the company's workforce, then implementation may very well take longer than three months. However, if restructuring in terms of the plan includes the sale of assets to realise a better

439. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 478(3)–478(4). Also see Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-50(4) at para 18.5.2.

dividend than in a liquidation, then the implementation of the business rescue plan may take less than three months.

Section 132(3) provides a useful reporting mechanism to the court[440] and to the CIPC if the business rescue proceedings commenced by way of a section 129 resolution.[441] The delivery of a report to the court would effectively be a report prepared by the practitioner and filed in the court file without the need to make a formal application to court for an extension.

Although generally a business rescue process should take no more than three months,[442] the larger workouts in companies where a buy-out of the assets/business or the company's shares is part of the plan, such three-month period is far too short.[443] The finalisation of the process is delayed by finding an interested or potential buyer, the raising of post-commencement finance, negotiations between directors, employees, shareholders and the ultimate purchaser, the finalisation of the transactional document, the need to agree a timeline for the fulfilment of certain critical conditions precedent, the finalisation of the plan (based on the transaction which is itself conditional on the plan being voted on and approved), once approved the fulfilment of the conditions precedent and the time taken to implement the plan on the part of the practitioner. Often, a period of four to six months (sometimes longer) is required.

It is submitted that the provisions of section 132 clearly set out the limitations, time frames and legal conclusions which result in the commencement of the business rescue process and its termination. Clearly, one cannot have a situation where a business rescue regime runs on indefinitely, without any "rescue" in sight. In such circumstances, the company

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440. Section 132(3)(b)(i) of the 2008 Companies Act: if the business rescue proceedings commenced by way of a section 131 Court order, then reports must be submitted to the Court (it is assumed merely to be placed in the Court file without a formal Court application and hearing being necessary). In *Resource Washing (Pty) Ltd v Zululand Coal Reclaimers Proprietary Limited and Others* (10862/14) [2015] ZAKZPHC 21 (20 March 2015), the court considered the need for the practitioner to apply to court for an extension of time if a company's business rescue proceedings had not ended within three months. The practitioner is obligated to provide a report on the progress of the proceedings and an update at the end of each subsequent month until the end of the proceedings. The practitioner must also deliver reports and regular updates to the court. Section 132 does not spell out what the consequences would be if the practitioner fails or refuses to apply to court for an extension.

441. Section 132(3)(b)(ii) of the 2008 Companies Act.

442. The timeline for a voluntary and compulsory business rescue process are dealt with specifically in the provisions set out in Chapter 6.

443. It has been argued that the three-month period is unrealistic and would be quite insufficient in most cases. The short time frame creates a substantial administrative burden for the practitioner, with added costs for a company as a result of this duty. The costs of having to apply to court for an extension will be substantial. It has been suggested that a period of 12 to 18 months would have been far more realistic to allow sufficient time for amendments to the business rescue plan that may be necessary, as well as for proper implementation of the plan. This short time frame also increases the risk that the business rescue practitioner will prematurely end his or her participation in the implementation of the plan to avoid the substantial administrative burden. See Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 2 (2010) 4 *TSAR* 698.

must be "put out of its misery" and be placed into liquidation. Business rescue practitioners need to be circumspect when assessing the ongoing viability of the company, once it is in business rescue. If there remains a "reasonable prospect" then such opportunity should continue to be explored.

Delays or putting off the inevitable liquidation of the company where there is no realistic hope or prospect of recovery is a dangerous practice and one which should be discouraged. Like in international jurisdictions, it is submitted that a prolonged business rescue process can result in diminished liquidation dividends which will seriously affect the creditor's ability to recover. Thus, business rescue practitioners who delay the process do so at substantial risk to themselves, especially when disgruntled creditors look for the proverbial "scapegoat" once the company goes into liquidation.

7.4 GENERAL MORATORIUM ON LEGAL PROCEEDINGS

The whole purpose of a business rescue proceeding is to offer the company some breathing space in order to allow its affairs to be restructured in such a way as to allow it to continue operating as a successful concern.[444]

The moratorium is dealt with in section 133(1)as follows:

> During business rescue proceedings, no legal proceeding, including enforcement action, against the company, or in relation to any property belonging to the company, or lawfully in its possession, may be commenced or proceeded with in any forum, except –
>
> (a) with the written consent of the practitioner;
>
> (b) with the leave of the Court and in accordance with any terms the Court considers suitable;
>
> (c) as a set-off against any claim made by the company in any legal proceedings, irrespective of whether those proceedings commenced before or after the business rescue proceedings began;
>
> (d) criminal proceedings against the company or any of its directors or officers;
>
> (e) proceedings concerning any property or right over which the company exercises the powers of a trustee; or

444. Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-50(7) at para 18.6,

(f) proceedings by a regulatory authority in the execution of its duties after written notification to the business rescue practitioner.

As has been set out above,[445] the moratorium on claims is a fundamental aspect of any successful rescue culture or mechanism used in the restructuring of debt within a company that is financially distressed. The company requires a breathing space and thus a "lock-down" or "freezing of claims" is an essential part of business rescue.[446]

No provision has been made for an interim moratorium that would protect the company before the official commencement of business rescue proceedings by an order of court. It is undesirable for business rescue proceedings to begin before the business rescue order is issued. It is problematic that a company will be exposed to a run on its assets by creditors in the period between the compulsory notification of the intended application and the (as yet uncertain) moment of commencement of the rescue proceedings that would result in the automatic moratorium. Provision should be made therefore for an interim moratorium in the period between presenting of the application to court and the commencement of business rescue proceedings.[447]

Section 428(2) of the 1973 Companies Act allowed a court (which had placed a company into provisional judicial management in terms of section 427) to direct that, while the company was under judicial management, all actions, proceedings, the execution of all writs, summonses and other processes against the company be stayed and not be proceeded with without the leave of the court. It was usual for judicial management orders, provisional or final, to contain these directions. If it were not to do so, the whole object of instituting the judicial management might be defeated.[448]

Section 133 of the 2008 Companies Act needs to be analysed. No definition is given to the term "legal proceedings". Kgomo J dealt with this issue in *Merchant West Working Capital*

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445. See Chapter 7, para 7.4.
446. One of the features of informal compromises was the inability of mainstream creditors preventing smaller and "greedy" creditors from enforcing their claims whether by action (summons), writs of execution, arbitration proceedings and winding-up applications. See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-50(7) at para 18.6.
447. Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 2 (2010) 4 *TSAR* 689.
448. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 931.

Solutions (Pty) Ltd and Advanced Technologies and Engineering Company (Pty) Ltd and Another:[449]

> The words "legal proceedings" are not in my view susceptible of any other meaning than their ordinary every-day literal one.
>
> Legal proceedings were described in *Van Zyl v Euodia Trust (Edms) Bpk*[450] as follows:
>
> > "the ordinary meaning of *legal proceedings* in the context of s. 13 ['regsgeding' in the signed Afrikaans version] is a lawsuit or 'hofsaak'."[451]

The words "enforcement action" are also not defined.[452] It is submitted that this can only be a reference to attempts made by creditors who have obtained judgment, to enforce such judgments by way of writs of execution, attachments and sales in execution. Proceeding with such action would constitute "enforcement" and would be prohibited by the section.[453]

Much debate has ensued around whether the calling up of a cession of book debts,[454] after the commencement of business rescue, would constitute "enforcement action". Section 133 refers to a prohibition on enforcement actions "against the company, or in relation to any property belonging to the company or lawfully in its possession". By its nature, a cession of book debts (which is not an "out-and-out cession", constituting a sale of the book debts to a creditor or third party) would mean that the debtors of the company are no longer

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449. *Advanced Technologies and Engineering Company (Pty) Ltd (in business rescue) v Aeronautique et Technologies Embarquees SAS and 4 Others* Case No. 72522/11, North Gauteng High Court, Pretoria (June 2012) (unreported) 28.

450. *Van Zyl v Euodia Trust (Edms) Bpk* 1983 (3) SA 394 (T).

451. *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Limited* 2013 JDR 1019 (GSJ) 27 at paras 63–64. In *Chetty t/a Nationwide Electrical v Hart NO and Another* [2015] JOL 32738 (KZD) it was held that arbitration proceedings are not legal proceedings for which the written consent of the practitioner is required in terms of section 133.

452. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 478(6)–478(6c) confirm that the intention of the provision is to cast the net as wide as possible in order to include any conceivable type of action against the company. Also see Rushworth "A Critical Analysis of the Business Rescue Regime in the Companies Act 71 of 2008" (2010) *Acta Juridica* 383–384.

453. In *Madodza (Pty) Ltd v Absa Bank Limited* 2012 JDR 1350 (GNP) 4, it was argued that because final court orders for the attachment of vehicles had occurred prior to the commencement of business rescue, such attachments fell outside the section 133 moratorium on enforcement proceedings. None of these court orders were the subject of appeals or rescission applications. The court agreed and ordered the return of the vehicles to the finance companies. The court held that because the assets were not the property of or in the lawful possession of the company (para 17), the vehicles had to be returned. Also see Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-50(7) at para 18.6. Although there is no definition of the terms "legal proceedings" or "enforcement action" in Chapter 6, the intention is clearly to cast the net as wide as possible in order to include any conceivable type of action against the company. See *Chetty v Hart NO* 2014 JDR 0585 (KZD), where the court held that arbitration proceedings are not legal proceedings as contemplated in section 133 of the 2008 Companies Act.

454. Cession *in securitatem debiti* is usually in the nature of a pledge whereby the cedent (the company) cedes the book debts to a cessionary (the bank) as security for an overdraft facility. Alternatively, the company might cede the book debts by way of an out-and-out cession to the bank or a factoring house. In the latter event, the cessionary can deal with the book debts how it deems fit. In a cession *in securitatem debiti*, the *dominium* (ownership) of the book debt does not transfer to the bank. The reversionary interest would result in the pledged book debts being re-ceded to the company (the cedent) upon payment of the indebtedness. Whether or not a cession *in securitatem debiti* allows the bank to call up the book debts after the commencement of business rescue remains an open question.

"property" of the company and thus the calling up of such a cession would be lawful and not in contravention of section 133(1).[455]

The words "in any forum", although not defined, could also refer to actions brought by way of arbitration proceedings. These, too, would be stayed.[456]

In *Chetty t/a Nationwide Electrical v Hart NO and Another*[457] the SCA considered whether "arbitration proceedings" are 'legal proceedings" as contemplated in section 133(1) of the 2008 Companies Act. In an arbitration hearing involving a contractual dispute relating to a building contract, the arbitrator made an award against Chetty in favour of a company that was in business rescue in terms of section 129 of the 2008 Companies Act. Chetty approached the lower court in KwaZulu-Natal to nullify the arbitral proceedings on the basis that at the time of the award, she had been unaware that the company was in business rescue, which had resulted in her failing to seek the written consent of the practitioner to continue with the arbitration in terms of section 133(1)(a). The company opposed the relief, on the basis that section 133(1) did not apply to arbitrations in that the phrase "legal proceedings" only referred to court proceedings and not to arbitrations. The lower court ruled that arbitration proceedings were not legal proceedings as contemplated by section 133(1), and that the ordinary meaning of a "legal proceeding" was a "lawsuit" or "hofsaak" which excluded arbitrations from its ambit.[458]

The SCA found to the contrary and held that arbitration proceedings were indeed legal proceedings for the purposes of section 133(1). The court held that the purpose of section 133(1), which is to give breathing space to the practitioner to get the company's financial affairs in order, requires the term "legal proceedings" to be construed widely. This is because arbitrations, like court proceedings, also involve a diversion of resources – both

455. In *Cloete Murray NNO and Another v FirstRand Bank Ltd t/a Wesbank* 2015 (3) SA 438 (SCA), the court held that the mere cancellation of a master instalment sale agreement does not amount to "enforcement action" that is subject to a moratorium in terms of section 133. Further, in *Madodza (Pty) Ltd v Absa Bank Limited* 2012 JDR 1350 (GNP), the applicant brought an urgent application to prohibit the removal of certain vehicles in the possession of the company until such time as the business rescue proceedings had terminated. The applicant based its application on the moratorium created by section 133(1). It was common cause that the vehicles were not the property of the applicant and the court, having found that the company was not in lawful possession of the vehicles, declared the vehicles to fall outside the ambit of the moratorium created by section 133(1) (at para 17). See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-50(10) at para 18.

456. In *Cloete Murray NNO and Another v FirstRand Bank Ltd t/a Wesbank* 2015 (3) SA 438 (SCA) 39, the court found that the meaning of "forum" must bear its ordinary grammatical meaning, and refers to a place or meeting where a public discussion is held – consequently the section envisages actual steps taken before a court of law or some other tribunal or place. See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-50(10) at para 18.

457. *Chetty t/a Nationwide Electrical v Hart NO and Another* [2015] ZASCA 112 (4 September 2015). Also see criticism of the judgment by Weyers "Do arbitration proceedings constitute legal proceedings?" (June 2015) *Without Prejudice* 75–76.

458. See *Chetty t/a Nationwide Electrical v Hart NO and Another* [2015] JOL 32738 (KZN).

time and money – that may hinder the effectiveness of the business rescue proceedings. To construe it narrowly, as the court *a quo* did, would be at odds with its language, defeat its purpose and lead to insensible and impractical consequences.[459]

Section 133(1)(a) contemplates certain circumstances where a business rescue practitioner would be required to protect the company's interests by consenting to legal proceedings (commenced or proceeded with).

The various exceptions allow legal proceedings to be continued against the company even though it is subject to business rescue proceedings. Section 133(1)(b) allows legal proceedings to be brought "with the leave of the court and in accordance with any terms the court considers suitable". This allows a wide range of legal proceedings to be brought against the company. Whether this would allow a creditor to launch independent proceedings for the winding-up of the company while under supervision is a moot point. It is submitted that once a company is under business rescue proceedings it is highly unlikely that a court would allow winding-up proceedings to be commenced against the company. This would clearly be contrary to the intention of the 2008 Companies Act, namely, its "rescue" in terms of Chapter 6.[460]

Section 133(1)(b) and the words "leave of the court" were considered by Kgomo J in *Merchant West Working Capital Solutions (Pty) Ltd and Advanced Technologies and Engineering Company (Pty) Limited and Another*:[461]

> "Leave of the Court" as laid down in section 133(1)(b) cannot be a simple one that can be advanced from the bar. Such leave in my view and finding must be motivated in the same way, just like, for instance, as criteria for departure from the Rules of Court to justify a prayer for urgency. A Court being asked for leave to proceed against a company under business rescue, thus during a moratorium, must receive a well-motivated application for that so that it could apply its mind to the facts and the

459. Ibid para 35. See commentary on the case in Kok "Do arbitration proceedings fall within the general moratorium on legal proceedings against a company under business rescue?" (2015) *De Rebus* 43.

460. An application for winding up while the company is under supervision should not be allowed even with the consent of the business rescue practitioner or the court. It should only be allowed after the business rescue proceedings have been set aside or terminated on the grounds provided in the 2008 Companies Act. See Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions (Part 2)" (2010) 4 *TSAR* 690. Also see *Elias Mechanics Building and Civil Engineering Contractors (Pty) Ltd v Stedone Civils (Pty) Ltd* Case No. 7410/2014, KZD (11 December 2014), where the court held that leave of the court is required to institute legal proceedings against a company under business rescue prior to such legal proceedings being instituted.

461. *Advanced Technologies and Engineering Company (Pty) Ltd (in business rescue) v Aeronautique et Technologies Embarquees SAS and 4 Others* Case No. 72522/11, North Gauteng High Court, Pretoria, June 2012 (unreported) 28.

law if necessary and then be in a position to make a ruling in accordance with any terms it may consider suitable in the peculiar circumstances.[462]

Thus the court will need to see a properly motivated application for taking action against the company while in business rescue which sets out proper detail supporting the need for an interference in the business rescue process. It is after all the "leave of the court" that is being applied for in terms of section 133(1)(b).

The applicability of the moratorium provided by section 133 to the question as to under what circumstances a litigant requires the leave of the court in order to launch proceedings against the company in business rescue has been considered in numerous cases before the High Court.[463] In the matter of *Moodley v On Digital Media Proprietary Ltd*[464] an application was brought to set aside the adopted business rescue plans. The question before the court was whether the moratorium in section 133 applied to proceedings relating to the development, adoption or implementation of a business rescue plan. Was the leave of the court or the consent of the practitioner required in order to proceed with the institution of legal proceedings against the practitioner or concerning matters relevant to the business rescue plans of the companies in rescue? The court held that the purpose of section 133(1) is to prohibit the commencement or continuation of any legal proceedings against the company in business rescue. The effect is that section 133(1) is not concerned with the development, adoption and implementation of the business rescue plan, but rather with the temporary "freezing or stay" of legal proceedings against the company in business rescue. Thus, section 133 has no application to legal proceedings instituted against a company's practitioner or in connection with the business rescue plan, including its interpretation, adoption and/or implementation. Consequently, there is no need for affected parties to seek leave from the practitioner or the court when instituting proceedings relating to the business rescue plan.

462. *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Limited* 2013 JDR 1019 (GSJ) 28 at para 67. Also see *Lanorco Home Owners Association v Prospect SA Investments 42 (Pty) Limited (in business rescue) and Others*, 2014 JDR 2273 (KZP) where it was held that the court which granted an order for business rescue has jurisdiction in terms of section 133(1) of the 2008 Companies Act to grant leave to commence or to proceed with legal proceedings during the business rescue proceedings, even if the registered office of the company is not within the area of jurisdiction of the court.

463. Section 133(1)(b) of the 2008 Companies Act. See *Redpath Mining South Africa (Pty) Ltd v Marsden NO and Others* (18486/2013) [2013] ZAGPJHC 148 (14 June 2013); *Absa Bank Ltd v Naude NO* 2014 JDR 0201 (GNP) and *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd and Others* 2013 (6) SA 471 (GNP).

464. *Moodley v On Digital Media Proprietary Limited* 2014 (6) SA 279 (GJ). See analysis of case in Motshwane and Gubuza "Moodley decision" (2015) *Without Prejudice* 22–23.

Our courts have come to the assistance of contracting parties who deem it necessary to terminate contracts after the commencement of business rescue. These cases have dealt with the cancellation of contracts where such party seeks vindicatory relief for the return of its property.

In *LA Sport 4 X 4 Outdoor CC and Another v Broadsword Trading 20 (Pty) Limited and Others*,[465] it was held that a cancellation of a contract was not a "legal proceeding" or "enforcement action" as contemplated in section 133(1). The court held that section 133(1) imposes a general moratorium which flows from the commencement of business rescue proceedings and prohibits the right to commence or proceed with legal process, not the performance of juristic acts. The dispatch of letters of demand, the making of elections to cancel a contract and the communication of such elections, do not take place within a "forum". Thus, notices and juristic acts do not fall within the purview of section 133(3).

In *DH Brothers Industries (Pty) Ltd v Gribnitz NO and Others*[466] the court pointed out that business rescue proceedings, in placing a moratorium on creditors enforcing their claims against a company, amount to a legislative intrusion into contractual relationships between parties. It is therefore an incursion into the existing law of contract and so one must apply the presumption that the legislature did not intend to alter the existing law more than is necessary, particularly if it takes away existing rights and where there is already a presumption against a forfeiture of rights.

In *Cloete Murray and Another NNO v FirstRand Bank Ltd t/a Wesbank*[467] the SCA held that the cancellation of a Master Instalment Agreement during business rescue proceedings is not a "legal proceeding, including enforcement action" which requires the written consent of the business rescue practitioner or the leave of the court. The court held that the moratorium provided by section 133 is of "cardinal importance since it provides a crucial breathing space or a period of respite to enable the company to restructure its affairs". The crisp issue in the matter related to whether the cancellation of the Master Instalment

465. *LA Sport 4 X 4 Outdoor CC and Another v Broadsword Trading 20 (Pty) Limited and Others* (A513/2013) [2015] ZAGPPHC 78 (26 February 2015).

466. *DH Brothers Industries (Pty) Ltd v Gribnitz NO and Others* 2014 (1) SA 103 (KZP).

467. *Cloete Murray and Another NNO v FirstRand Bank Ltd t/a Wesbank* 2015 (3) SA 438 (SCA). Note that the provisions of section 134(1)(c) were not dealt with in this case as it was not relied upon by the liquidators in their argument before the court. This judgment supports the contention that the intention of the moratorium is to afford the company in distress the breathing space but not to interfere with the contractual rights and obligations of parties to an agreement. See Tsusi "Interpretation of section 133(1) of the Companies Act 71 of 2008 – the principle of moratorium redefined under business rescue" (July 2015) *Without Prejudice* 51–52; Ramson "Beware the perceived blanket moratorium" (July 2015) *Without Prejudice* 12–13.

Agreement constituted "enforcement action" as meant in section 133(1) of the 2008 Companies Act. The court considered the meaning of the phrase "enforcement action". "Enforce" and "enforcement" usually refers to the enforcement of obligations. In section 133(1), reference is made to "no legal proceeding, including enforcement action". The judge was of the view that "enforcement action" was a specie of legal proceeding. This conclusion was strengthened by the fact that section 133(1) provides that no legal proceeding, including enforcement action "may be commenced or proceeded with in any forum". Reference was made to the meaning of "any forum" as a court or tribunal. In addition, the court held that the terms "enforcement" and "cancellation" are mutually exclusive. The term "cancellation" connotes the termination of obligations between parties to an agreement. The liquidators had tried to contend that the "enforcement action" included the cancellation of the agreement.[468]

The court held that an interpretation of section 133(1) to the effect that the cancellation of the agreement did not constitute "enforcement action" would not do violence to the purpose of section 133(1).[469]

In *Barloworld South Africa Proprietary Ltd t/a Barloworld Equipment Rental and CAT Rental Store v Blue Chip Mining and Drilling Proprietary Ltd and 3 Others*,[470] the court ordered the return of equipment to the owner that formed part of a rental agreement that had been cancelled during business rescue. The company had resolved to begin business rescue proceedings on 9 December 2014, and the applicant cancelled the rental agreement with effect from 19 February 2015. The issue before the court was whether the applicant, by reason of the cancellation of the rental agreement, was entitled to vindicatory relief for the repossession of its equipment, or whether this right was subject to the moratorium and the granting of leave by the court under section 133(1) of the Act.

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468. *Cloete Murray and Another NNO v FirstRand Bank Ltd t/a Wesbank* 2015 (3) SA 438 (SCA) at paras 32–33.

469. Ibid para 36. See Weyers "Cancellation or Suspension of Agreements During Business Rescue" (May 2015) *Without Prejudice* 16–17. If a practitioner suspends an obligation of an agreement before a creditor cancels the agreement, any further attempt by the creditor to cancel the agreement would be unlawful (see p. 17).

470. *Barloworld South Africa Proprietary Limited t/a Barloworld Equipment Rental and CAT Rental Store v Blue Chip Mining and Drilling Proprietary Limited and 3 Others*, Northern Cape Provincial Division, Case No. 332/2015 (19 March 2015) (unreported).

The court held (following the findings in the matters of *LA Sport* and *Cloete Murray*) that the notice of cancellation of the rental agreement fell outside the purview of a legal proceeding or enforcement action, and required no leave of the court for its validity.[471]

Further approaches have been made by parties seeking "leave of the court" to launch proceedings in terms of section 133(1)(b) after the commencement of business rescue proceedings.

In *Resource Washing (Pty) Ltd v Zululand Coal Reclaimers Proprietary Ltd and Others*,[472] the applicant sought an order granting "to the extent necessary" leave in terms of section 133(1)(b) of the 2008 Companies Act to launch proceedings to set aside the resolution in terms of section 130(1)(a) and 130(5)(a) of the 2008 Companies Act. The order included relief declaring the business rescue proceedings to have terminated and for the provisional winding-up of the company. The court held that there was no need to apply in terms of section 133(1)(b) for leave to institute proceedings to set aside the resolution, as sections 130(5) and 132(2)(a)(i) permit applications to court to set aside a company's resolution to begin business rescue proceedings, without rendering these sections subject to the leave of the court being granted in terms of section 133.[473]

Section 133(1)(c) allows a set-off claim to be made against any claim made by the company in any legal proceedings, irrespective of whether those proceedings commenced before or after business rescue proceedings began. In insolvency law, a set-off of claims cannot apply against claims in the liquidated company, unless set-off had applied in the ordinary course of business prior to the liquidation of the company.[474]

One of the key features of business rescue is that a company in business rescue must retain the benefits of having a moratorium on claims by its creditors. Claims remain intact and are dealt with in the business rescue plan. As seen above, set-off is an exception to the principle of a moratorium on claims. It is not clear why set-off was included as an exception as it appears to undermine the general scheme of a business rescue. It would

471. Ibid at para 14.

472. *Resource Washing (Pty) Ltd v Zululand Coal Reclaimers Proprietary Limited and Others* (10862/14) [2015] ZAKZPHC 21 (20 March 2015).

473. Ibid at para 13. Also see *Msunduzi Municipality v Uphill Trading 14 (Pty) Ltd and Others* (11553/2012) [2014] ZAKZPHC 64 (27 June 2014), where the court held that leave in terms of section 133(1)(b) is required before the matter may be proceeded with. It is not permissible to proceed without the leave of the court and attempt, when the point is taken, to apply for such leave from the bar.

474. Section 46 of the Insolvency Act. See Marcus "Business Law & Tax Review" (4 October 2013) *Business Day*.

make more sense if it applied only to enable pre- business rescue claims to be set off against each other. The exception places the practitioner in a difficult position. The practitioner faces the challenge of ensuring a post- business rescue trading partner and in particular a creditor, does not have pre- business rescue claims to set off against post-business rescue obligations. A further issue is that section 154(2) of the 2008 Companies Act states that if a plan has been approved and implemented in accordance with Chapter 6, a creditor is not entitled to enforce any debt owed by the company immediately before the commencement of the business rescue process except to the extent provided for in the business rescue plan. The issue that arises is whether this provision trumps section 133(1)(c). Would a creditor be able to enforce its pre- business rescue claim if such claim to enforcement was recognised as part of the business rescue plan? The issue remains open to debate.[475]

Section 133(1)(f) deals with the exception to the initiation of proceedings by a "regulatory authority in the execution of its duties". It is submitted that a regulatory authority would include a municipality and parastatals such as Eskom.

"Regulatory authority" is defined in the 2008 Companies Act to mean an entity established in terms of national or provincial legislation responsible for regulating an industry or sector of an industry. This definition therefore has two legs, namely –

- an entity must firstly be established in terms of national or provincial legislation; and
- such entity must secondly be responsible for regulating an industry or sector of an industry.

In submissions made to the DTI in January 2011, it was suggested that the definition of "regulatory authority" should include the South African Revenue Authority (SARS). SARS was established by the South African Revenue Service Act 34 of 1997 (the SARS Act). It therefore successfully fulfils the first leg of the definition of business rescue.[476]

475. Ibid.

476. See section 128(1)(b)(iii) of the 2008 Companies Act. Also dealt with in Chapter 7, para 7.2.1.2. It was proposed that prior to the finalisation of the 2008 Companies Act, the legislature should have defined what was meant by a "regulatory authority". DTI's response was that the definition was wide enough to include all regulatory authorities and therefore no amendment was recommended. See Department of Trade and Industry website http://www.thedti.gov.za for presentation on the Business Rescue Bill – Slide 17.

Insofar as the second leg is concerned, one must consider the meaning of "regulating" and "industry". To *regulate* means to control or supervise by means of rules and regulations, and often the power to *regulate* necessarily implies the power to a certain extent of restricting and prohibiting.[477] SARS was established by legislation to collect revenue and ensure compliance with tax law. In terms of the SARS Act, SARS is an administratively autonomous organ of the State: it is outside the public service, but within the public administration. So although South Africa's tax regime is set by the National Treasury, it is managed by SARS.

Unfortunately, however, "industry" is not defined by the 2008 Companies Act and one must therefore look toward the ordinary and common-law meanings thereof. Black's Law Dictionary[478] defines "industry" as meaning (1) diligence in the performance of a task; (2) systematic labour for some useful purpose, akin to work in manufacturing or production; and (3) a particular form or branch of productive labour; an aggregate of enterprises employing similar production and marketing facilities to produce items having markedly similar characteristics. It would seem as though South African common law has accepted the third of such definitions, as the case of *R v Sidersky* 1928 TPD[479] held that:

> "industry" must signify something different from the words "trade" and "occupation" with which it is collocated, and should receive its accepted sense of a class of productive work or manufacture. For example, the building industry would therefore mean a branch of work through which buildings are produced.

SARS was clearly not established by national legislation to be responsible for regulating an industry in particular (nor a sector thereof), but rather to regulate compliance by all industries in terms of South African tax laws.

On a strict interpretation, therefore, SARS does not qualify as a *regulatory authority* as contemplated in the 2008 Companies Act as it was not established to regulate an industry (or sector thereof) in the sense of a class of productive work or manufacture. On a broad

477. *R v Du Preez* 1942 CPD.
478. Garner *Black's Law Dictionary* (2004).
479. *R v Sidersky* 1928 TPD 109.

interpretation, however, SARS can indeed be seen to be a *regulatory authority* as it regulates all industries.[480]

Section 133 creates much debate, and to an extent confusion, in the way it has been drafted. Notwithstanding this, the moratorium is a fundamental aspect in the rescue process and certainly requires clarity of interpretation.

In practice, it appears that this debate has become academic as the court has ruled that SARS are concurrent creditors in a business rescue.[481]

The moratorium often entices boards of directors to commence a voluntary commencement process so as to hold off aggressive creditors looking to recover on their claims. This constitutes an abuse of the benefits of the moratorium. The moratorium should only be available when a company can realistically be rescued in terms of the provisions of Chapter 6.

In *Johan Theron and Erf 2343 Houghton Estate CC (FirstRand Bank intervening),*[482] Berridge AJ stated:

> The moratorium which is created thereby (as well as the general moratorium on legal proceedings against the company during business rescue proceedings, as provided for in section 133 of the 2008 Act) could, if used for ulterior purposes, facilitate and enable yet further avoidance, or at least delay of debt, particularly in cases where there is no genuine *bona fide* intention to rescue the business of the Company. The potential for such abuse ought to be avoided by applicants for business rescue ensuring that full disclosure of all pertinent and relevant facts is made in the founding papers. It also hardly bears mentioning that any application for the commencement of business rescue proceedings must be *bona fide* and motivated by a genuine desire to achieve the purposes of the 2008 Act and the socio-economic purpose which it is intended to fulfil.

Many debtor companies that are in a position of financial distress would gladly place themselves into business rescue proceedings so as to obtain the benefits of the moratorium on claims offered by section 133 of the 2008 Companies Act. Many see such action as an abuse of the business rescue process. Unfortunately, the "payment holiday" to creditors in

480. In practice, we have not seen SARS seeking to obtain special treatment as a regulatory authority. Although this has not occurred, it is an issue that remains open to debate.

481. See *Commissioner of South African Revenue Services v Beginsel NO and Others* 2013 (1) SA 307 (WCC).

482. *Johan Theron v Erf 2343 Houghton Estate Limited, Private SA DVD Distribution (FirstRand Bank intervening)*, Case No. 2011/28187, South Gauteng High Court, Johannesburg (14 June 2012) (unreported) 23 at para 41.

the moratorium period is only one part of the process. Companies often fail to understand that in a very short period of time (at least within the ten-day period after the business rescue practitioner has been appointed) an essential aspect has to be dealt with: to persuade the practitioner that there is the possibility of the company being rescued or delivering a better dividend than in a liquidation. Often this possibility is found to be unrealistic and after the first meeting of creditors has taken place, the practitioner has no alternative but to place the company into liquidation.

It is submitted that business rescue must be considered at a very early stage of the company's slide into financial distress. Directors of South African companies really need to understand the legislation and the meaning of the definition of financial distress. The six-month period set out in section 128(1)(f) is there for a reason. The legislature clearly wanted directors to commence the financial distress assessment analysis to the forefront of the directors' agenda at board meetings where the issue might be considered. If there is a recognition of financial distress, coupled with a timely appointment of a business rescue practitioner, then the company has a realistic prospect of being rescued. Those resolutions that come too late might only result in a business rescue which delivers up a better dividend than one would receive in a liquidation. Those companies which are in fact insolvent would end up in a formal liquidation, with a liquidator selling off assets at distressed/liquidation values, usually delivering a negligible dividend to creditors.

It is also important to consider section 133 and the impact of such section on suretyships.[483] A suretyship is a contract whereby a person (the surety) undertakes to a creditor on behalf of a principal debtor, for the payment of the whole or part of what is due from such principal debtor, and by way of accession to his obligation.[484] By its very nature, a contract of suretyship in relation to a money debt, is one whereby the surety agrees with the creditor that, as accessory to the principal debtor's primary liability, he or she too will be liable for the debt. The essence of a suretyship obligation is the existence of the principal obligation of the debtor to which that of the surety becomes accessory.[485]

483. Section 133(1) of the 2008 Companies Act imposes the moratorium (stay) on claims during the business rescue period. The impact that such moratorium has on creditors' claims on suretyships is a controversial and complex issue.

484. For the legal definition of a contract of suretyship, see Forsyth and Pretorius *Caney's The Law of Suretyship* (2010) 29.

485. *Orkin Lingerie (Pty) Ltd v Melamed & Hurwitz* 1963 (1) SA 326 (W). See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-50(9) at para 18.6. For the nature of an accessory obligation, see Forsyth and Pretorius *Caney's The Law of Suretyship* (2010) 29.

Chapter 6 of the 2008 Companies Act deals with suretyships specifically in section 133(2) where the following is stated:

> During business rescue proceedings, a guarantee or surety by a company in favour of any other person may not be enforced by any person against the company except with the leave of the Court and in accordance with any terms the Court considers just and equitable in the circumstances.

It is clear that due to the accessory nature of a suretyship, this would mean that a suretyship is dependent on the existence of a valid underlying obligation. The obligation would be "stayed" on commencement of business rescue proceedings and could not be enforced in terms of section 133(1) of the 2008 Companies Act. It is submitted that the legislator intended that as a result of the commencement of business rescue proceedings, the general moratorium on legal proceedings against the company as imposed by section 133(1) of the 2008 Companies Act, would also apply where such company has given a guarantee or surety to a creditor on behalf of the indebtedness of the principal debtor to that creditor. The general moratorium on legal proceedings to enforce such guarantee or surety would therefore also apply to such guarantee or surety given by the company.

Generally, standard suretyships include standard wording relating to a "co-principal debtor". Alternatively, many suretyships contain provisions where the sureties bind themselves as sureties for the payment when due of all their present future debts of any kind of the principal debtor. Many financial institutions have removed the reference to "co-principal debtor" from their standard suretyship agreements as a result of the provisions set out in the National Credit Act. Many banks have removed the obligation of having to perform an affordability assessment of the surety on each and every occasion a suretyship is provided to the bank as surety for the co-principal obligation of the principal debtor.

However, it is submitted that this becomes problematic when one considers the implications of section 133 of the 2008 Companies Act in that no legal proceedings can occur against the company once business rescue proceedings have commenced. As a result this would prohibit the bank from proceeding against a surety on the basis that the 2008 Companies Act will prohibit action to be taken against the principal debtor, namely the company. Once such valid underlying obligation becomes tainted from an enforceability point of view, the bank will not be entitled to proceed against the surety itself.

However, should banks consider reintroducing the words "co-principal debtor" in their agreements, it is submitted that, notwithstanding section 133's prohibition on legal proceedings, the fact that the surety is a stand-alone, independent co-principal debtor, would entitle banks to proceed against such surety, notwithstanding the fact that the principal debtor, namely the company, had commenced business rescue proceedings. Consideration has been given by banks to possibly insisting that a standard guarantee is put up by all third parties that wish to "guarantee" the obligations of a company for its financial exposure to financial institutions.

In *Investec Bank Ltd v Bruyns*[486] the court distinguished the special provision contained in this subsection from the general moratorium provision contained in section 133(1), stating that section 133(2) applies to the exclusion of section 133(1) insofar as claims based on guarantees and suretyships are concerned. The court also confirmed that in cases dealing with guarantees and suretyships, the claims against the company may be enforced only with the leave of the court (and not with the consent of the business rescue practitioner).

In *Walkers Fruit Farms Limited v Sumner*[487] the word "guarantee" was given its ordinary meaning, which was to "assure a person of the receipt or possession of something"**.**

The word "guarantee" has commonly been used in the sense of a promise to pay upon the happening of a certain event rather than in the usual and more proper sense, when it is employed by a surety who promises to saddle himself with an obligation in respect of which the principal obligator defaulted.[488]

In *Investec Bank Limited v Bruyns*[489] Rogers AJ dealt specifically with the impact that a business rescue proceeding and section 133 would have on a suretyship given by an individual in favour of the company. The court carefully considered section 133(2) of the 2008 Companies Act and held that the section directly applied to a surety by the company and enforcement of that surety against the company itself. Section 133(1) allowed a defence *in personam* and could not be raised by the surety as a defence to a claim on suretyship.[490] In other words, a defence which is purely personal to the principal debtor

486. *Investec Bank Ltd v Bruyns* 2012 (5) SA 430 (WCC).
487. *Walkers Fruit Farms Limited v Sumner* 1930 TPD 398.
488. See *Hazis v Transvaal and Delagoa Bay Investment Co Ltd* 1939 AD 372. As a guarantee is an undertaking to pay and is not a suretyship, this would transpose the guarantor into a situation where he provides an independent and stand-alone undertaking in terms of which the guarantor guarantees the performance of the third party and thus creates a principal obligation entirely independent of the principal debt. In the case of a guarantee, it is submitted that the prohibition in section 133 of the 2008 Companies Act would not prohibit a bank from proceeding to enforce the guarantee, notwithstanding the fact that the company had filed for business rescue proceedings.
489. *Investec Bank Ltd v Bruyns* 2012 (5) SA 430 (WCC).
490. Ibid 435 at para 17.

(i.e. the company) may not be raised by the surety. The Judge stated "… if the lawmaker intended to prohibit creditors from enforcing their claims against sureties of companies undergoing business rescue proceedings, it would have done so".[491]

In a matter held before the Metal and Engineering Industries Bargaining Council Centre for Dispute, the Council ruled that section 133 does not prevent the Council from arbitrating a dispute over which it would otherwise have jurisdiction. The Council concurred with the finding in National Union of Metal Workers of South Africa on behalf of members of Motheo Steel Engineering CC, that section 133 of the 2008 Companies Act does not expressly amend the provisions of the Labour Relations Act and that the council would not be barred from determining the dispute.[492] In *Burba v Integcom (Pty) Ltd*[493] it was held that unfair dismissal proceedings may not be commenced or proceeded with in the Labour Court without the written consent of the business rescue practitioner or the leave of the High Court that has jurisdiction over the matter and as provided for in section 133(1) of the 2008 Companies Act.

In *Cawood NO and Others v Reaan Swanepoel t/a Reaan Swanepoel Attorneys and Others*,[494] the court ruled that it would be a contravention of section 133(1) if, while a company is under business rescue proceedings, a payment is made in terms of a writ of execution. This would be a contravention of the moratorium against "legal proceedings, including enforcement action".

Clearly, payment in terms of a writ of execution is contrary to the spirit of business rescue, in that all pre-commencement claims (including judgments and consequent writs of execution) be stayed in terms of the section 133(1) moratorium.

No provision in section 133 provides for what would happen if there was a violation of the moratorium. Mongalo states:

> As regards the concept of Moratorium, while our law is comparable with debtor-friendly jurisdictions in providing for the stay of proceedings against debtor in possession, a concern has been raised that there is no explicit provision addressing

491. Ibid 437 at para 23.
492. See *National Union of Metal Workers of South Africa obo Members v Motheo Steel Engineering* (J271/2014) [2014] ZALCJBH 315 (7 February 2014).
493. *Burba v Integcom (Pty) Ltd* JS539/12 – 2013, Labour Court Johannesburg (29 November 2013).
494. *Cawood NO and Others v Reaan Swanepoel t/a Reaan Swanepoel Attorneys and Others* 2015 JOL 34283 GP.

> violations of the stay, whereas under Chapter 11 of the Bankruptcy Code (11 U.S.C.§ 362), an act in violation of the stay can result in a civil contempt citation and is null and void. Furthermore, it appears as though, under Chapter 6 of the Companies Act, the moratorium can continue even after the business rescue plan is adopted whereas under Chapter 11, the stay concludes at the end of the Chapter 11 proceedings.[495]

The general moratorium created by section 133 applies only for the duration of the company's business rescue proceedings. When the moratorium commences, and when it ends, depends on the manner in which business rescue proceedings have commenced or terminated. It is possible for a business rescue plan, in terms of section 150(2)(b)(i), to provide for a moratorium that extends beyond the duration of the business rescue proceedings. Such a moratorium would not be a wide one, but would be specific to a creditor or a specific group of creditors. At all times, however, section 133(1)(b) permits the court to grant leave to a person to institute legal proceedings.[496]

It is submitted that South Africa has made significant steps forward in providing an automatic moratorium upon the commencement of business rescue. As in international jurisdictions, the breathing space afforded to the company in securing time to restructure, without the burden of having to deal with creditor claims, is an essential feature of any successful restructuring regime. The moratorium preserves assets and prevents the watering down of value by creditors sharing in the assets of the company with no prospect of the compromise of debt. Any restructuring regime without a moratorium is doomed to failure. The moratorium, like in international jurisdictions, provides the company with the ability to properly understand the financial position of the company and assists the practitioner in assessing claims, the value of the business and assets, the nature and effect of prejudicial contracts and generally the ability to assess the prospects of rescue. This ability ultimately protects creditors as the result of the process is a maximisation of the value of the estate and the ability to deliver a decent rescue dividend to creditors.

495. Mongalo "Two Steps Forward and One Step Back is better than One Step Forward and Two Steps Back: A Limited Comparative Analysis of Business Rescue in South Africa" Opening address for *Business Rescue – First three years* University of Pretoria (7 October 2014) 5. On the importance of the moratorium in South African business rescue proceedings, see Wessels and De Weijs *International Contributions to the Reform of Chapter 11 U.S. Bankruptcy Code* (2015) 140.

496. Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-50(9) at para 18.6. Also see *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd and Others* 2013 (6) SA 471 (GNP) at para 5. For general comments on the section 133(1) moratorium see Van Niekerk and Hattingh "Instituting proceedings against a company under supervision" (2015) *De Rebus* 32 – 33.

7.5 MANAGEMENT OF THE COMPANY IN THE RESCUE PROCESS – THE BUSINESS RESCUE PRACTITIONER

The business rescue practitioner is the most important party in the business rescue process. From the moment he or she is appointed, the practitioner is obligated to supervise the company in terms of the provisions of the 2008 Companies Act. There are important duties and obligations that the practitioner must comply with, as well as very strict time lines that guide the efficient conduct of the process.[497]

As stated above, the appointment of a supervisor or practitioner is a feature of international restructuring practice.[498] The supervisor plays a critical role in drafting a business rescue plan which can be placed before creditors and other stakeholders for approval. His or her skill set is unique, in that the practitioner must oversee and direct the ongoing conduct of the company while at the same time attend to the restructuring of the affairs and business of the company, albeit within the confines of a moratorium on claims.[499]

An independent business rescue practitioner is appointed to supervise the company in terms of the 2008 Companies Act. The business rescue practitioner is either appointed by the court or by the company in terms of a board resolution.[500]

A practitioner has various powers in terms of supervision of the company and in particular has full management control during the process. The practitioner's objective is to place a business rescue plan before creditors for approval and to achieve the objectives set out in Chapter 6 of the 2008 Companies Act.[501]

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497. For a synopsis of the role of the business rescue practitioner see Van der Walt "A Turnaround Practitioner's View of New Business Rescue Legislation" in Harvey (ed) *Turnaround Management and Corporate Renewal: A South African Perspective* (2011) 148–150.

498. See Chapter 5, para 5.5.3.1.

499. See Chapter 5, para 5.5.3.1. The principles set out in the UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 174 confirm the need to appoint an appropriately qualified supervisor that will effect an efficient and effective rescue of the failing entity. In addition, the role and importance of a competent supervisor once appointed are a feature of the EBRD – see the principles applicable to insolvency officers. See www.ebrd.com.

500. Sections 129 and 131 of the 2008 Companies Act.

501. Section 140(1) of the 2008 Companies Act. For a full analysis of the role of the business rescue practitioner, see Chapter 3, para 3.4.9. The practitioner takes over the running (supervision) of the company together with its board of directors. This is not a "debtor-in-possession" scenario like in Chapter 11 of the US Bankruptcy Code. As regards the Business Rescue Practitioner, prior to the introduction of Chapter 6 Business Rescue Proceedings, the previous statute allowed for the appointment of a judicial manager who typically took over the running of the business and was, for all intents and purposes, a predecessor to (if not the) liquidator. The new provision has effectively emulated this practice by introducing the position of a business rescue practitioner, who, like the judicial manager, takes over the running of the business with an intention to rescue it, although he may delegate his powers to the directors and managers of the corporate entity concerned. In a typical "debtor in possession" business rescue dispensation like that of the US, pursuant to U.S.C. § 1104(a); 1107, the debtor company is left in control of the business and bankruptcy proceedings except in very limited situations where a trustee may be appointed only for cause, including "fraud, dishonesty, incompetence".

The business rescue practitioner is an individual whose skill set is quite different to that of the traditional South African liquidator,[502] although similarities exist. Bradstreet was of the following view:

> Quite the contrary, however, would be the case when the practitioner arrives on a salvage mission, seeking to slow the sinking of the business and bringing as much property as possible to shore. In this capacity, a business rescue practitioner will serve a role similar to that of a liquidator, and in spite of the criticisms that have been advanced in relation to such persons acting as "rehabilitation" practitioners, the skill sets of liquidators would be invaluable where the practitioner is tasked with reorganising with a view to an effective liquidation by way of s 131.[503]

In South Africa, the role of the practitioner is focused on the "rescue" or "rehabilitation" of the enterprise. Bradstreet states:

> Taking this approach in appropriate circumstances should therefore not portray the practitioner as a managerial mutineer seeking to plunder the vessel for its loot (the old maxim for this metaphor being "liquidation ex debito justitiae"), but rather a method of preserving value for creditors and other interested parties where the only other option would be traditional liquidation proceedings.[504]

The skill set of the practitioner is fundamental to the success of the outcome that is envisaged in terms of section 128(1)(b).[505] As Bradstreet alludes to, many of the practitioners come from a liquidation background where their historical focus was on the realisation of assets at best, not necessarily on the rehabilitation of companies. It is submitted that what is required is a skill set on the part of the individual practitioner who understands the legislation and the expectation that is required when implementing the rescue provisions set out in Chapter 6. A fundamental understanding of the legislation, coupled with an ability to understand the financial position of the company, the inherent shortfalls in its business model and the extent that is required to restructure the company from a loss making position to that of profit, will be the focus in years to come.

Also see Mongalo "Two Steps Forward and One Step Back is better than One Step Forward and Two Steps Back: A Limited Comparative Analysis of Business Rescue in South Africa" Opening address for *Business Rescue – First three years* University of Pretoria (7 October 2014) 5.

502. Appointed in terms of Chapter 14 of the 1973 Companies Act.

503. Bradstreet "Lending a Helping Hand – The Role of Creditors in Business Rescue?" (December 2013) *De Rebus* 23.

504. Ibid. For the debate regarding whether creditors in South Africa still have the right to liquidate a company in South Africa, see Mahon "Ex Debito Justitiae Principle Liquidated?" (March 2013) *De Rebus* 38.

505. Rushworth "A Critical Analysis of the Business Rescue Regime in the Companies Act 71 of 2008" (2010) *Acta Juridica* 389–392.

7.5.1 QUALIFICATIONS

During the bill phase of the 2008 Companies Act, there was some debate as to whether business rescue practitioners should be taken from the existing ranks of insolvency practitioners or whether a whole new business rescue industry or profession should be created.

The level of qualification for business rescue practitioners set out in sections 138(1), (2) and (3) as follows:

> (1) A person may be appointed as the business rescue practitioner of a company only if the person –
>
> (a) is a member in good standing of a legal, accounting or business management profession accredited by the CIPC;
>
> (b) has been licensed as such by the CIPC in terms of subsection (2);
>
> (c) is not subject to an order of probation in terms of section 162(7);
>
> (d) would not be disqualified from acting as a director of the company in terms of section 69(8);
>
> (e) 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
>
> (f) is not related to a person who has a relationship contemplated in paragraph (d).
>
> (2) For the purposes of subsection (1)(a)(ii), the CIPC may license any qualified person to practice in terms of this Chapter and may suspend or withdraw any such licence in the prescribed manner.
>
> (3) The Minister may make regulations prescribing –
>
> (a) standards and procedures to be followed by the CIPC in carrying out its licensing functions and powers in terms of this section; and
>
> (b) minimum qualifications for a person to practice as a business rescue practitioner, including different minimum qualifications for different categories of companies.

The regulations[506] deal with the manner in which the accreditation of professions and licensing of business rescue practitioners should take place.[507]

The English text of section 138(1)(a) is in conflict with the Afrikaans text of the 2008 Companies Act, creating confusion when one interprets the section. The English text requires prospective business rescue practitioners to be *both* (a) a member in good standing of a legal, accounting or business management profession[508] accredited by the CIPC, *and*[509] (b) someone who has been licensed by the CIPC in terms of subsection 2. It is submitted that the English version of the 2008 Companies Act is incorrect.

The Afrikaans version of section 138(1) as well as the Regulations require prospective candidates for appointment as business rescue practitioners to qualify by *either* being a member of one of the accredited professions *or* licensed by the CIPC.

The President of the Republic of South Africa signed the English version of the 2008 Companies Act, that is, the incorrect version, and thus the incorrect English version of the 2008 Companies Act remains applicable.

The problem is that to date, the CIPC has not yet accredited any of the professions in South Africa. Therefore, every appointment that has been made to date only gives effect to the "licensing" portion as set out in section 138(2).[510]

Until May 2015, the CIPC appointed business rescue practitioners on an *ad hoc* basis to each company that had become subject to supervision in terms of the 2008 Companies

506. Regulation 126 to the 2008 Companies Act. This regulation prescribes the factors that the CIPC must take into account when considering an application for accreditation of a profession under section 138(1) of the 2008 Companies Act. Issues such as the qualifications and experience that are set as conditions for membership of any such profession (legal, accounting or business management practice) and the ability of such profession to discipline its members will eventually be taken into account by the CIPC when it decides to accredit a profession. Once a practitioner is a member of a duly accredited profession, it is envisaged that there will no longer be a need for him or her to apply for a licence as set out in section 138(1)(b) of the 2008 Companies Act.

507. Recent attempts have been made by the CIPC to "accredit" professional bodies so as to assist with the elevation of the standards and competency levels of business rescue practitioners. These attempts however remain work in progress.

508. "Business management profession" is not defined in the 2008 Companies Act.

509. The word "and" does not appear in the section but one must read it into the interpretation of section 138(1) of the 2008 Companies Act.

510. Strictly speaking, every appointment of a business rescue practitioner to date has thus been invalid, as no business rescue practitioner is a member of a profession duly accredited by the CIPC. The Afrikaans version of the 2008 Companies Act has thus been applied to date when it comes to appointing business rescue practitioners. To date there has been no official Practice Note published by the CIPC in regard to the status of accreditation of practitioners. on 5 July 2011. In such note, the CIPC stated (see www.cipc.co.za) as follows:

> The CIPC has decided to thoroughly investigate the turnaround practices locally and internationally before final licenses are granted to appropriate applicants to execute business rescue proceedings. It is also envisaged that a workshop will be arranged with relevant stakeholders to ensure proper consultation on the guidelines and requirements when such licenses are issued.
>
> In the interim all business that make a decision to start rescue proceedings can file notices prescribed in the 2008 Companies Act with the CIPC and identify a prospective practitioner that will be considered to be licensed on an urgent basis. Such interim licences will be granted for a limited period and will relate only to that specific business. Several licences granted on this basis have been issued. It is not foreseen that this process will continue for longer than three months.

Act.[511] The business rescue practitioner would make application to the CIPC to be appointed in a particular company in which that business rescue practitioner had been nominated. Generally, successful practitioners tend to be appointed in the larger companies that file for business rescue.[512] The business rescue practitioner would, together with the resolution appointing him or her,[513] submit a comprehensive curriculum vitae to the CIPC motivating why he or she should be appointed. If such person's application met the requirements of regulation 126(2) to (8), he or she would be appointed.[514]

The same procedure would apply if a business rescue practitioner is appointed by the court in terms of section 131(5) of the 2008 Companies Act. The business rescue practitioner is appointed by the court as an interim practitioner, if such person satisfies the requirements of section 138. The business rescue practitioner would then be appointed by the CIPC on the same basis as above.

The court-appointed business rescue practitioner remains an interim practitioner until his or her appointment is ratified at the first meeting of creditors by a majority of independent creditors' voting interests.[515]

It is interesting to note that it is the court-appointed practitioner that requires ratification at the first meeting of creditors and not the practitioner appointed by the board of directors of the company by way of a section 129 resolution.[516]

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511. Regulation 126(2)–(8) to the 2008 Companies Act sets out the manner in which licences will be granted and when such licences will be revoked. Generally, if a practitioner makes application for an *ad hoc* licence, he or she must show the CIPC that he or she is of good character and integrity and that the practitioner has sufficient education and experience to equip such practitioner to perform the functions of a business rescue practitioner. Disqualifications for such applications are set out in section 138(1)(c)–(f) as read with regulation 126(4) and (5).

512. Bradstreet "Business Rescue Practitioners: What Role for the Legal Profession? (July 2012) *De Rebus* 22. Owing to the expenses involved in business rescue, particularly the practitioner's remuneration, it is generally accepted that close corporations, although in theory they have access to the procedure, will be largely excluded. Smaller close corporations' lack of capital and BRPs' lack of experience generally, however, appear to have fostered a mutually beneficial relationship between close corporations and BRPs, whereby the latter have been willing to charge lower fees in exchange for the benefit of gaining experience in rescuing close corporations. However, this wider accessibility for close corporations is likely to be for a limited time only.

513. In terms of section 129(3)(b) of the 2008 Companies Act, within five business days after a company has adopted and filed a resolution (period can be extended by the CIPC), the company must appoint a business rescue practitioner who satisfies the requirements of section 138. The business rescue practitioner must have consented in writing to accept such appointment.

514. The business rescue practitioner would be appointed by the CIPC in terms of Form CoR 123.2. Regulation 127(2)(b) to the 2008 Companies Act classifies companies as large, medium or small, depending on the public interest score of each such company (see Regulation 26(2)). The business rescue practitioner would also be classified in terms of Regulation 127(2)(c) as senior, experienced and junior practitioners, depending on how many years of practice each such practitioner might have had as a practitioner or in business turnaround practice. The latter is defined in Regulation 127(2)(a) as "activities of a professional nature engaged in before the effective date, that are comparable to the functions of a business rescue practitioner in terms of the 2008 Companies Act". The various categories of business rescue practitioners (senior, experienced and junior) would be appointed to large, medium and small companies respectively.

515. Section 147 of the 2008 Companies Act. See Bradstreet "Business Rescue Practitioners: What Role for the Legal Profession?" (July 2012) *De Rebus* 22.

Conditional licensing on an *ad hoc* basis had its supporters. Bradstreet is of the opinion that the CIPC should use the conditional licensing mechanism in a manner which imposes restrictive conditions on the issue of a license in terms of regulation 126(6)(b)[517] Bradstreet was concerned that in the early stages of business rescue it was necessary to promote creditor confidence in the procedure, and thus the appointment of able and efficient practitioners was of extreme importance.[518]

Conditional licensing for practitioners is dealt with in regulation 126 (Part B) to the 2008 Companies Act Regulations. The CIPC can revoke a licence if the practitioner, after being licensed, becomes disqualified from appointment as a practitioner in terms of section 138(1)(c) or (d). Further, the CIPC may suspend or revoke a license if the CIPC has reasonable grounds to believe that the person is no longer qualified to be licensed or has contravened the conditions of the license.[519]

In May 2015, the CIPC commenced issuing practitioners with "open licences". If a practitioner satisfied the requirements, he or she will get a "conditional license to act as a practitioner". These "licensed" practitioners will be able to be appointed as practitioner to a company without having to submit their credentials each time a company nominates such practitioner for an appointment.[520] Such a "conditional license" can be suspended or withdrawn on good cause shown to the CIPC.[521]

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516. One would have thought that this would be the opposite. A court-appointed practitioner is only appointed once the basis of such nomination is fully debated and set out in the court papers and which is carefully deliberated by the Presiding Judge, whereas the appointment of the practitioner by way of resolution is effected by directors at a board meeting without significant deliberation by any forum.

517. See Bradstreet "Business Rescue Practitioners: What Role for the Legal Profession? (July 2012) *De Rebus* 22. Regulation 126(6)(b) allows the CIPC to issue a conditional license on terms that are reasonable, having regard to the applicant's education and experience.

518. Ibid.

519. In a Practice Note (4 of 2015), the CIPC provided certain guidelines for business rescue practitioners with the title *Conditions of the Conditional License*. Such practice note sets out certain prescriptive conditions to what is expected of practitioners in respect of their role in the administration of a company under business rescue. Compliance with the "conditions" were set out in the Practice Note which include reminders to adhere to the provisions of section 132(3); reporting requirements; sections 147 and 148 in respect of convening meetings of creditors/employees; section 150 in respect of the preparation of the business rescue plan; section 151 in respect of the publication of the business rescue plan and section 153(1) and (5) in respect of the filing of the notice of the termination of the business rescue proceedings. The CIPC stated that "failure to comply with these conditions will be regarded as reasonable grounds for the Commission to suspend or withdraw the license of the Practitioner in terms of Regulation 126(7)(b) for a particular rescue proceeding or on good cause, for all business rescue proceedings".

520. Laher "Issuing of business rescue licenses by the CIPC" Letter to the South African Restructuring and Insolvency Practitioners Association (SARIPA) (8 May 2014) available at www.saripa.co.za.

> CIPC has recently discontinued its practice of issuing ad hoc licenses to business rescue practitioners (BRPs) on a per appointment basis. As a result, CIPC is no longer accepting CoR126.1 forms (and attachments) when processing a BRP's appointment as a company's business rescue practitioner.
>
> Instead of issuing the certificate known as the form CoR126.2 (in respect of each business rescue in which a BRP takes an appointment), CIPC is now issuing a "conditional license" to each BRP. This license, which is over-arching and therefore not temporary, must be obtained before any further appointments in a business rescue will be confirmed by CIPC.

Many practitioners in South Africa come from an accounting background, rather than a legal background.[522] The role that the legal profession plays in business rescue proceedings has been debated. Some argue that the legal profession may have a somewhat limited role to play in business rescue. In the main, it is the practitioner who comes on board to realign the internal management and strategy of the business with a view to steering it towards a profitable going concern.[523]

Research has shown that the development and implementation of a business rescue plan, involves a high degree of expertise in management and business strategy rather than legal knowledge, although some legal expertise is crucial, particularly in regard to issues of compliance.[524] Thus the role of the legal profession in the business rescue process remains uncertain.[525]

The Act envisages that persons to be appointed should have some experience of "business management". No professions have yet been accredited in terms of the 2008 Companies Act despite the CIPC stating publicly that they are "investigating" this as a possibility.[526]

Some practitioners are actually liquidators.[527] There has been some debate relevant to the skill set available to liquidators who would normally be tasked to realise and sell off assets

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Accordingly, CIPC will not process any form CoR123.2 received unless the BRP named therein has already obtained his or her "conditional license".

521. See CIPC Practice Note 1 of 2015: *Conditions of the Conditional License*. In terms of Regulation 126(7)(b) to the 2008 Companies Act, the CIPC can suspend or revoke a license if the CIPC has reasonable grounds to believe that the person is no longer qualified to be licensed or has contravened the conditions of the license. Further, see *Notice to Customers*: Application for conditional licensing as a business rescue practitioner (CoR126.1), Notice 32 of 2015, 29/5/2015 (www.cipc.co.za).

522. Bradstreet "Business Rescue Practitioners: What Role for the Legal Profession?" (July 2012) *De Rebus* 22.

523. Ibid 23.

524. See Pretorius "Tasks and activities of the business rescue practitioner: A strategy as practice approach" (2013) 17 (3) 1 *South African Business Review*. The author (being a legal practitioner himself) concurs with this view. In the larger cases where issues are complex, where there are large volumes and value of creditors, where a buy-out transaction is being negotiated and where the company's exposure is significant, a practitioner will require legal assistance in the conduct of the business rescue proceedings. In particular a practitioner is entitled to employ legal support services and recover such legal fees as is contemplated in regulation 128(3) as read with section 143(1) to (4) of the 2008 Companies Act. Also see comments by Pretorius in this article.

525. Bradstreet "Business Rescue Practitioners: What Role for the Legal Profession?" (July 2012) *De Rebus* 22 states the following:

> The question that remains is where this leaves the attorneys. Attorneys or firms of attorneys may be attractive to financially distressed companies – or their creditors (or other "affected persons") – when they have expertise in a particular sector that is likely to contribute to the success of a business rescue. Creditors would probably consult their attorneys in most cases about the viability of applying to court to place a debtor under business recue, and financially distressed companies are likely to have someone in mind who they would like to assist in an internally instigated rescue and restructuring. Attorneys may be particularly useful in drafting a "business rescue plan" in terms of section 150(2). An analysis of available business rescue plans to date by Professor Marius Pretorius and Wesley Smith of the University of Pretoria indicates that compliance with the minimum requirements set out in the Act is very poor. Significant deficiencies include a lack of information regarding the financially distressed company's creditors, details regarding the post-commencement financing and property available to pay creditors, and the absence of projected financial statements.

526. See Pretorius "A Competency Framework for the Business Rescue Practitioner Profession" (18 August 2014) 14 (2) *Acta Comercii* available at http://www.actacommercii.co.za/index.php/acta/article/view/227.

piecemeal and at "fire-sale" values. Practitioners, on the other hand, have to keep the business of the company afloat, ensure that management remains intact, pursue post-commencement finance, construct a plan, engage with creditors, shareholders, employees and prospective officers for the business of the company. The practitioner is a supervisor and does not have the luxury of time on his or her side.[528]Loubser holds the opinion that "liquidators are financial undertakers, not rescuers".[529] Liquidators are experts in breaking up and selling of businesses piecemeal, while business rescue practitioners would continue running the business of the company until a purchase is identified. Historically, judicial managers were appointed from the ranks of liquidators. Notwithstanding the fact that the new legislation now creates a separate profession for business rescue practitioners, the majority of applicants for a business rescue license will come from liquidators. The mindset will be that liquidators will perceive business rescue as a "normal extension of their profession".[530]

In practice, we have seen the establishment and development of a new industry of business rescue practitioners. Although certain of these individuals did (and still do) practice as liquidators. the vast majority of these practitioners come from accounting, engineering and legal backgrounds. As we have not yet seen formal accreditation of professions (in terms of regulation 126), we continue to see licensing by the CIPC of a number of practitioners, all from varying and disparate backgrounds.

In the case of *Breedt v P G Breedt Boorkontrakteurs CC and Others*,[531] Hughes AJ dealt with a business rescue plan submitted by the member of the close corporation in conjunction with chartered accountant, who was nominated to be the suggested business

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527. Liquidators in South Africa remain unregulated. Recent amendments involving a new roster system for the appointment of liquidators have been published for comment. See Government Gazette No. 37287 Notice 77 *Policy on the Appointment of Insolvency Practitioners* (7 February 2014). Also see Loubser "An International Perspective on the Regulation of Insolvency Practitioners" (2007) 19 *SA Merc LJ*. Prior to the promulgation of the 2008 Companies Act, there was quite some debate as to whether business rescue practitioners should be taken from the existing ranks of liquidators (insolvency practitioners), or whether a whole new profession should be created. In the end, government opted to create a whole new profession, namely business rescue practitioners. Although this is the case, many liquidators qualify for appointment. While liquidators do not have to formally qualify for appointment to companies in liquidation, business rescue practitioners do have to be appointed by the CIPC to supervise a company under supervision. Therefore, some regulation exists in respect of business rescue practitioners, at least insofar as the appointment is concerned. See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-78 at para 18.14.1.

528. Section 132(3) of the 2008 Companies Act. The period for a business rescue proceeding to commence and terminate is 3 months, a very limited time period.

529. Loubser "Tilting at Windmills? The Quest for an Effective Corporate Rescue Procedure in South African Law" (2013) 25 *SA Merc LJ* 137.

530. Ibid.

531. *Breedt v P G Breedt Boorkontrakteurs CC and Others* (10581 / 2012) [2013] ZAGPPHC 17 (4 February 2013).

rescue practitioner. This very plan was annexed to the court application for an order for business rescue in terms of section 131 of the 2008 Companies Act. The nominated business rescue practitioner had already had some "prior dealings with the provisional plan". The Judge was of the view that, in this particular matter, such prior dealings and influence over the plan were in conflict with the provisions of section 138(1)(e) and the proposed practitioner was therefore conflicted.

Statistics from the CIPC show how many practitioners are from the accounting and legal professions as opposed to those from the body of practising liquidators. As at the end of September 2014, CIPC confirmed that 201 licences have been granted to practitioners (accredited) for business rescue appointments. From those, 42 per cent are accountants, 42 per cent are attorneys and 11 per cent are business consultants. The South African Restructuring and Insolvency Practitioners Association (SARIPA)[532] has now included business rescue practitioners as members of the association. Bradstreet is of the view that the new business rescue legislation will create an expectation of "new opportunities and a new area of specialisation". There will be the potential of financial reward for those who will seize the opportunity.[533]

Statistics demonstrate that since the date of the implementation of Chapter 6, in May 2011, there have been 1756 business rescue filings in South Africa.[534] The CIPC believes that the success rate as at 2014 was approximately 12 to 15 per cent, which takes into account those companies where business rescue matters are still pending.[535]

These statistics remain a moving target and it is hoped that the CIPC will continue to provide updated statistics on an ongoing basis.

532. The South African Restructuring and Insolvency Practitioners Association (SARIPA) has formed a Business Rescue and Restructuring Committee dedicated to assisting members of SARIPA with education and training on business rescue issues as well as liaising with CIPC in respect of future possible accreditation of business rescue practitioners in South Africa. The author is a member of this committee.

533. Bradstreet "Business Rescue Practitioners: What Role for the Legal Profession?" (July 2012) *De Rebus* 22. As stated previously, the business rescue process has created a whole new industry for practitioners. It is the author's view that practitioners who have a financial and accounting background are best placed to assist as practitioners.

534. See CIPC *Status of Business Rescue Proceedings in South Africa* (November 2015) http://www.cipc.co.za/files/5914/4488/9277/Status_of_Business_Rescue_in_South_Africa_November_2015_version1_0.pdf. See discussion on up-to-date statistics in Chapter 8, para 8.3.3.

535. Courtesy of CIPC; statistics made available at a presentation given by Mrs C Klokow on 7 October 2014 at the University of Pretoria. Success rates of business rescue proceedings to date remain unspecified and vague. See discussion on up-to-date statistics in Chapter 8, para 8.3.3.

7.5.2 REMOVAL AND REPLACEMENT

A business rescue practitioner may be removed or replaced. In terms of section 139:

> (1) A practitioner may be removed only –
>
> (a) by a Court order in terms of section 130; or
>
> (b) as provided for in this section.
>
> (2) Upon request of an affected person, or on its own motion, the Court may remove a practitioner from office on any of the following grounds:
>
> (a) Incompetence or failure to perform the duties of a business rescue practitioner of the particular company;
>
> (b) failure to exercise the proper degree of care in the performance of the practitioner's functions;
>
> (c) engaging in illegal acts or conduct;
>
> (d) if the practitioner no longer satisfies the requirements set out in section 138(1);
>
> (e) conflict of interest or lack of independence; or
>
> (f) the practitioner is incapacitated and unable to perform the functions of that office, and is unlikely to regain that capacity within a reasonable time.
>
> (3) The company, or the creditor who nominated the practitioner, as the case may be, must appoint a new practitioner if a practitioner dies, resigns or is removed from office, subject to the right of an affected person to bring a fresh application in terms of section 130(1)(b) to set aside that new appointment.

A business rescue practitioner may be removed by an order of court in terms of section 130,[536] or as provided for in section 139. It is not clear from the provisions of section 139 what "incompetence" by the practitioner amounts to, but no doubt this is something that the court will decide by looking at all the facts and by judging each case on its own merits.

Chapter 6 does not provide any guidance as to what is meant by a practitioner not exercising the proper degree of care in the performance of his or her functions. However,

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536. Section 130(1)(b) of the 2008 Companies Act provides that a practitioner may be removed on the grounds that the practitioner does not satisfy the requirements of section 138, is not independent and lacks the necessary skills having regard to the company's circumstances. This type of removal is, however, linked to the appointment of the practitioner in the section 129 resolution (voluntary commencement procedure). See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-84–18.85 at para 18.14.3.

the practitioner, in addition to the powers and duties specifically conferred on him or her by Chapter 6, also has the responsibilities, duties and liabilities of a director as set out in sections 75 to 77 of the 2008 Companies Act. No doubt the court will look at all of these factors holistically in order to determine whether or not a business rescue practitioner has exercised the proper degree of care in the performance of his or her functions.[537]

In *Copper Sunset Trading 220 (Pty) Ltd t/a Build It Lephalale (in business rescue) v Spar Group Limited and Normandien Farms (Pty) Ltd*,[538] the court considered the implication of section 138(1)(e) of the 2008 Companies Act. Section 138(1)(e) provides that a person may be appointed as the business rescue practitioner of a company only if that person 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.[539] The court held that there was no factual basis to show that the duly appointed practitioner's integrity, impartiality or objectivity was compromised by the mere fact that he acted as the attorney of record for the company prior to the commencement of the business rescue proceedings. No objection was raised at any of the creditors' meetings held and thus it was held that the respondents had acquiesced to his appointment as practitioner.[540]

Business rescue practitioners need to ensure that throughout the business rescue process they remain independent. If creditors believe that any class of creditor is being favoured in any manner, such creditors would have good grounds to launch an application for the practitioner's removal. Conflicts of interest would also feature in such a consideration. As set out above, a pre-assessment done by the practitioner prior to his appointment would not affect his independence, even if such practitioner's fees were paid by the company or by a creditor or group of creditors. Of course, all depends on the facts in each case and the manner in which the practitioner conducts him- or herself in the supervision of the company during the business rescue period.[541]

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537. Ibid 18-84–18-86 at para 18.14.3.

538. *Copper Sunset Trading 220 (Pty) Ltd t/a Build It Lephalale (in business rescue) and Spar Group Limited and Normandien Farms (Pty) Ltd* 2014 (6) SA 214 (LP).

539. This would be one of the grounds of removal contemplated in section 139(2)(d) of the 2008 Companies Act.

540. *Copper Sunset Trading 220 (Pty) Ltd t/a Build It Lephalale (in business rescue) and Spar Group Limited and Normandien Farms (Pty) Ltd* 2014 (6) SA 214 (LP) at paras 23–24.

541. In the matter of *Advanced Technologies and Engineering Company (Pty) Ltd (in business rescue) v Aeronautique et Technologies Embarquees SAS and 4 Others* Case No. 72522/11, North Gauteng High Court, Pretoria (June 2012) (unreported), the business rescue

The status and obligations of a practitioner in terms of Chapter 6 were clearly set out by Pillay J in *Resource Washing (Pty) Ltd v Zululand Coal Reclaimers Proprietary Limited and Others*.[542]

The judge made it quite clear that a business rescue practitioner has the same responsibilities, duties and liabilities as a director of the company, as set out in sections 75 to 77 of the 2008 Companies Act.[543] Their duties are non-negotiable and they are duty bound to exercise independent discretion and cannot be a "dummy" or "puppet", blinding following the instructions of a shareholder or anyone else who appointed him/her. The practitioner has a statutory duty to act *bona fide* and in the best interests of the company. Under section 77, the practitioner assumes the same liability as directors and prescribed officers in the company. His/her liability will include those arising from a breach of his/her fiduciary duty which results in losses, damages or costs unnecessarily incurred by the company.[544]

The judge went on to confirm that the practitioner is a facilitator and will have to deal with conflicting and competing claims. There is an expectation that he/she be trustworthy, open, independent, impartial, competent and capable.[545]

It is submitted that the elevation of a practitioner to that of a director is important. The legislature intended that with the appointment as business rescue practitioner, comes significant responsibilities which should be taken seriously by the appointee. Multiple appointments by practitioners in various companies under rescue will not assist. It is submitted that practitioners can only really administer/supervise one or two appointments at any one time effectively. Proper attention and time must be devoted to the task at hand. If this is not done, the successful outcome of a business rescue process will be prejudiced. Independence and impartiality must be present which enable a practitioner to take a high

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practitioner was "removed" only by virtue of the fact that the Court set aside the company's resolution for business rescue as a nullity, in terms of section 129(5). Also see Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 1 (2010) 3 *TSAR* 2010 507–508.

542. *Resource Washing (Pty) Ltd v Zululand Coal Reclaimers Proprietary Limited and Others* (10862/14) [2015] ZAKZPHC 21 (20 March 2015) 20 at paras 54–56 20.

543. In particular section 75 of the 2008 Companies Act deals with directors' personal financial interests; section 76 with the standard of directors' conduct and section 77 with liability of directors and prescribed officers for breaches of the 2008 Companies Act. Note the basis upon which a practitioner can be removed in section 139 of the 2008 Companies Act.

544. See *Resource Washing (Pty) Ltd v Zululand Coal Reclaimers Proprietary Limited and Others* (10862/14) [2015] ZAKZPHC 21 (20 March 2015) 20 at paras 54–56 20.

545. Ibid.

level view of the business, its prospects of trading into a solvent position and whether a discharge from business rescue is a realistic and achievable possibility.

7.5.3 POWERS AND DUTIES

As set out in section 140(1), during a company's business rescue proceedings, the business rescue practitioner has full management control of the company in substitution for its board and pre-existing management.[546]

South Africa has not followed the Chapter 11 approach of "debtor in possession" which allows for the *bona fide* management of the company to continue as if it were not under any form of administration. The legislature has rather gone for the British and Australian approach by placing the property and affairs of the company into the hands of an independent practitioner.[547]

Chapter 6 does not provide for complete divestment (like in the old judicial management procedure) but instead confers broad powers on the business rescue practitioner, who has full management control of the company in substitution for its board and pre-existing management.[548]

"Management control" has not been defined in the 2008 Companies Act. Whilst there may be an argument that management control would refer to day-to-day management, it is submitted that the business rescue practitioner would sit alongside the existing directors in the role of supervisor to the board and management.[549]

The business rescue practitioner would, in addition to such a supervisory role, have the obligation to make important decisions in respect of, *inter alia*, post-commencement financing,[550] the changes to the workforce having regard to the ordinary course of attrition and negotiating new employment terms,[551] the necessity to consider retrenchments,[552] the

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546. Section 140(1)(a) of the 2008 Companies Act.
547. Bradstreet "The Leak in the Chapter 6 Lifeboat: Inadequate Regulation of Business Rescue Practitioners may Adversely Affect Lenders' Willingness and the Growth of the Economy" (2010) *SA Merc LJ* 199.
548. Note that it is not clear whether the words "in substitution" imply a complete divestment. See Winer *The Companies Bill 2008: Chapter 6 – Business Rescue and Compromise with Creditors* (15 September 2009) available at http://www.werksmans.co.za/60/seminar-material 20.
549. Section 128(1)(i) of the 2008 Companies Act refers to "supervision" as the oversight imposed on a company during its business rescue proceedings.
550. Section 135(2) of the 2008 Companies Act.
551. Sections 136(1)(i) and (ii) of the 2008 Companies Act.

supervision and/or cancellation of existing contracts prejudicial to the company,[553] and whether to terminate business rescue proceedings and convert the proceedings into liquidation proceedings.[554] In addition, the business rescue practitioner has the obligation to investigate the affairs of the company,[555] prepare a business rescue plan, put such plan to the vote in terms of section 150 and, if approved, proceed to implement the plan in accordance with its terms. Once the business rescue plan has been substantially implemented, the practitioner must file a notice of the substantial implementation of the business rescue plan,[556] and discharge the company from its business rescue proceedings.

Whilst implementing the relevant provisions of Chapter 6, the practitioner must act as if he or she is an officer of the court in accordance with the applicable rules of, or orders made by, the court.[557] The practitioner can delegate responsibilities, powers or functions to persons who were members of the board or pre-existing management.[558]

In terms of section 140(1)(c)(ii), a practitioner may appoint a person as part of the management of a company, whether to fill a vacancy or not. Such appointment is subject to the independence provisions contained in section 140(2). The ability for the practitioner to include outside management and expertise is fundamental to the successful implementation of the business rescue plan. Practitioners are often faced with a company with either no or dysfunctional management and unreliable or incompetent information. The practitioner, in these circumstances, should act prudently and appoint additional management members, industry specialists, forensic experts and legal advisors as soon as possible.[559]

Further, the practitioner can delegate any power or function of the practitioner to a person who was part of the board or pre-existing management of the company.[560] The problem with this is that the practitioner must delegate what is, in fact, a financial (or technical)

552. Section 136(1)(b) of the 2008 Companies Act.
553. Section 136(2)(a) and (b) of the 2008 Companies Act.
554. Section 132(1)(b) of the 2008 Companies Act.
555. Section 141 of the 2008 Companies Act.
556. Section 152(8) of the 2008 Companies Act.
557. Section 140(3)(a) of the 2008 Companies Act.
558. Section 140(1)(b) of the 2008 Companies Act.
559. Braatvedt "Costs of Business Rescue" (October 2014) *Without Prejudice* 23–24.
560. Section 140(1)(b) of the 2008 Companies Act.

disaster to a person who was in all likelihood partly responsible for the demise of the company in the first place.[561]

This power of delegation implies that, although management may remain in place to be merely overseen by the practitioner, the practitioner is the one with ultimate control over the management of the business. Although there is a marked shift away from the judicial management principle of a "management displacement" approach, a company under Chapter 6 rescue is still nowhere close to being a debtor in possession (where a reorganisation would be marked by valuation and asset sales) since Chapter 6 places limits on the company's dealings with its own property.[562] Bradstreet states:

> The location of a rescue regime in this spectrum affects creditors in broadly two ways. Firstly, and generally speaking, the greater the displacement of management, the more interested creditors would be in the scope of powers exercisable by the practitioners as well as his business rescuing abilities. Secondly, "[r]isk averse management may become less motivated to work hard under a strictly enforcing regime which not only removes them from office upon business distress but also severely penalizes them as a bonus if they are later found to have effectively resigned too late". Following this logic, it is submitted that the creditors' interests are better served in principle by placing more control in the hands of the directors of a company. The business rescue practitioner's conduct will have a direct effect on the extent of the displacement of a company's existing management and the effectiveness of a rescue in protecting the interests of the various stakeholders.[563]

The interests of creditors must be weighed up as against the interests of the debtor company. The practitioner has a duty to consider this balancing act in the course of his or her administration of the company in its rescue. It is a balancing act which will test the practitioner's competency, independence and ability and which, if not carefully managed, can end up in the demise of the company by its conversion to liquidation. Bradstreet goes further to state that Chapter 6, unlike judicial management, provides an "even spread" of protection to all stakeholders (not just to creditors). The success of the process is highly

561. Braatvedt "Costs of Business Rescue" (October 2014) *Without Prejudice* 23. In terms of regulation 128 to the 2008 Companies Act, the practitioner is entitled to be reimbursed for the actual costs of any disbursements made by him or her to the extent reasonably necessary to carry out the functions and facilitate the conduct of the company's business rescue proceedings. The challenge and difficult task faced by the practitioner is to what extent he or she can employ an expert to deal with the information and the situation he or she faces. Also see *Murgatroyd v Van Den Heever and Others NNO* 2015 (2) SA 514 (GJ) in respect of a liquidator challenging a business rescue practitioner's entitlement to reimbursement of legal fees and expenses. Also see commentary on this case in Braatvedt "Costs of Business Rescue" (October 2014) *Without Prejudice* 24.

562. See section 134 of the 2008 Companies Act and Bradstreet "The Leak in the Chapter 6 Lifeboat: Inadequate Regulation of Business Rescue Practitioners may Adversely Affect Lenders' Willingness and the Growth of the Economy" (2010) *SA Merc LJ* 200. For a discussion of the "debtor in possession" concept and how it differs from the South African business rescue model, see Chapter 7, para 7.5.

563. Bradstreet "The Leak in the Chapter 6 Lifeboat: Inadequate Regulation of Business Rescue Practitioners may Adversely Affect Lenders' Willingness and the Growth of the Economy" (2010) *SA Merc LJ* 200.

dependent on the "impartial and capable" individual placed in control. Thus, the practitioner is, in a sense, the "weakest link" for creditors and if creditors are not happy with his/her conduct, this could result in the subject matter of litigation, with the necessary costs being incurred. The answer has to be to provide for a highly qualified practitioner serving as a safeguard against problems that could arise as a result of his/her inability to properly run the rescue process.[564]

We have not yet seen extensive litigation brought by disgruntled creditors against practitioners who have failed to deliver on the expectations of creditors. This statement might be premature and we might very well see such litigation in the future. It is correct that the answer would certainly be to train and accredit practitioners so as to increase competence levels to avert massive losses to creditors due to incompetence. However, with the best will in the world, one will never be able to completely protect practitioners from claims brought by creditors, unhappy with diminished/low levels of dividends paid out of a rescue. Creditors might very well argue that the practitioner that kept the company going in rescue, when the company should have been placed into liquidation at a much earlier stage, will be liable to creditors for the differential in dividend levels as a result of "milking" the company during its period of rescue and not filing for an earlier liquidation.

Existing directors and management must continue to exercise the functions of a director or manager but always subject to the authority of the practitioner.[565] Directors have a duty to continue to exercise any management functions within the company in accordance with the express instructions or direction of the practitioner, to the extent that it is reasonable to do so.[566] Full cooperation is required from the directors when requested by the practitioner, including the provision of information to the practitioner relevant to the company.[567]

No decisions or actions taken by the board that require the approval of the practitioner would be valid unless approved by the practitioner.[568] The Act does not specify which "decisions or actions" would require practitioner approval. It leaves this open and,

564. Ibid 211.

565. Section 137(2)(a) of the 2008 Companies Act.

566. Section 137(2)(b) of the 2008 Companies Act.

567. Section 137(3) of the 2008 Companies Act. For the role and function of the business rescue practitioner, see Bradstreet "The Leak in the Chapter 6 Lifeboat: Inadequate Regulation of Business Rescue Practitioners may Adversely Affect Lenders' Willingness and the Growth of the Economy" (2010) 201–210.

568. Section 137(4) of the 2008 Companies Act.

strangely, in the discretion of the board. It is submitted that all material decisions (with reference to the memorandum and articles of the company)[569] would require the consent and approval of the practitioner. In any event, all parties dealing with a company in business rescue should be circumspect and at all times ensure that the practitioner approves substantial orders and supply agreements. Failure to do so would be highly risky and could result in the transaction or agreement being declared void.

The practitioner is an officer of the court and must report to the court in accordance with any applicable rules of or orders made by the court.[570]

The practitioner has the responsibilities, duties and liabilities of a director of the company, as set out in sections 75 to 77 of the 2008 Companies Act.[571] Any appointed practitioner would be wise to carefully consider these sections, as a contravention could result in the practitioner being sued for damages flowing from a breach of these sections.[572]

There is no requirement in the 2008 Companies Act for the board to ratify or approve the actions of a practitioner. The decision to, for example, obtain post-commencement funding,[573] is one given to the practitioner by the provisions of the 2008 Companies Act and thus does not require the consent of the directors. It is, however, submitted that a practitioner should carefully check the memorandum and articles (now the memorandum of incorporation ("MOI") of the company and establish whether or not the statutory documents of the company limit the ability of the directors to borrow money or obtain funds from encumbering assets. A cautious practitioner might, if possible, obtain a resolution from the directors authorising him or her to take actions on behalf of the company but, it is submitted, this is not peremptory.

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569. The Act now requires a company to file a Memorandum of Incorporation (MOI) with the CIPC – Section 15.

570. Section 140(3)(a) of the 2008 Companies Act.

571. Section 140(3)(b) of the 2008 Companies Act. Section 75 of the 2008 Companies Act deals with the declaration of directors' financial interests, section 76 with the standards of directors' conduct, and section 77 with the liability of directors and prescribed officers.

572. Business rescue practitioners would be well advised to consider professional indemnity insurance to protect a practitioner from his or her own gross negligence whilst he or she is involved in the supervision of a company. Insurance companies are suggesting t*hat policies be taken out in each and every matter where a practitioner is appointed in a particular company*. It is further suggested that the practitioner ensures that the premium is paid for by the company and is a term of the business rescue plan. Further it may be argued that if the business rescue plan fails, the liquidator has a duty to investigate the conduct and actions of the practitioner. After all, he is akin to a director (refer to section 140(3)(a)) and his conduct should be investigated as would the conduct of any director. Again, the practitioner might open him- or herself up to claims in contravention of sections 75, 76 and 77 of the 2008 Companies Act. Section 22 (reckless trading) might also feature in the liquidator's investigations. It is also likely that a practitioner could be summoned to be interrogated at a section 417 enquiry (1973 Companies Act) to explain his or her conduct in the business rescue proceedings.

573. Section 135(2)(a) of the 2008 Companies Act.

In terms of section 140(3)(c)(i), the practitioner is not liable for any act or omission in good faith in the course of the exercise of the powers and performance of the functions of the practitioner. However, he or she may (in terms of section 140(3)(c)(ii) be held liable in accordance with any relevant law for the consequences of any act or omission amounting to gross negligence in the exercise of the powers and performance of the functions of a practitioner.

In terms of section 140(2), except with the approval of the court on application by the practitioner, a practitioner may not appoint a person as part of the management of the company, or an advisor to the company or to the practitioner, if that person has any other relationship with the company, such as would lend a reasonable and informed third party to conclude that the integrity, impartiality or objectivity of that person is compromised by that relationship or someone who is related to a person who has a relationship as contemplated above. The purpose of this section is to ensure that the practitioner does not compromise his or her independence and ability to conduct the business rescue proceedings to the detriment of the company and affected persons. It is submitted that the company's legal advisors (prior to business rescue) should not be appointed to represent the practitioner in his position as supervisor of the company.[574]

In terms of section 140(4), if the business rescue process concludes with an order placing the company into liquidation, any person who has acted as practitioner during the business rescue process may not be appointed as liquidator of the company. It is submitted that there is an inherent conflict in allowing the same practitioner appointed as such to a company in its business rescue proceedings, to also be the liquidator of the company once it is placed under winding-up. The liquidator, once appointed, might very well be called upon by the creditors (or other affected persons) to examine the conduct of the practitioner in the period that he or she was appointed. It might transpire that there is a claim by creditors against the practitioner for delaying the business rescue process unnecessarily, resulting in diminished liquidation dividends as a result of such delay. Thus, the appointees must be separate and independent of each other.

574. However, see the comments on this in *Fisher v Vusela Asset Holdings (Pty) Ltd and Vusela Construction (Pty) Ltd (in liquidation) and 4 others, High Court of South Africa (Western Cape Division, Cape Town)*, Case No. 8079/14 (12 September 2014) (unreported) 8. Here the court found that there is nothing inherently untoward about liquidators engaging, as their attorneys, the same attorneys who acted for the company (typically a petitioning creditor) also acting in the liquidation. The court recognised that there are often advantages to the same set of attorneys acting and that it would be too costly to have to engage another set of attorneys with no prior involvement in the matter.

In the matter of *Fisher v Vusela Asset Holdings (Pty) Ltd and Vusela Construction (Pty) Ltd (in liquidation) and 4 others*,[575] section 140(4) was considered in the context of an application brought for the removal of a liquidator on the basis that such liquidator's firm (Sanek Trust) had previously, through one of its directors, Mr Glaum, been appointed as business rescue practitioner to Vusela. The applicant argued that both Mr Glaum and the duly appointed liquidator, Mr Moodliar, were directors of Sanek Trust and thus Mr Moodliar was prohibited by section 140(4) from remaining on as Vusela's liquidator. The applicant based his argument on the definition of the word "person" in section 2 of the 2008 Companies Act, which includes a juristic person such as Sanek Trust. The court held that it had been Mr Glaum, and not Sanek Trust, who had been appointed as business rescue practitioner and likewise, it had been Mr Moodliar, and not Sanek Trust, that had been appointed as liquidator of Vusela. The court found that the appointment as business rescue practitioner invariably attaches to a natural person and not to the juristic entity with which he or she is associated (if there is such an entity).[576] The court held that no good purpose would be served, having considered the considerable amount of work the liquidator had already completed in advancing the winding-up, by removing the liquidator.[577]

It should further be noted that a business rescue practitioner will soon be regarded as a "representative tax payer" and will become subject to duties and liabilities in terms of the Income Tax Act 58 of 1962.[578]

7.5.4 INVESTIGATIVE POWERS

The business practitioner also has considerable investigative powers. In terms of section 141(1) and (2):

> (1) As soon as practicable after being appointed, a practitioner must investigate the company's affairs, business, property, and financial situation, and after having done so, consider whether there is any reasonable prospect of the company being rescued.

575. *Fisher v Vusela Asset Holdings (Pty) Ltd and Vusela Construction (Pty) Ltd (in liquidation) and 4 others, High Court of South Africa (Western Cape Division, Cape Town)*, Case No. 8079/14 (12 September 2014) (unreported).

576. Ibid 6.

577. Ibid 13.

578. See Tax Administration Laws Amendment Act 44 of 2014 where a "representative tax payer" will include the business rescue practitioner of a company placed under business rescue in terms of Chapter 4 of the 2008 Companies Act.

(2) If at any time during business rescue proceedings, the practitioner concludes that –

(a) there is no reasonable prospect for the company to be rescued, the practitioner must –

(i) so inform the Court, the company, and all affected persons in the prescribed manner; and

(ii) apply to the Court for an order discontinuing the business rescue proceedings and placing the company into liquidation;

(b) there no longer are reasonable grounds to believe that the company is financially distressed, the practitioner must so inform the Court, the company, and all affected persons in the prescribed manner, and –

(i) if the business rescue process was confirmed by a Court order in terms of section 130, or initiated by an application to the Court in terms of section 131, apply to a Court for an order terminating the business rescue proceedings; or

(ii) otherwise, file a notice of termination of the business rescue proceedings; or

(c) there is evidence, in the dealings of the company before the business rescue proceedings began, of –

(i) voidable transactions, or the failure by the company or any director to perform any material obligation relating to the company, the practitioner must take any necessary steps to rectify the matter and may direct the management to take appropriate steps.

(ii) reckless trading, fraud or other contravention of any law relating to the company, the practitioner must –

(aa) forward the evidence to the appropriate authority for further investigation and possible prosecution; and

(bb) direct the management to take any necessary steps to rectify the matter, including recovering any misappropriated assets of the company.

From the moment the practitioner is appointed, he or she is obligated to commence investigating the company's affairs, business, property and financial situation. Once he or she has done so, the practitioner must determine whether the company is financially distressed and, if so, whether there is any reasonable prospect of the company being rescued.[579]

If the practitioner concludes that there is no reasonable prospect of the company being rescued, the practitioner must inform all affected persons and apply to the court for an order discontinuing the business rescue proceedings and place the company into liquidation.[580] The court will consider any application made and will either place the company into liquidation or make an order it considers appropriate in the circumstances.[581] This might result in an order directing the practitioner to investigate further, reconvene creditors' meetings, investigate additional possibilities of post-commencement finance and a myriad of other options. Of course, any affected person may participate in these proceedings and make submissions to the court on affidavit in such proceedings.

In the matter of *Ex Parte Nel and Others NNO*,[582] the business rescue practitioners elected to take action in terms of section 132(2)(b) as read with section 153(5) of the 2008 Companies Act. A notice of termination had been filed in terms of section 153(5) of the 2008 Companies Act. The effect of the filing of the court order was to end the business rescue proceedings. SARS argued that the practitioners were, thereafter, *functus officio* and did not have *locus standi* in their capacities as business rescue practitioners of the company, and therefore could not launch proceedings to liquidate the company in terms of section 141(2)(a)(ii). The court considered the obligations of the practitioner in terms of section 132(2)(a)(ii) as opposed to section 141(2)(a)(ii). The court was of the view that the provisions of section 132(2)(a)(ii) cannot be given effect to before that provided in section 141(2)(a)(ii). Section 132(2)(a) and (b) apply after a completion of the business rescue process. Prior to this culmination, the deliberations contemplated in section 131(2)(a) and (b) (either that there is no reasonable prospect for the company to be rescued or there are no longer reasonable grounds to believe that the company is financially distressed) have to be considered. Thus, in order to reach the finality provided for in section 132(2)(a)(ii), the practitioner must either apply for the discontinuance of the rescue proceedings or file a

579. Section 141(1) of the 2008 Companies Act. Also see *Southern Palace Investments 256 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd* 2012 (2) SA 423 (WCC) in respect of the term "reasonable prospect". Also see Rushworth "A Critical Analysis of the Business Rescue Regime in the Companies Act 71 of 2008" (2010) *Acta Juridica* 393–395.

580. Section 141(2)(a)(i) and (ii) of the 2008 Companies Act.

581. Section 141(3) of the 2008 Companies Act.

582. *Ex Parte Nel and Others NNO* 2014 (6) SA 545 (GP).

notice of termination. The action taken by the practitioner will result in the "state of affairs" provided for in section 132(2)(a)(ii). Thus the court held that it is correct that section 132(2)(b) can only occur where the company is no longer in distress.[583]

Clearly the intention of the legislature must not have been to allow the practitioner to step away from his statutory obligations when business rescue proceedings came to an end. The practitioner will need to proceed with a liquidation application in terms of section 141(2)(a)(ii). Only then will business rescue proceedings end in terms of section 132(2)(a)(ii).

The practitioner has no authority to convene any inquiry or financial investigation into the affairs of the company while it is subject to business rescue proceedings. In terms of section 417 of the 1973 Companies Act, a liquidator or creditor could convene an "insolvency inquiry" and proceed to interrogate directors, management and any person who would have information and/or documentation relevant to the trade, dealings and affairs of the company.[584] No such possibility exists in business rescue and despite the obligations set out in the 2008 Companies Act in respect of the directors having to cooperate with and assist the practitioner,[585] there is no opportunity for the practitioner to force directors and management to cooperate or interrogate such persons in a formal inquiry.

It is submitted that this may well hamper the ability of the practitioner to properly determine whether or not there is a reasonable prospect of rescuing the company or whether the company is in fact financially distressed.[586] A practitioner can remove a difficult or uncooperative director or manager from office[587] and replace such person with the practitioner's nominee (who must be independent).[588]

This, however, does not assist a practitioner who requires (in a short space of time) the cooperation of existing management and directors, in order to make the determination of whether there is a reasonable prospect of rescuing the company. The bar has been set fairly

583. Ibid 12–13 at paras 18–20.
584. Sections 417 and 418 of the 1973 Companies Act.
585. Section 142 of the 2008 Companies Act.
586. Section 141(2)(b) of the 2008 Companies Act.
587. Section 140(1)(c)(i) of the 2008 Companies Act.
588. Section 140(1)(c)(ii) of the 2008 Companies Act.

high for the practitioner to make such a decision and thus his or her skill set will be of the utmost importance in ensuring that he or she is in a position to make a decision which is in the best interests of the company.

In the course of investigations, the practitioner might find evidence of "voidable transactions",[589] which occurred in the period prior to the commencement of business rescue proceedings. If such "voidable transactions" are identified, the practitioner must take any necessary steps to rectify the matter and may direct the management to take appropriate steps. No definition of "voidable dispositions" appears in the 2008 Companies Act. The reference to the word "voidable" must not necessarily be seen in the context of what is termed "voidable dispositions" as set out in the Insolvency Act.[590] It is further unclear if the reference to the term "voidable" is a reference to what would be "voidable" in terms of the common law or the law of contract.

Voidable transactions would rather refer to actions that had been taken by the company which fell to be set aside due to prejudice or potential liability/exposure of the company which could be dealt with by the practitioner in the business rescue plan. The practitioner would have to use his or her discretion to establish whether or not a transaction was one which fell to be dealt with by management so as to create a better position for the company going forward.[591]

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589. Section 141(2)(c)(i) of the 2008 Companies Act.

590. Reference is made to sections 26, 29, 30, 31, 32, 33 and 34 of the Insolvency Act where transactions may be set aside (generally by way of an application to Court). Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 496(1) points out that transactions entered into by the company with third parties will be valid until set aside by a court. It is therefore difficult to see how the management of the company will be able to take steps "to rectify the matter" without some sort of supporting or enabling legislation.

591. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 496(1) submit that the term "voidable transaction" must be interpreted in accordance with the relevant provisions of the Insolvency Act. Henochsberg at 496) states:

> The Act does not define the term "voidable transactions" as used in this subsection, but it is submitted that the provisions of the Insolvency Act (ss 26 to 34) should be applied by the business rescue practitioner in determining whether or not there have been transactions that may be treated as voidable for the purposes of this subsection. It is lamentable that the legislature did not make the provisions of the Insolvency Act relating to voidable transactions mutatis mutandis applicable to the transactions referred to in sub-s (2)(c)(i), as on the current construction of the section it is doubtful whether the business rescue practitioner will be able to set aside any such transaction in the event any are identified. Since the provision does not contain any sanction for non-compliance, and since transactions entered into by the company with third parties are valid until set aside by the Court in terms of the provisions of the Insolvency Act (see Meskin, Insolvency Law and its operation in winding-up para 5.31.1 and the case law mentioned in notes 13A and 14), it is difficult to see how the business rescue practitioner, or for that matter the management of the company, can take steps to "rectify the matter" without some sort of supporting or enabling legislation.
>
> If at any time during the business rescue proceedings the business rescue practitioner arrives at the conclusion that there is evidence in the dealings of the company (before the business rescue proceedings began) of reckless trading, fraud, or the contravention of any other law relating to the company, the business rescue practitioner must (1) forward the evidence to the appropriate authority for further investigation and possible prosecution, and (2) direct the management of the company to take any necessary steps to rectify the matter, including recovering any misappropriated assets of the company. Since transactions entered into by the company with third parties will be valid until set aside by a Court, it is difficult to see how the management of the company will be able to take steps to "rectify the matter" without some sort of supporting or enabling legislation.

The challenge for the practitioner is that he or she does not have the investigative powers of a commission of enquiry or the use of subpoenas where evidence could be obtained within a short space of time and thereafter dealt with effectively by the practitioner and management.[592] Additionally, the practitioner does not have the mechanisms available to him or her (as does a liquidator) to set aside voidable dispositions on the basis set out in sections 26, 29, 30, 31, 32, 33 and 34 of the Insolvency Act. Furthermore, how does a practitioner go about investigating such voidable dispositions with the very same directors (and management) that possibly gave effect to such unlawful dispositions in the first place? There is an expectation on the part of the legislature that the practitioner must "direct the management to take appropriate steps" to rectify such voidable transactions.[593] How would the practitioner go about doing that, again, with the very same managers that were compliant in actioning the voidable dispositions?

Examples of this approach are evidenced by the applications made by the practitioner to convert business rescue proceedings into the winding-up of the company.[594]

7.5.5 DIRECTORS AND COOPERATION WITH THE BUSINESS RESCUE PRACTITIONER

During a company's business rescue proceedings, there is an obligation on each director of the company to attend to the requests of the business rescue practitioner at all times, and to provide the practitioner with any information about the company's affairs as may be reasonably required.[595]

In South Africa, the notion of leaving the debtor in control of the distressed company is foreign. The general South African reaction to the idea of leaving the debtor in possession to reorganise its business (although not necessarily true) appears to be that the debtor's

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Furthermore it is submitted that, unlike the old sections found in the 1973 Companies Act regarding judicial management (sections 436 and 437), the 2008 Companies Act does not provide mechanisms to specifically deal with "voidable dispositions".

592. In *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others* 2013 (4) SA 539 (SCA) 20, the Court commented that the facts of the matter were the very circumstances at which the investigative powers of a liquidator under sections 417 and 418 were aimed. It was recognised that the business rescue practitioner has limited powers to examine the affairs of the company.

593. Section 141(2)(c)(i) of the 2008 Companies Act.

594. In the matter of *Pinnacle Point v 1Time Airlines (Pty) Ltd*, brought in the North Gauteng High Court, Pretoria, Case No. 53915/12 (unreported), applications were made to the High Court to have the business rescue proceedings converted into liquidation proceedings. In both companies, the practitioner was unable to sell the company to prospective offerors and thus had no alternative but to file applications for the termination of the business rescue proceedings and applied to have the companies placed into liquidation; see section 141(2) as read with section 344 of the 1973 Companies Act.

595. Section 137(3) of the 2008 Companies Act. See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-75–18.77 at para 18.13.2.

management has already shown itself to be untrustworthy and perhaps fraudulent, accordingly leaving the debtor in possession makes no sense, and thus a trustee should always be appointed.[596]

In South Africa the business rescue practitioner oversees the company during business rescue proceedings. The practitioner is obligated, once appointed, to temporarily supervise the company, the management of its affairs, business and property.[597] The directors of the company continue to exercise the functions of director, but subject to the authority of the practitioner.[598] Directors under business rescue have a duty to continue to exercise management functions within the company in accordance with the express instructions or direction of the practitioner, to the extent that it is possible to do so.[599] Full cooperation is required by the directors with the business rescue practitioner and directors are obligated to provide any information about the company's affairs as maybe reasonably required by the practitioner.[600]

All action taken on behalf of the company by directors should have the approval of the practitioner. If not, such action is void, unless approved by the practitioner at a later stage.[601]

Thus, it is submitted, South Africa has a very specific hybrid regime. The existing board and management remain in place, but under the strict supervision of the practitioner.[602] It is certainly a situation where the company through its directors continues to trade, but in terms of the new business rescue regime specified by Chapter 6 of the 2008 Companies Act.

Section 137(2) sets out the continuing role of directors during a company's business rescue proceedings as follows:

> During a company's business rescue proceedings, each director of the company:

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596. Rochelle "Lowering the Penalties for Failure: Using the Insolvency Law as a Tool for Spurring Economic Growth: The American Experience, and Possible Uses for South Africa" (1996) *TSAR* 326.
597. Section 128(1)(b) and (d) of the 2008 Companies Act.
598. Section 137(2)(a) of the 2008 Companies Act.
599. Section 137(2)(b) of the 2008 Companies Act.
600. Section 137(3) of the 2008 Companies Act.
601. Section 137(4) of the 2008 Companies Act.
602. In a liquidation, the liquidator divests the director and the board of all its power: Section 353(2) of the 1973 Companies Act.

(a) must continue to exercise the functions of director, subject to the authority of the practitioner;

(b) has a duty to the company to exercise any management function within the company in accordance with the express instructions or direction of the practitioner, to the extent that it is reasonable to do so;

(c) remains bound by the requirements of section 75 concerning personal financial interests of the director or a related person; and

(d) to the extent that the director acts in accordance with paragraphs (b) and (c), is relieved from the duties of a director as set out in section 76, and the liabilities set out in section 77, other than section 77(3)(a), (b) and (c).

It is submitted that the existing board of directors would continue to function in the ordinary course of its business, but subject to "the authority of the practitioner". The board's powers would be set out in the memorandum of incorporation, together with terms relevant to directors' appointments, the conduct of board meetings and the voting in of resolutions. The board conducts "business as usual" but subject to the supervision of the business rescue practitioner.[603]

Section 137(4) confirms that any action taken on behalf of the board that requires the approval of the business rescue practitioner is void, unless approved by the practitioner. The sanction of board decisions by the business rescue practitioner is thus essential.[604]

One of the issues that has been raised in practice is the following: In what circumstances can the business rescue practitioner act on his own, without board approval (by way of resolution)?

Section 140(1)(a) of the 2008 Companies Act states that during business rescue proceedings, the business rescue practitioner "has full management control of the company in substitution for its board and pre-existing arrangement". However, "management control" is not defined in the 2008 Companies Act.

There is also no requirement in the 2008 Companies Act for the board of a company under business rescue proceedings to ratify or approve the actions of the business rescue

603. Section 128(1)(i) of the 2008 Companies Act defines "supervision" as the oversight imposed on a company during its business rescue proceedings. For a useful analysis of the role of the practitioner in business rescue see Pretorius "Tasks and activities of the business rescue practitioner: A strategy as practice approach" (2013) 17 (3) 1 *South African Business Review*.

604. See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-75–18-77 at para 18.13.

practitioner. Rather, section 140(3)(b) provides that, *inter alia*, during business rescue proceedings a business rescue practitioner "has the responsibilities, duties and liabilities of a director of a company, as set out in sections 75 to 77".[605] Consequently, it is submitted that the business rescue practitioner must act as if he or she was a director in the management of the company, including the specific management required of him or her as set out in Chapter 6.

As an example, section 135(2)(a) states that during business rescue proceedings, the company may obtain financing, and any such financing may be secured to the lender by utilising any asset of the company to the extent that it is not otherwise encumbered. Would there be an expectation that the business rescue practitioner must first obtain a resolution from the board of directors of the company prior to his or her ability to secure post-commencement finance? What if the board of directors is reluctant to cooperate in this process, even though the memorandum of incorporation authorises the board to secure loan finance as well as encumber the assets of the company to the lender?

Whilst there may be an argument that the business rescue practitioner's "management control" is limited to the day-to-day operations of the company, the intention of the legislature could never have been that prescriptive so as to disallow the business rescue practitioner from securing post-commencement finance as is required (and as is essential for the ongoing survival of the company) by section 135(2)(a) of the 2008 Companies Act. A limitation on this ability would severely limit the possibility of a successful business rescue.

In the case of *Creditworx (Pty) Ltd v Emid (Pty) Ltd*,[606] Hiemstra AJ considered section 137(4) of the 2008 Companies Act. A resolution in terms of section 129 of the 2008 Companies Act had been passed by the company's board of directors to place the company into a voluntary business rescue. On the same date, the company launched an urgent application in terms of which it sought an order directing Emid (Pty) Ltd to provide certain services to the company in terms of an outsourcing agreement that had been concluded between the company and Emid. On the same date that the application was

605. Sections 75 to 77 of the 2008 Companies Act deal with the duties and obligations of directors as well as their personal liability for decisions taken in that role.

606. *Creditworx (Pty) Ltd v Emid (Pty) Ltd*, Case No. 21652/2012, North Gauteng High Court, Pretoria (24 July 2012).

before the court, a business rescue practitioner was appointed. The court noted that pursuant to section 137(4) of the 2008 Companies Act, the institution of legal proceedings by a company under business rescue proceedings requires the approval of the business rescue practitioner. The company had not yet sought such approval as its business rescue practitioner had not yet been appointed at the time the application had been launched. The company argued in a supplementary affidavit that this defect could be cured by the business rescue practitioner ratifying the conduct of the company on an *ex post facto* basis. The court held that this was insufficient and that the company first had to appoint a practitioner and seek his or her approval, prior to launching such proceedings. The application was dismissed.

It is submitted that a glaring feature of Chapter 6 is the watered-down role that shareholders play in a business rescue. There is no "shareholders committee" that is set up to consult with the practitioner. Simply put, shareholders are left out in the cold. While section 146 does allow them to intervene by way of court proceedings in the business rescue process, when it comes to voting, shareholders have no say in the ongoing preservation of their investment. From a voting perspective, shareholders will only participate if their "rights are being affected". Otherwise, they have no say in the development and approval of the plan.

It is clear that the legislation foresaw an ongoing role for directors once their company had been placed into a business rescue process. Although all decisions are subject to the approval of the practitioner, the boards of companies in rescue remain intact. It is a hybrid of a debtor-in-possession" model, coupled with the need for a supervisor.[607]

Section 142 sets out a host of obligations for directors to consider once the company has commenced business rescue proceedings.[608] The most significant obligation is to deliver to the practitioner all the books and records that relate to the affairs of the company.[609] This should be done immediately and as soon as possible after the practitioner has been appointed.

607. See discussion in Chapter 5, para 5.5.3 and Chapter 7, para 7.5.8.

608. For a synopsis of the director's role in a business rescue see Van der Walt "A Turnaround Practitioner's View of New Business Rescue Legislation" in Harvey (ed) *Turnaround Management and Corporate Renewal: A South African Perspective* (2011) 150–151.

609. Section 142(1) of the 2008 Companies Act.

This information is vital and necessary as the practitioner, in a very short space of time, has to consider and investigate the company's affairs with a view to reporting to creditors at the first meeting of creditors which must occur within 10 days from the date of his or her appointment.[610]

Again, the practitioner has no effective mechanism to subpoena directors and management to deliver such information to him or her. This might ultimately hamper the practitioner in preparing the business rescue plan, which he or she is obligated to do within 25 days after appointment.[611]

No lien is allowed to be claimed over books and records and thus those in possession of such documentation must hand these over to the practitioner on demand. The reason is that the practitioner must make an urgent determination as to whether the company is financially distressed and whether or not there is a reasonable prospect of rescuing the company.

It is further submitted that the hybrid approach adopted by Chapter 6, allows creditors to gain confidence in the fact that the asset is being administered by a third-party, independent practitioner, who can draw on the knowledge and experience of management to ensure that the objections of rescue are achieved for the benefit of all stakeholders. The practitioner is well entitled to remove disruptive directors who are impeding the ongoing functions of the practitioner in the exercise of his or her powers and management functions.[612]

It is also submitted that the challenge for any supervisor will be to effectively engage with the directors (and management) and ensure that the company can continue to trade during its restructuring period. Many of these directors will themselves be subject to intense scrutiny as it is these very same directors who brought the company into its period of financial distress.

It is clear that the role of the practitioner (supervisor) is not that different from those duly appointed bankruptcy trustees and administrators appointed in foreign jurisdictions, such

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610. Sections 141(1) and 147 of the 2008 Companies Act.
611. Section 150(5) of the 2008 Companies Act.
612. Section 137(5) of the 2008 Companies Act. For a discussion on the role of the supervisor, see Chapter 5, para 5.5.3.

as the US and the UK. The role of the practitioner is critical and he or she has the responsibility to direct and manage the rescue proceedings to their ultimate successful conclusion. The practitioner will be the person who will ultimately make the call as to whether the restructuring process should continue or be called to an end.

It is thus submitted that the practitioner's role is arduous, time consuming and pressurised. His or her competency levels will be critical in ensuring that the process runs smoothly. Most importantly his or her independence and ability to make important decisions objectively will determine the rescue outcome.

7.5.6 REMUNERATION

In practice, business rescue practitioners are charging fees in accordance with the tariffs set out in the regulations.[613] Additionally, practitioners are entitled to charge in terms of an agreement providing for further remuneration (additional to fees charged per tariff), to be calculated on the basis of a contingency related to:

(a) the adoption of a business rescue plan at all, or within a particular time, or the inclusion of any particular matter within such a plan; or

(b) the attainment of any particular result or combination of results relating to the business rescue proceedings.[614]

Such a contingency agreement must be agreed to by a majority of the creditors' voting interests at a meeting called to consider such an agreement and by the holders (present and voting) of a majority of the voting rights attached to any shares of the company that entitle the shareholder to a portion of the residual value of the company on winding-up, at a meeting called for such purpose.[615]

Section 143(5) ranks the practitioner's remuneration and expense claims in priority, before payment to the claims of all other secured and unsecured creditors (if not paid during the course of the business rescue proceedings).

613. Regulation 128 to the 2008 Companies Act prescribes the hourly tariffs which practitioners are entitled to charge depending on whether the company is a small, medium or large company as defined in the 2008 Companies Act.

614. See section 143(2)(a) and (b) of the 2008 Companies Act. See also Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-92–18-94(1) at para 18.14.6.

615. Section 143(3)(a) and (b) of the 2008 Companies Act.

In practice, contingency fees are being agreed to on the basis of percentage payments in line with achievables during the course of the conduct and/or implementation of the business rescue plan, earnings linked to percentage dividend payments made to creditors, based on values achieved on the sales of assets and opportunity to take a stake/shareholding in the company once it exits from the business rescue process.[616]

To date, we have not seen any creditor challenge such contingency fee arrangements, even though creditors and shareholders (who voted against such contingency fee proposal) are entitled to do so in terms of section 143(4). Such a challenge would be based on the fact that such remuneration is unreasonable having regard to the financial circumstances of the company.[617] These contingency fees should be set out in writing and confirmed by the creditors' committee and the practitioner.[618]

In section 143(5), the following is stated:

> To the extent that the practitioner's remuneration and expenses are not fully paid, the practitioner's claim for those amounts will rank in priority before the claims of all other secured and unsecured creditors.

The practitioner's unpaid remuneration and expenses/costs incurred in the administration of the business rescue proceedings rank prior to all other claims in a liquidation. In all likelihood, the practitioner will have to file a claim with the liquidator for outstanding remuneration, expenses and costs in terms of section 44 of the Insolvency Act.[619]

The liquidator's fees incurred as a cost of administration are paid before the outstanding practitioner's fees. The practitioner's claims are merely super-preferent claims and in terms of section 143(5) rank above all other secured and unsecured creditors, but below the costs of the liquidation and liquidator's fees incurred in the administration of the winding-up.

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616. The basis for contingency fees might include, *inter alia*, a threshold level of percentage dividend for creditors, the level and extent of labour force retention, the comparison of what was achieved in rescue than what would have been achieved in a liquidation, or a combination of these factors.

617. Section 143(4)(b) of the 2008 Companies Act.

618. Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-94 at para 18.14.6.

619. Some are of the view that the practitioner should not be forced to prove his or her claim. It would be highly problematic if the practitioner had to be a contributor to a shortfall in the estate (i.e. a contribution). Rather, it is argued that the legislature must have intended that a practitioner's claim does not have to be proved like the claims of the general body of creditors once the company is in the winding-up process. The unpaid practitioner's fee should merely rank as an administrative expense prior to the costs of liquidation.

7.5.7 PROTECTION OF PROPERTY INTERESTS

Once in rescue mode, the practitioner needs to identify and deal with the company's property. This is often of urgent and important consideration for the practitioner as any disposition or impairment of the company's property will affect the practitioner's right to preserve value and to have an effective business rescue plan approved by creditors.

The rights of property owners are dealt with in section 134(1) as follows:

> (1) Subject to subsections (2) and (3), during a company's business rescue proceedings –
>
> (a) the company may dispose, or agree to dispose, of property only –
>
> (i) in the ordinary course of its business;
>
> (ii) in a bona fide transaction at arm's length for fair value approved in advance and in writing by the practitioner; or
>
> (iii) in a transaction contemplated within, and undertaken as part of the implementation of, a business rescue plan that has been approved in terms of section 152;
>
> (b) any person who, as a result of an agreement made in the ordinary course of the company's business before the business rescue proceedings began, is in lawful possession of any property owned by the company may continue to exercise any right in respect of that property as contemplated in that agreement, subject to section 136; and
>
> (c) despite any provision of an agreement to the contrary, no person may exercise any right in respect of any property in the lawful possession of the company, irrespective of whether the property is owned by the company, except to the extent that the practitioner consents in writing.
>
> (2) The practitioner may not unreasonably withhold consent in terms of subsection (1)(c), having regard to –
>
> (a) the purposes of this Chapter;
>
> (b) the circumstances of the company; and
>
> (c) the nature of the property, and the rights claimed in respect of it.
>
> (3) If, during a company's business rescue proceedings, the company wishes to dispose of any property over which another person has any security or title interest, the company must –

(a) obtain the prior consent of that other person, unless the proceeds of the disposal would be sufficient to fully discharge the indebtedness protected by that person's security or title interest; and

(b) promptly –

(i) pay to that other person the sale proceeds attributable to that property up to the amount of the company's indebtedness to that other person; or

(ii) provide security for the amount of those proceeds, to the reasonable satisfaction of that other person.

Section 134 aims to protect the company's property once business rescue commences.[620] The company will have property (and debtors) which must be protected in this period to enable the company to continue trading while its affairs are being restructured. Creditors might hold security over the company's assets and these security rights should not be interfered with without the consent of such security holders.[621]

In broad terms, the provisions of section 134 provide for the disposal of property only in circumstances where it is required for the normal operation of the business of the company or as part of the business rescue plan. The section particularly regulates the position where property disposed of by the company is held by a creditor as security for its claim, and seeks to protect such secured creditor from any potential prejudice that may flow from the actions taken by the company or the business rescue practitioner during the business rescue proceedings.[622]

Agreements for the disposal of property will have to comply with the prerequisites set out in this section.[623] Property can only be disposed of in the ordinary course of the company's business. In order to meet this requirement, a consideration of all the circumstances relevant to such disposal will need to be made, coupled with a decision as to whether,

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620. See Rushworth "A Critical Analysis of the Business Rescue Regime in the Companies Act 71 of 2008" (2010) *Acta Juridica* 384–385.

621. In the US, a Chapter 11 debtor's ability to use, sell or lease estate property is governed primarily by section 363 of the US Bankruptcy Code. It imposes restrictions on the debtor's use of any cash collateral and on the debtor's use of any estate property outside the ordinary course of business. The power to use and sell collateral in the ordinary course is perhaps the single greatest innovation in Chapter 11, as it allows the business to continue operating without interruption, notwithstanding bankruptcy. See Ferriell and Janger *Understanding Bankruptcy* (2013) 723; also see 275 –308 (Operating the debtor). In the UK, the administrator is entitled to deal with company property in terms of the relevant schedule to the UK Insolvency Act. See Fletcher *The Law of Insolvency* (2009) 570–574. Also see Wachtell, Lipton, Rosen & Katz *Distressed Mergers and Acquisitions* (2014) available at http://www.wlrk.com/files/2014/DistressedMA. pdf 159–214.

622. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 478(7). Also see Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-50(12)–18-50(53) at para 18.7.

623. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 478(7).

given such circumstances, it would have occurred between solvent businessmen (or, in the context of business rescue, in circumstances where neither of the parties were financially distressed).[624]

Further, the disposal must be in terms of a *bona fide* transaction at arm's length, for fair value, approved in advance and in writing by the practitioner. All that is envisaged here is that the transaction should not be a simulated one and that there should not be a questionable relationship between the company and the other party to the transaction. The purchase price should reflect the fair market value of the property being disposed of. The only additional requirement is that the transaction must have been approved of in writing by the practitioner prior to the disposal (or agreement to dispose).[625]

Section 134(1)(c) prohibits the exercise of any right by a person in respect of property in the lawful possession of the company (whether or not the property is owned by the company and despite any provision of an agreement to the contrary), except to the extent that the business rescue practitioner consents in writing.[626] Mongalo states:

> An interesting point to be made with regard to the disposal of property outside the ordinary course of business is that while under s 134 of our Act, property may be disposed of outside ordinary course of business if transaction is approved in writing by practitioner, without need for court approval, in the USA, the debtor is free to "use, sell or lease" assets in the ordinary course of business and if the transaction is not in the ordinary course of business, notice and a hearing are required. (11 U.S.C. § 363).
>
> With regard to the protection of creditor interests, one aspect deserves mentioning. It appears under § 134(1)(c), that the lessor of property to the company that is in business rescue proceedings cannot reclaim the leased property and it is impossible to sell secured property without creditor consent or payment in full. Consequently, there is no provision allowing for credit bidding. This is in clear contrast with the Chapter 11 proceedings in terms of which any creditor that has an interest in property may object to use, sale or lease of that property and the court will prohibit or condition such use as is necessary to provide "adequate protection". Importantly, under Chapter 11, debtor may sell property notwithstanding contrary provision in loan agreement, and creditor may "credit bid". (See 11 U.S.C. § 363.)[627]

624. Ibid 478(8).

625. Ibid 478(8).

626. Ibid 478(8). See Mongalo "Two Steps Forward and One Step Back is better than One Step Forward and Two Steps Back: A Limited Comparative Analysis of Business Rescue in South Africa" Opening address for *Business Rescue – First three years* University of Pretoria (7 October 2014) 6.

627. Ibid 5–6.

Property interests are clearly protected within the framework of business rescue. After all, the business of the company continues under business rescue, albeit under the supervision of the business rescue practitioner. In order to trade, a company cannot suddenly have its property removed, disposed of or become useless in the conduct of its business. More particularly, lease arrangements must be kept intact.

In terms of section 134(2), the practitioner may not unreasonably withhold consent having regard to the overall purposes of Chapter 6, the circumstances of the company, the nature of the property and the rights claimed in respect of it.

In terms of section 134(3), where property is subject to "security or title interest", such property cannot be disposed of without the prior consent of that security or title holder, unless the proceeds of the disposal would be sufficient to fully discharge the indebtedness protected by that person's security or title interest.[628]

Once sold, the practitioner must promptly pay to the security/title holder the sale proceeds attributable to that property, up to the amount of the company's indebtedness to that other person, or provide security for the amount of those proceeds to the reasonable satisfaction of that other person.[629]

Section 134 should be carefully considered together with the effect of section 133 of the 2008 Companies Act. The effect that sections 133 and 134 have on the perfection of GNBs should also be considered.

Section 133(1) of the 2008 Companies Act states that during business rescue proceedings, "no legal proceeding, including enforcement action, against the company, or in relation to any property belonging to the company, or lawfully in its possession, may be commenced or proceeded with in any forum, except in certain specified circumstances.

In the ordinary course, banks generally would apply to court by way of motion proceedings, to perfect a GNB prior to a company passing a resolution for business rescue proceedings.

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628. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 478(9). An example would be a mortgage bond registered over immovable property.

629. Section 134(3)(b) of the 2008 Companies Act.

Once an application is launched and has been brought (normally on an urgent basis) before the Presiding Judge, the bank would seek an order to perfect the GNB, placing the bank into a secured position on insolvency.

Section 131(7) deals with the power of the court to order business rescue proceedings during proceedings brought to enforce security against a company:

> In addition to the powers of a Court on an application contemplated in this section, a Court may make an order contemplated in subsection 4, or 5 if applicable, at any time during the course of any liquidation proceedings or proceedings to enforce any security against the company.

It is submitted that the legislator envisages that a court may place the company under business rescue proceedings or further appoint an interim practitioner to supervise the company under business rescue proceedings, at any time during the course of liquidation proceedings itself, or proceedings to enforce any security against the company, i.e. the perfection of a GNB by way of court application. This means that the presiding judge may take the view during the hearing of the perfection application that, in fact, the company should be placed under business rescue. This, as we understand it, can be done on a *mero motu* basis and is entirely within the discretion of the presiding judge.

It is unclear what factors would be taken into account by the presiding judge in exercising this discretion. The judge might believe that because the entire business is going to be prejudiced by the grant of a perfection order, thus affecting the status of the companies' property, that the company should be given the opportunity of rehabilitation by way of the business rescue procedure. The judge may very well decide not to grant the perfection order and place the company into business rescue. There is no way that the bank can, in its GNB documentation, contract out of this consequence.

The other danger, of course, is that if the perfection order is not granted and the presiding judge orders a business rescue proceeding which is unsuccessful ultimately, and liquidation ensues, the bank will not be in a position to perfect its GNB.

The most critical issue for the bank to consider when making application to perfect a GNB could even arise before the order is actually sought in court. In this regard, if a debtor is experiencing financial difficulties and if the bank then serves and files its application to perfect its security in terms of its GNB, the company itself could file a resolution to commence business rescue proceedings with the CIPC and this would defeat the whole exercise of the bank trying to perfect its security prior to the commencement of business rescue proceedings.

Therefore, the bank should consider whether a GNB, as opposed to a special notarial bond ("SNB"), has any value in the future taking the effects of business rescue procedures into account.[630]

In terms of section 155(4) of the 2008 Companies Act, a secured creditor has a voting interest equal to the value of the amount owed to that creditor by the company. In the event that the company is now placed under business rescue proceedings, the bank would be a secured creditor by virtue of it holding a "contingent liability", in terms of the guarantee. Notwithstanding, the bank would be entitled to vote on such contingent claim when a business rescue plan is put to the vote by the business rescue practitioner as a secured creditor if it holds such cash as security for the contingent liability.[631]

A further question relates to whether a contingent/conditional creditor qualifies as a creditor for purposes of business rescue, i.e. is such a creditor an affected person in terms of section 128(1)(a)(i) of the 2008 Companies Act? In practice, if one party has signed surety for another party for the latter party's obligations to the debtor company, would the surety creditor be recognised as a contingent creditor if the debtor company were to go into business rescue? The Act is silent on this issue. Section 148 of the Insolvency Act recognises contingent/conditional creditors in the liquidation of a company. It is submitted that similarly, if a contingent/conditional creditor has an interest in a business rescue proceeding or if such creditor's rights will be affected by the plan, then such a creditor must be recognised as an affected person.[632]

Seligson SC concurs with this view:

630. It is submitted that banks should further consider inserting a cash cover clause into the bank's standard guarantees in order to ensure that the bank has the option to debit an amount equivalent to the value of the guarantee at any time so as to ensure that an actual indebtedness is owed to the bank for purposes of voting. In the ordinary course, the bank may very well provide a guarantee for the obligations of a particular company to its creditor and would hold cash cover against such guarantee as security. If that is the case, the bank would be viewed as a "secured creditor" in the business rescue proceeding.

631. Section 4(2)(b) of the 2008 Companies Act recognises the importance of reasonably foreseeable contingent assets and liabilities being recognised for the purposes of the Solvency and Liquidity test.

632. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 445–446.

> I think that the better view is that contingent creditors who have suretyship undertakings from a company should in any event qualify as creditors when the company is placed under business rescue.[633]

Once the company has filed for business rescue, the question is then raised as to whether or not the bank would be entitled to take the cash held as cover/security for its obligations in terms of the guarantee if such guarantee is called up. Again, section 133 of the 2008 Companies Act would apply, in that this would be viewed to be an “enforcement action” that would be prohibited by such section. If, of course, such cash is allocated to the bank in terms of the approved (duly voted) business rescue plan, that would be sufficient for the relevant allocation of the cash security.

Section 133 of the 2008 Companies Act is also applicable with regard to cession of debtors.

The debtors of a company are clearly property of the company and would belong to the company notwithstanding the fact that a cession had been granted to the bank. A typical clause in a bank’s standard cession of debtors would be as follows:

> If the cedent does not comply with the terms and conditions of the cession and any other agreement which the cedent now has or may in the future have with the bank, the bank may enforce and deal with its rights as set out in the cession …

The bank would generally have the right to give notice of the cession to the debtors at any time, collect the claims and, *inter alia*, institute such legal proceedings against the debtors as the bank may consider necessary.

In section 133 of the 2008 Companies Act, the words “including enforcement action” are used. Clearly, this is contemplated in the “calling up” of the cession. The bank would be enforcing its rights by giving notice of the cession to the debtors when it calls up such cession of debtors. This would clearly be prohibited if business rescue proceedings have already commenced.

The bank therefore has little choice but to ensure that all enforcement actions in respect of its cession of debtors occur well prior to the commencement of business rescue proceedings, if this is at all possible.

633. Opinion by Milton Seligson SC (14 November 2012) 16.

There would be two scenarios:

- where the bank has attempted to enforce or exercise its cession prior to the enforcement of business rescue proceedings and thereafter business rescue proceedings intervene, with payments still being made by debtors to the company and not to the bank; alternatively,
- where there has been no enforcement or exercise of the cession of debtors prior to the commencement of business rescue proceedings.

Insofar as the former is concerned, once payment has been made to the company, the receipts of payments made by debtors to the company would constitute property belonging to the company. Insofar as the latter is concerned, section 133 would in all likelihood prohibit enforcement and the exercise of the cession post-commencement of the business rescue proceedings.

In terms of section 134(3) of the 2008 Companies Act, if, during the company's business rescue proceedings, the company wishes to dispose of any property over which another person (the bank) has any security or title interest, the company must -

- obtain the prior consent of that other person, unless the process of the disposal would be sufficient to fully discharge the indebtedness protected by that person's security or title interests; and
- promptly pay to that other person the sale proceeds attributable to that property up to the amount of the company's indebtedness to that other person or provide security for the amount of those proceeds, to the reasonable satisfaction of that other person.

The question is whether or not section 134(3) of the 2008 Companies Act prohibits the business rescue practitioner from utilising the debtors of the company as working capital during the business rescue proceedings, without the consent of the bank.

Whether or not the utilisation of the debtors' book as working capital for the company would constitute a "disposal" of the company's property has also been called into question.

If this was the case, the bank could withhold its consent. The definition of "disposal" in law is "to transfer", "to part with", or to alienate in some manner or form.[634] Whether or not the use by the company of the proceeds of the ceded debtor's book would constitute an effective "disposal" which would require the bank's consent as provided for in section 134(3), is debatable.

In terms of section 134(1)(b) of the 2008 Companies Act, any person who, as a result of an agreement made in the ordinary course of the company's business before the business rescue proceedings began (i.e. by way of a cession of debtors), is in lawful possession of property (the debtors) owned by the company, may continue to exercise any right in respect of that property as contemplated in that agreement, subject to section 136. Thus, if there was a suspension or cancellation of the cession of debtor's agreement by the business rescue practitioner, the bank would continue to exercise its right of cession over the book debts of the company and any disposal would be subject to the consent provision of section 134(3) of the 2008 Companies Act.

Consequently, there cannot be any attempt by the business rescue practitioner to sell the entire book debt. This would constitute a disposal. However, should such disposal or, for that matter, a utilisation of the company's book debt to finance ongoing liabilities of the company be part of the business rescue plan and such business rescue plan is approved, then it is submitted such utilisation would be permissible.

In *Gormley v West City Precinct Properties & Others*,[635] Traverso J dealt with a company that was unable to pay its debts and where its only source of income was the rent and revenue derived from certain properties owned by it. The rental stream had been ceded to the bank and the practitioner sought to use such rental stream to trade, and to cover its trading expenses, and to pay creditors. The court held that such rental stream and revenue (ceded to the bank) did not belong to the company. Section 133(1) had no bearing on the bank's entitlement to the rents and revenue, and the bank's collection thereof was not a "proceeding" prohibited by such section.[636]

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634. A "disposal" is defined in section 2 of the Insolvency Act as "any transfer or abandonment of rights to property and includes a sale, lease, mortgage, pledge, delivery, payment, release, compromise, donation or any contract therefore, but does not include a disposition in compliance with an order of court".
635. *Gormley v West City Precinct Properties* (Pty) Ltd 2013 JDR 1895 (WCC).
636. Ibid 14–15 at paras 17–18.

This judgment is in support of the argument that the enforcement of a cession of debtors is not an "enforcement action" as contemplated by section 133 of the 2008 Companies Act.[637]

Although the section 133 moratorium refers to a freezing of claims only for the period of business rescue, there is no reason why a business rescue plan should not contain provisions that extend the conditions of a moratorium to a period beyond the duration of business rescue proceedings.[638]

In *Kritzinger and Another v Standard Bank of South Africa*,[639] the book debtors of the company had been ceded to the bank. The court held that where a creditor holds security over a debtor's property, in this instance the company's debtors, the practitioner cannot dispose of or use such encumbered property without the secured creditor's consent unless he first discharges the debtor's debts in favour of the creditor in terms of section 134(3). The practitioner's contention that the debtor book still belonged to the company was misplaced.[640]

In *Redpath Mining South Africa (Pty) Ltd v Marsden NO and Others*,[641] the court considered an application for an interdict preventing the implementation of a plan, pending an action to set aside such plan, on the basis that the applicant's security (a lien over a mine) was being deprived in contravention of section 134 of the 2008 Companies Act. The applicant contended that the 2008 Companies Act did not permit the practitioner, in proposing a plan, to make inroads into the applicant's security without the applicant's consent as provided for in section 134 of the 2008 Companies Act. The applicant further contended that Section 134 had, as its premise, the recognition and protection of the rights of secured creditors and that by implementing the plan, the applicant's rights as a secured creditor would be unlawfully deprived and would further have the result that the applicant's constitutional rights to have access to the court would further be infringed.[642] The judge was of the view that secured creditors in a business rescue stand on the same

637. This argument has not been tested in proceedings to enforce a cession *in securitatem debiti* during a business rescue proceeding. There are, however, different views on the ability of the creditor to enforce it. It is submitted that such a view can be enforced and that a creditor is entitled to the proceeds from such cession. However, the practitioner would always be entitled to invoke the provisions of section 136(2)(a) to suspend the cession of access to relevant proceeds are required to enable him or her to efficiently administer and operate the company while it continues to trade in business rescue.

638. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 478(b).

639. *Kritzinger and Another v Standard Bank of South Africa* (3034/2013) [2013] ZAFSHC 215 (19 September 2013).

640. Ibid 17.

641. *Redpath Mining South Africa (Pty) Ltd v Marsden NO and Others* (18486/2013) [2013] ZAGPJHC 148 (14 June 2013).

642. Ibid 9–10 at paras 25–26.

footing as other creditors. Section 134(3) serves as a safeguard and assurance to secured creditors that they are protected. Even if the lien in question was disputed, the dispute resolution mechanism provided for in the plan should be utilised to resolve such issue and is open to all affected and interested parties.[643]

The position of a secured creditor has thus been clearly clarified. Security remains intact and cannot be altered or prejudiced by the business rescue process. If security rights are disputed, the practitioner can always propose a dispute resolution process in terms of the plan to resolve such disputes effectively and within a short time frame.

In *Moodley and On Digital Media (Pty) Ltd and Others*[644] the court considered the application of section 133 of the 2008 Companies Act in proceedings instituted against the business rescue practitioner and the company in relation to the implementation of the plan. The court held that section 133 had no application and there was therefore no need for the applicant (in those proceedings) to request leave from the court to launch such proceedings. The court held as follows:

> Section 133, therefore, finds no application in legal proceedings against a company in business rescue and its business rescue practitioner in connection with the business rescue plan, including its interpretation and execution towards implementation. I respectfully consider the contrary finding in Redpath to be clearly wrong and decline to follow it. The applicant does not require the leave of this court as contemplated in s 133(1)(b) of the Companies Act to proceed with the present proceedings.

It is submitted that the practitioner's ability to preserve the company's assets and property is a fundamental international principle of rescue. Business rescue in a Chapter 6 scenario is not a liquidation. The principle is to keep the business of the company afloat. There is no sense in allowing creditors to prejudice the prospect of the company continuing to do business effectively without allowing the practitioner to have access to the company's property, its ability to collect on its debtors' books and specifically to its tools of trade. Preservation of the fundamental property of the company, without allowing an early distribution of the company's assets to its secured creditors, will give the company a real opportunity for a successful restructure of its business.

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643. Ibid 24–25 at paras 63–68.
644. *Moodley and On Digital Media (Pty) Ltd and Others* 2014 (6) SA 279 (GJ).

7.5.8 MANAGING SHAREHOLDERS AND HOLDERS OF COMPANY SECURITIES

In order for a business rescue practitioner to properly manage the restructuring process, there is an important need to engage with and manage the expectations of shareholders and holders of company securities.[645]

Any alteration to the classification or status of securities of a company is dealt with in section 137(1) as follows:

> (1) During business rescue proceedings an alteration in the classification or status of any issued securities of a company, other than by way of a transfer of securities in the ordinary course of business, is invalid except to the extent –
>
> (a) that the Court otherwise directs; or
>
> (b) contemplated in an approved business rescue plan.

Holders of a company's securities (shareholders), where the company is subject to business rescue, have a very limited role to play in the ultimate outcome of a business rescue process.[646]

The word "securities" is defined in the 2008 Companies Act as "any shares, debentures or other instruments, irrespective of their form or title, issued or authorised by a profit company".[647] Thus, the holder of securities would be a shareholder of a company.

Section 146 entitles shareholders (holders of any issued security of the company) to notification of court proceedings, decisions, meetings as well as the right to participate in any court proceeding and the business rescue proceedings themselves. When it comes to voting in a business rescue plan, section 146(d) limits the rights of shareholders to vote to approve or reject a proposed business rescue plan in the manner contemplated in section 152, unless the plan would alter the rights associated with the class of securities held by that person.

645. Section 1 of the 2008 Companies Act defines "securities" as "any shares, debentures or other instruments irrespective of their form or title, issued or authorised to be issued by a profit company. Thus "shareholders" and the "holders of company securities" are one and the same party in the context of the 2008 Companies Act.

646. See Loubser "The Role of Shareholders During Corporate Rescue Proceedings: Always on the Outside Looking in?" (2008) *SA Merc LJ* 370–390.

647. Section 1 of the 2008 Companies Act. See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-71–18-74 at para 18.12.

When a company is wound up for reasons of insolvency, it is very likely that there will be no funds left to compensate its ordinary shareholders for the loss of their invested funds. Their active involvement in the winding-up process becomes academic. However, shareholders should have every right and reason to be involved in corporate rescue procedures, because they have a real interest in the outcome. A successful rescue would revive their shares and these shares would regain at least some of their previous value.[648]

The traditional view in South Africa has always been that creditors have the most to lose when a debtor becomes insolvent, and thus they should play a prominent role in insolvency proceedings as well as corporate rescues. Shareholders are perceived as having been afforded the benefit of limited liability and the price they have to pay for this is that they carry the risk of losing their investment if the company becomes insolvent. Loubser states:[649]

> Unfortunately, one cannot escape the impression that the new business rescue proceedings are often characterised by an unsympathetic attitude to shareholders and a distrust of company management. Many provisions seem to be based on the assumption that shareholders are rich capitalists who do not need any assistance or support when trying to rescue the company and that only the employees need protection. While this may have been true when judicial management was introduced into South African law for the first time, it is not a true reflection of the current situation. It is a widely accepted fact that the major providers of capital to South African companies are the institutional investors who are investing the pension fund contributions and savings of ordinary workers. If a company fails, many more workers than those who were actively employed by the company could thus lose their livelihood.[650]

It might be correct that shareholders ultimately have a lot to lose if a business rescue fails and goes into liquidation. However, shareholders risk of capital invested is a function of corporate participation. It is submitted that shareholders (unless their rights are affected and where they get to vote in the business rescue plan) should be in the background where it comes to decision making in the business rescue context. It is up to the directors, existing management and the practitioner to come up with a rescue plan at an operational level, devoid of the influence of shareholders.

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648. Loubser "The Role of Shareholders During Corporate Rescue Proceedings: Always on the Outside Looking in?" (2008) *SA Merc LJ* 372.
649. Ibid. For the role of shareholders in a judicial management, see pp. 372–379.
650. Ibid 381–382. See also Loubser "Some Comparative Aspects of Corporate Rescue in South African Company Law" (LLD thesis, University of South Africa 2010).

However, as set out above, Chapter 6 does provide shareholders with participation opportunities in a business rescue and, if their rights are affected, an opportunity to vote on the plan.[651]

The rights associated with the "class of securities" is vague. When does a shareholder get to vote in a plan? If the plan contemplates a "dilution" of such shareholder's equity, would the "rights" of such shareholder be affected?[652]

Section 137(1) supports this view in that during business rescue proceedings, an alteration in the classification or status of any issued securities of a company, other than by way of a transfer of securities in the ordinary course of business, is invalid except to the extent that the court otherwise directs or is contemplated in an approved business rescue plan.

Would a "rights issue" proposed as part of a plan affect the "rights attaching to securities"? Counsel's view was as follows:

> The rights issue does nothing to change or modify the status or classification of any rights which continue to exist precisely in the form that they did prior to the proposed plan. While it is correct that a rights issue, if a relevant shareholder does not follow its rights, would result in a dilution, we do not believe that that is a result contemplated by the word "alter". Of course, the relevant shareholder is at liberty to follow its rights.[653]

Holders of company securities (shareholders) and their level of participation in the rescue process are specifically dealt with in section 146 of the 2008 Companies Act. Section 146 states:

> During a company's business rescue proceedings, each holder of any issued security of the company is entitled to –
>
> (a) notice of each Court proceeding, decision, meeting or other relevant event concerning the business rescue proceedings;
>
> (b) participate in any Court proceedings arising during the business rescue proceedings;

651. See Loubser "The Role of Shareholders During Corporate Rescue Proceedings: Always on the Outside Looking in?" (2008) *SA Merc LJ* 379–390.

652. Senior counsel have expressed views on this issue. They have interpreted the "rights of shareholders" to include –

> a change or modification to the rights attaching to the relevant security or class of security to be effected by the proposed plan…

Opinion by Slomowitz SC and Blou SC (2 September 2011).

653. Ibid 2.

(c) formally participate in a company's business rescue proceedings to the extent provided for in this Chapter;

(d) vote to approve or reject a proposed business rescue plan in the manner contemplated in section 152, if the plan would alter the rights associated with the class of securities held by that person; and

(e) if the business rescue plan is rejected, to –

(i) propose the development of an alternative plan, in the manner contemplated in section 153; or

(ii) present an offer to acquire the interests of any or all of the creditors or other holders of the company's securities in the manner contemplated in section 153."

Section 1 defines the holders of a company's securities as the holder of "any shares, debentures or other instruments, irrespective of their form or title, issued or authorised to be issued by a profit company".

"Shareholder" is defined in section 1 as "the holder of a share issued by a company and who is entered as such in the certificated or uncertificated securities register, as the case may be".

Thus, both shareholders and debenture holders (a debtor/creditor relationship) will have voting rights to vote on the approval or rejection of a business rescue plan if their rights are being altered by that plan.[654] Debenture holders might therefore participate as both creditors and as holders of security. Although the relationship between a company and a debenture holder is one of debtor and creditor (with the debenture holder as a creditor) debenture holders (and other forms of security holders) can have voting rights in respect of the plan and in terms of section 146(d). Thus, debenture holders (and other holders of the company's security that confer similar rights) will be able to participate in the company's business rescue proceedings as both creditors and as holders of security issued by the company.[655]

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654. Section 146(d) and section 152(3)(c) of the 2008 Companies Act. The alternation of shareholder or security holder rights remains open to debate. If a plan involves a sale of shares of the company, generally the shareholders' vote is required as contemplated by section 152 (3)(c) of the 2008 Companies Act. If approved by creditors and by shareholders, the plan is finally adopted in terms section 152 (3)(c)(ii)(aa) of the 2008 Companies Act.

655. Bertelsmann et al. *Mars*: *The law of Insolvency in South Africa* (2008) at para 18.12.1. Also see Rushworth "A Critical Analysis of the Business Rescue Regime in the Companies Act 71 of 2008" (2010) *Acta Juridica* 388–389; 399–400.

As shareholders are affected persons, they can apply to court for compulsory business rescue. During business rescue proceedings, an alternation in the classification or status of any issued securities of a company, other than by way of a transfer of securities (shares) in the ordinary course of business, is invalid except to the extent that the court otherwise directs or is contemplated in an approved business rescue plan.[656]

Security holders (shareholders) have rights to participate in any legal proceedings arising during business rescue proceedings.

Shareholders are indeed entitled to notification of court proceedings, decisions, meetings and other relevant events concerning the business rescue proceedings,[657] can participate in court proceedings,[658] and can formally participate in the business rescue proceedings themselves.[659] However, their rights are limited on voting on approval or rejection of the plan.

The question of "alienation of rights" remains open to debate. The general view is that section 146(d) as read with section 152(3)(c)(i),[660] contemplates a change or modification to the rights attaching to the relevant security or class of security to be affected by the proposed plan. Section 137(1), which refers to the alteration to the "classification or status" of issued security, supports that view.[661]

Shareholders further have the opportunity to propose the development of an alternative plan, in the manner contemplated in section 153, or present an offer to acquire the interests of any or all of the creditors or other holders of the company's securities in the manner contemplated in section 153.[662]

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656. Bertelsmann et al. *Mars*: *The law of Insolvency in South Africa* (2008) at para 18.12.1.
657. Section 146(a) of the 2008 Companies Act.
658. Section 146(b) of the 2008 Companies Act.
659. Section 146(c) of the 2008 Companies Act.
660. Section 152(3)(c)(i) of the 2008 Companies Act states that if a proposed business rescue plan does alter the rights of any class of holders of the company's securities (shares), then the practitioner must hold a meeting of the holders of the class or classes of securities whose rights would be altered by the plan and call for a vote by them to approve the adoption of the proposed business rescue plan.
661. Opinion of Slomowitz SC and Blou SC (2 September 2011) 2.
662. Section 146(e)(ii) of the 2008 Companies Act. The provisions and the methodology set out in section 153 will be dealt with below.

Most importantly, security holders can, in terms of section 146(e), present an offer to acquire the interests of any or all of the creditors or other holders of the company's securities in the manner contemplated in section 153.[663]

It is submitted that although shareholders (as affected persons) are given a "role" in the business rescue process, such a role is quite limited. Often a plan is proposed which does not affect the rights of shareholders. If this is the case, shareholders do not get to vote on the plan. The reason for this is that the legislature recognised that in a company that is financially distressed, shares are generally worth some negligible value, if not zero value. Shareholders are facing a possible liquidation of the company and thus in many instances, their shares are valued at a "liquidation value". Thus, it is the creditors that are placed in an advantageous position in a business rescue, and shareholders are somewhat left in the doldrums of having invested in a company that is virtually insolvent.

7.6 TREATMENT OF CREDITORS, EMPLOYEES AND CONTRACTS

7.6.1 CREDITORS

As South Africa, at least in theory, moves away from a creditor-driven rescue regime to one in favour of the debtor company, one would expect a higher level of participation by the directors of the company in the business rescue proceedings. However, participation by creditors in the voting process remains paramount in the practical application of approving of and voting in a business rescue plan in South Africa.

It is submitted that overall, business rescue has proven to be creditor-friendly. Those creditors who were concerned about a loss of protection under the new Chapter 6 disposition need not be overanxious. Whereas judicial management and liquidation have in the past been implemented disproportionately in favour of creditors – not least for the reason that the former often led to the latter as a matter of course – the new procedure seeks to protect a wider range of interests in the business rescue process.[664]

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663. The implications of making a binding offer to buy out the voting interests of other parties will be dealt with in Chapter 7, para 7.8.2.
664. See Bradstreet "Business Rescue proves to be Creditor Friendly – CJ Claassen's Analysis of New Business Rescue Procedure in *Oakdene Square Properties*" (2013) *SALJ* 44.

The importance of the role of creditors in the US was highlighted in a presentation by a New York restructuring lawyer, Philip Mindlin, in March 2013, to the South African Department of Trade and Industry:

> New York Attorney, Philip Mindlin, notes that the active role played by creditors in bankruptcy cases in the United States (US) is one of the features that contribute to the success of reorganisation under the American form of corporate reorganisation (under ch 11 of the US Bankruptcy Code). Such involvement is partially through membership of committees of creditors who employ sophisticated advisers to promote their interests in court proceedings and also assist the analyses of the reorganisation case as it develops. Large creditors also play a meaningful role outside of the committees by "filing pleadings with the court on every significant matter and appearing to express their views", and investors who buy claims against bankrupt companies are often able to play a role in proceedings that would not have been cost-effective for the previous holders of that debt to have played.[665]

Section 145 of the 2008 Companies Act allows creditors to participate in court proceedings (generally by intervening in the court application brought in terms of section 131) and to both formally and informally participate in the company's business rescue proceedings.[666]

Section 145(1)(a) provides that each creditor is entitled to notice of all court proceedings, decisions, meetings or any other relevant event concerning the business rescue proceedings. It is very much an all-inclusive process and very much driven by creditors, either by being informed individually throughout the process or through notification to the creditors' committee[667] duly constituted at the first creditors' meeting. Creditors further may participate in court proceedings arising during the business rescue proceedings and informally participate in those proceedings by making proposals for a business rescue plan to the practitioner.[668]

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665. Mindlin *Comparative Analysis of Chapter 6 of the South African Companies Act No. 71 of 2008* (Presentation to the Company Law Symposium organised by the South African Department of Trade and Industry and the Specialist Committee on Company Law, Johannesburg, 1 March 2013) available at http://www.thedti.gov.za/business_regulation/presentations/symposium1of6.pdf.

666. Section 145(1)(b), (c) and (d) of the 2008 Companies Act. See Rushworth "A Critical Analysis of the Business Rescue Regime in the Companies Act 71 of 2008" (2010) *Acta Juridica* 397–399. Also see Marcus "South Africa reforms business rescue laws: new objectives, new opportunities (30 September 2013) 2, where he states:

> The egalitarian treatment of creditors is also a step forward. Insolvency law in South Africa has a strict hierarchy of creditors. In business rescue the only persons protected are post-commencement financiers, and employees who retain the protection of ordinary labour law. In business rescue, all creditors are treated equally – they participate on the value of their claims whether unsecured or not (although security is protected). Commercial creditors will raise a cheer to know that the South African fiscus has no preference, albeit to its considerable disgruntlement.

667. Section 145(3) of the 2008 Companies Act.

668. Section 145(1)(a)–(d) of the 2008 Companies Act. See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-58(1)–18-64 at para 18.10 on the role of creditors in a business rescue proceeding.

Creditors participate in respect of the voting on the plan and can vote to amend, approve or reject a proposed business rescue plan.[669] Creditors can further present an offer to acquire the interests of any or all of the other creditors in terms of section 153. The buy-out provision is a fundamental right of creditors to purchase the voting interest of creditors who vote down the plan (dissenting votes).[670]

Section 145(3) allows creditors to form a creditors' committee. Through this committee, creditors are entitled to be consulted by the practitioner during the development of the business rescue plan. Creditors are, however, limited to making proposals to the practitioner and may not direct him or her to take action or instruct him or her to do anything in the course of his or her conduct in such proceedings. It is submitted that creditors' committees have limited powers as they cannot "instruct" the practitioner to act in a certain way, but can only "consult" with the practitioner.[671]

The first meeting of creditors is dealt with in terms of section 147:

(1) Within 10 business days after being appointed, the practitioner must convene, and preside over, a first meeting of creditors, at which –

(a) the practitioner –

(i) must inform the creditors whether the practitioner believes that there is a reasonable prospect of rescuing the company; and

(ii) may receive proof of claims by creditors; and

(b) the creditors may determine whether or not a committee of creditors should be appointed and, if so, may appoint the members of the committee.

(2) The practitioner must give notice of the first meeting of creditors to every creditor of the company whose name and address is known to, or can reasonably be obtained by, the practitioner, setting out the –

(a) date, time and place of the meeting; and

669. Section 152 of the 2008 Companies Act.

670. The rights of creditors to buy out dissenting creditors at liquidation value is the equivalent "cram-down" provision as contained in the Chapter 11 process in the US. Dissenting creditors must be prepared to sell (by way of a binding offer process) to those creditors who support the plan. Thus the "hold-out" issue prevalent in foreign jurisdictions is catered for in Chapter 6 (see section 153(1)(b)(ii) of the 2008 Companies Act).

671. Section 145(1)(d) of the 2008 Companies Act and (3). These committees can prove to be very effective when representing large groups of creditors and alleviate the need for the practitioner having to consult with large numbers of creditors on an individual basis. The same would apply to employee committees set up in terms of section 148 of the 2008 Companies Act. Thus the practitioner can receive input on his or her proposed plan from such committees. See comments by Wessels and De Weijs *International Contributions to the Reform of Chapter 11 U.S. Bankruptcy Code* (2015) 101.

(b) agenda for the meeting.

(3) At any meeting of creditors, other than the meeting contemplated in section 151, a decision supported by the holders of a simple majority of the independent creditors' voting interests voted on a matter, is the decision of the meeting on that matter.

Creditors who have an interest in the outcome of the business rescue proceedings should ensure that they attend the first meeting of creditors. Such meeting should occur within 10 business days after the practitioner has been appointed.

At this meeting, the practitioner must inform the creditors whether the practitioner believes that there is a reasonable prospect of rescuing the company. This is a tall order for a practitioner who was appointed only ten days prior to the meeting. However, if a careful pre-assessment has been completed, in liaison with creditors, such determination by the practitioner is possible.[672]

In practice, one would expect vigorous debate at the first meeting of creditors as to the reasons for business rescue, the role and reasoning of the directors in passing a section 129 resolution, the possibility of post-commencement finance and the sustainability thereof, the extent of the creditors' claims and securities in place, the role of the shareholders and the possibility of them injecting more capital into the business, the status of employees, the prospects and viability of the business of the company going forward, an identification of prejudicial contracts and the possibility of the company trading its way through the business rescue process to a solvent position.

In terms of section 147(3), at any meeting of creditors, other than the meeting contemplated in section 151, a decision supported by the holders of a simple majority of the independent creditors' voting interests in a matter is the decision of the meeting on that matter.

The practitioner is also obligated to receive proof of claims by creditors at the first meeting of creditors.[673] In practice, the submission of claims is not obligatory at this stage.

672. The benefits of pre-assessment are dealt with in Chapter 7, para 7.5.

673. Section 147 (1)(a)(ii) of the 2008 Companies Act. There is no specific provision in the 2008 Companies Act dealing with the manner and form of creditors' proof of claims or how such claims are to be determined. There is no formal or legislated procedure for proof of creditors' claims. In terms of section 147(1)(a)(ii) of the 2008 Companies Act, the practitioner must receive "proof of claims by creditors". It is submitted that the practitioner must examine all claims provided to him or her on such claims' merits and ensure that such creditor has proven to his or her satisfaction that there in fact exists a lawful and valid claim.

However, it is very useful for the practitioner to receive claims (10 days into the proceedings) as it allows him or her to determine the extent of liabilities existing in the company at a very early stage.

The form of proof of claims is an open question. It is not necessary to submit these claims on affidavit (in terms of section 44 of the Insolvency Act), but it is submitted it is preferable to do so if possible. A finite position on liabilities is critical for the practitioner to determine whether or not there is a reasonable prospect of rescuing the company and this will also determine the value of a creditor's vote on the business rescue plan in terms of section 152(1)(e) as well as determining secured, statutory, preferent and concurrent creditors as is required in the drafting of the business rescue plan (section 150(2)(a)(ii)).

There is also no mechanism available for the practitioner to assess the validity of claims. Claims could be incorrectly calculated, fraudulent, inflated and based on incorrect or inaccurate documentation or invalid in law.

Further, at the first meeting of creditors, a creditors' committee must be appointed, if required.

The short time frame between the appointment of a practitioner and the convening of the first meeting of creditors (a period of 10 days) makes the task of the practitioner quite difficult.[674]

Section 149 sets out the functions and duties of the creditors' committee.[675]

Creditors are entitled, through their committee, to consult with the practitioner about any matter relating to the business rescue proceedings, but may not direct or instruct the

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674. See Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 513 where the following is stated:

> Considering the short time frames involved, it would be surprising if the business rescue practitioner is in position to definitively state that there is a reasonable prospect of rescuing the company already at the first meeting of creditors. However, if there is clearly no prospect at all of saving the company the business rescue practitioner would be obliged to inform the creditors' meeting of this fact so that the business rescue procedure can be terminated and converted to liquidation proceedings as soon as possible.

675. Ibid 515:

> Section 149 of the 2008 Companies Act sets out the functions, duties and membership of the creditors' committee and the committee of employees' representatives. From the provisions of this section it is clear that the committees concerned do not have any real powers, as they may not direct or instruct the business rescue practitioner in any way regarding the business rescue proceedings. However, these committees can prove to be very effective when representing large groups of creditors and/or employees, and will be of great assistance to the business rescue practitioner who will then not need to consult with a large number of creditors and employees on an individual basis. Although the purpose of these committees is to represent the interests of the creditors or the employees on a collective basis, it is submitted that there is nothing in Chapter 6 of the Act generally that precludes creditors or employees from consulting with the business rescue practitioner on an individual basis.

practitioner on any matter.[676] Creditors are entitled to be consulted by the practitioner during the development of the plan. In practice, the practitioner consults extensively with major creditors (especially those creditors who will determine the vote) in respect of the content and feasibility of the plan; the objective being that once the plan is published, the practitioner will know that he or she will have the support of the major creditors when it comes to approval of the plan. Mindlin states:

> If creditors become constructively involved in the business rescue process, by way of numerous provisions that exist to facilitate their involvement during the process, particularly when creditors bring applications themselves to make use of business rescue under section 131 with the intention of being co-operative rather than hostile in the enforcement of their claims, we may see this shift in approach to defaulting debtors transferred into practice.[677]

Creditors have generally "bought" into the business rescue process. We have seen very few creditors opposing the proposed plan, nor the implementation thereof. Creditors understand that if the plan fails, in all likelihood their returns in a liquidation are minimal. Secured creditors would weigh up what their security would realise in a liquidation, and make a decision as to whether support of a business rescue plan would ultimately realise a better return. Again, we are seeing a shift in the mindset of creditors to focus more on the possible successful rescue of the debtor company, rather than on what could be realised from security in a liquidation.

Most importantly, creditors are given the right to vote in a business rescue plan in terms of section 145(2)(a)(b) as follows:

> (2) In addition to the rights set out in subsection (1), each creditor has –
>
> (a) the right to vote to amend, approve or reject a proposed business rescue plan, in the manner contemplated in section 152; and
>
> (b) if the proposed business rescue plan is rejected, a further right to –
>
> (i) propose the development of an alternative plan, in the manner contemplated in section 153; or

676. Section 149(1)(a) of the 2008 Companies Act. For the rights of creditors in business rescue, see Le Roux and Duncan "The Naked Truth: Creditor Understanding of Business Rescue: A Small Business Perspective" (2013) *SAJESBM* 57–74.

677. Mindlin *Comparative Analysis of Chapter 6 of the South African Companies Act, No. 71 of 2008* (Presentation to the Company Law Symposium organised by the South African Department of Trade and Industry and the Specialist Committee on Company Law, Johannesburg, 1 March 2013) available at http://www.thedti.gov.za/business_regulation/presentations/symposium1of6.pdf.

(ii) present an offer to acquire the interests of any or all of the other creditors in the manner contemplated in section 153.

During the course of the business rescue proceedings, the creditors are entitled to receive and consider reports relating to such proceedings.[678] The creditors committee must, however, act independently of the practitioner to ensure fair and unbiased representation of creditors' interests.[679] Only independent creditors are entitled to be represented on the creditors' committee.[680]

As set out above, creditors in effect control the voting on a business rescue plan.[681] Shareholders rarely have an opportunity to vote on a plan, unless the business rescue plan "alters the rights associated with the class of securities held."[682]

The manner in which a creditor votes on a business rescue plan at a meeting convened in terms of section 151 is of crucial importance.[683] Section 145(4) sets out the value attributed to creditors voting on a business rescue plan:

(4) In respect of any decision contemplated in this Chapter that requires the support of the holders of creditors' voting interests –

(a) a secured or unsecured creditor has a voting interest equal to the value of the amount owed to that creditor by the company; and

(b) a concurrent creditor who would be subordinated in a liquidation has a voting interest, as independently and expertly appraised and valued at the request of the practitioner, equal to the amount, if any, that the creditor could reasonably expect to receive in such a liquidation of the company.

In respect of any decision that requires the support of a creditor's voting interest, subsection (4)(a) provides that a secured or unsecured creditor has a voting interest equal to the value of the amount owed to that creditor by the company.

678. Section 149(1)(b) of the 2008 Companies Act.
679. Section 149(1)(c) of the 2008 Companies Act.
680. Section 149(2)(a) of the 2008 Companies Act.
681. Section 152 of the 2008 Companies Act.
682. Section 146(d) of the 2008 Companies Act. See Section 1 (definitions), where "securities" is defined as "shares, debentures or other instruments irrespective of their form or title, issued or authorised to be issued by a profit company".
683. See section 152(2) of the 2008 Companies Act. Creditors would vote in a plan (on a preliminary approval basis) if it was supported by the holders of more than 75 per cent of the creditors' voting interests (such creditors to be independent).

The terminology of "secured or unsecured creditors' claims" remains unclear. There is no definition to assist us in interpretation.[684]

Banks may, from time to time, take cession of shareholders' loan accounts held in companies, and which shareholders' loans may very well be subordinated by way of formal agreements. Once such shareholders' loans have been ceded to the bank, and the relevant company goes into business rescue proceedings, the bank may want to be in a position to vote on such shareholders' loans in respect of a business rescue plan.

In terms of section 145(4)(b), a concurrent creditor who would be subordinated in a liquidation,[685] will have a voting interest, as independently and expertly appraised and valued at the request of the business rescue practitioner, equal to the amount, if any, that the creditor could reasonably expect to receive in a liquidation of the company.

In terms of section 145(5)(b), the business rescue practitioner must request a suitably qualified person to independently and expertly appraise and value such interests as contemplated in subsection 145(4)(b). The section specifically refers to a "concurrent creditor" who would be subordinated in a liquidation and not a "secured creditor" who might have subordinated its claim to senior creditors or lenders. The question as to whether or not their claims would also have to be left to be appraised by an independent person at liquidation value remains open.

It therefore appears that notwithstanding the subordination of the loan account, if the bank has taken cession of the loan account, the bank would be entitled to vote, but in accordance with the abovementioned provisions.

684. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 508 state the following:

> The terminology adopted by the legislature in s 145(4) is somewhat confusing. Under South African insolvency law creditors are categorised as being either secured or unsecured. Unsecured creditors are then either preferent or concurrent. Creditors are categorised as preferent (unsecured) creditors for specific amounts owing prior to insolvency (see ss 96-102 of the Insolvency Act), and creditors that receive no preferential treatment at all are regarded as being concurrent (s 103 of the Insolvency Act). Chapter 6 does not contain a definition of the term "unsecured creditor". Given its normal meaning, the term "unsecured creditor" refers to all creditors whose claims are not secured, including concurrent creditors; however, in s 145(4) this is clearly not the intention as concurrent creditors have been specifically mentioned. Since Chapter 6 uses the term "preferred unsecured creditor" to denote an unsecured claim that is to receive preferential treatment (see egg s 144(2) where employees who have claims against the company for amounts owing prior to the commencement of the business rescue proceedings, are classified as being "preferred unsecured creditors" of the company), sub-s (4)(a) could have been stated more clearly by using the same terminology. Perhaps this was just an oversight by the legislature, as clearly the subsection is only intended to cover "preferred unsecured creditors".

685. The common view is that a subordination must occur by way of a written (formal) subordination agreement whereby a creditor formally subordinates its claim to either one particular creditor or, alternatively, all of the creditors of a company.

It is very important to determine whether or not a creditor is independent. An "independent creditor" is defined[686] as a person who:

(i) is a creditor of the company, including an employee of the company who is a creditor in terms of section 144(2); and

(ii) is not related to the company, a director, or the practitioner, subject to subsection (2).[687]

Section 128(2) states –

(2) For the purpose of subsection (1)(g), an employee of a company is not related to that company solely as a result of being a member of a trade union that holds securities of that company;

What is meant by "related to [the] company"?

"Related", when used in respect of two persons, means persons who are connected to one another in any manner contemplated in section 2(1)(a) to (c).[688] In terms of section 2(1)(b),

"an individual is related to a juristic person if the individual directly or indirectly controls the juristic person, as determined in accordance with subsection (2);

in terms of section 2(1)(c)

"a juristic person is related to another juristic person if –

(i) either of them directly or indirectly controls the other, or the business of the other, as determined in accordance with subsection (2);

(ii) either is a subsidiary of the other; or

(iii) a person directly or indirectly controls each of them, or the business of each of them, as determined in accordance with subsection (2).

"Control" is dealt with in section 2(2) as follows:

(2) For the purpose of subsection (1), a person controls a juristic person, or its business, if –

(a) in the case of a juristic person that is a company –

686. Section 128(1)(g) of the 2008 Companies Act.
687. The definition of "person" in section 1 of the 2008 Companies Act includes a juristic person.
688. See section 1 for a definition of the word "related".

(i) that juristic person is a subsidiary of that first person, as determined in accordance with section 3(1)(a); or

(ii) that first person together with any related or inter-related person, is –

(aa) directly or indirectly able to exercise or control the exercise of a majority of the voting rights associated with securities of that company, whether pursuant to a shareholder agreement or otherwise; or

(bb) has the right to appoint or elect, or control the appointment or election of, directors of that company who control a majority of the votes at a meeting of the board;

(b) in the case of a juristic person that is a close corporation, that first person owns the majority of the members' interest, or controls directly, or has the right to control, the majority of members' votes in the close corporation;

(c) in the case of a juristic person that is a trust, that first person has the ability to control the majority of the votes of the trustees or to appoint the majority of the trustees, or to appoint or change the majority of the beneficiaries of the trust; or

(d) that first person has the ability to materially influence the policy of the juristic person in a manner comparable to a person who, in ordinary commercial practice, would be able to exercise an element of control referred to in paragraph (a), (b) or (c).

(3) With respect to any particular matter arising in terms of this Act, a Court, the Companies Tribunal or the Panel may exempt any person from the application of a provision of this Act that would apply to that person because of a relationship contemplated in subsection (1) if the person can show that, in respect of that particular matter, there is sufficient evidence to conclude that the person acts independently of any related or inter-related person.

The practitioner is obligated to determine whether or not a creditor is independent for the purposes of Chapter 6 of the 2008 Companies Act.[689] Creditors that are independent would carry the vote at the first meeting of creditors[690] at 75 per cent of the holders of creditors'

689. Section 147(3) of the 2008 Companies Act states that a decision supported by the holders of the independent creditors' voting interests voted on a matter, is the decision of the meeting on that matter.

690. Section 145(6) of the 2008 Companies Act. Any person may review the practitioner's determination that a person is, or is not, an independent creditor.

voting interests, provided that the votes in support of the proposed plan included at least 50 per cent of the independent creditors' voting interests, if any, that were voted.[691]

An interesting question is whether the bank, by taking cession of a loan account claim, would lose its status as an independent creditor when it came to voting on those particular claims. Independent creditors, as defined, are persons who are not related to the company, a director, or the practitioner. Clearly, a loan account creditor, such as a shareholder who has a loan account in the company, would not be an independent creditor, but a cession of a loan account to an independent creditor such as the bank may still be permissible.[692]

In terms of section of 145(5) of the 2008 Companies Act, the business rescue practitioner must determine whether a creditor is independent for the purposes of Chapter 6. This becomes important when a plan is put to the vote in terms of section 152 of the 2008 Companies Act. A business rescue plan will be approved if it is supported by the holders of more than 75 per cent of the creditors' (all creditors) voting interests that were voted (in value) and the vote and support of the proposed plan must include at least 50 per cent of the independent creditors voting interests, if any, that were voted.

If one refers to the voting provisions in respect of the business rescue plan, particularly in section 145(5), where the practitioner must determine whether a creditor is independent for the purposes of the chapter, all roads lead to the issue of "independence". Issues relating to control are not relevant for these purposes. This is supported by the fact that, in terms of section 147(3) of the 2008 Companies Act, at any meeting of creditors, other than the meeting contemplated in section 151, a decision supported by the holders of a simple majority of the independent creditors' voting interests, voting on a matter, is a binding decision of the meeting on that matter. In other words, it is the independent creditors (such as the bank) that will control decisions at the first meeting of creditors, in particular the makeup of the committee of creditors.

Section 152(2)(b) of the 2008 Companies Act contemplates votes in support of the proposed business rescue plan to include at least 50 per cent of the independent creditors' voting interests, if any, that were voted, for a plan to succeed. The legislator clearly

691. Section 152(2)(a) and (b) of the 2008 Companies Act.

692. The fact that a creditor, such as the bank, has taken cession of a loan account held by a shareholder or has taken a pledge of shares as security for its claim, would not affect the status of the bank as an "independent creditor".

contemplates a situation where a business rescue plan cannot be rejected or unfairly influenced by the votes of non-independent creditors.

The determination of the liquidation value of a creditor's claim (which has been subordinated by way of a formal agreement) must be determined by a suitably qualified person who would independently and expertly appraise and value such claim.[693] Generally, a creditor's claim in a liquidation would be of negligible or zero value, thus resulting, effectively, in that creditor getting a nil vote on the plan.

Once a determination on independence has been made and a value on a subordinated claim has been determined, such creditor must be notified of such determination and appraised value at least 15 business days before the date of the section 151 meeting.[694]

Within five business days after receiving a notice of such determination, a person may apply to court to review the practitioner's independence determination and/or review, reappraise and revalue that person's voting subordinated interest. The common view is that it is only the person who is in receipt of the practitioner's determination effected in terms of section 145(5) who can approach the court for a review in terms of section 145(6), and not any other person or creditor.

This issue of the valuation of a subordinated claim has not yet been dealt with by our courts. However, this issue might become very important. If the liquidation value is determined at a very low or negligible amount, that creditor simply does not get a vote. One way to deal with this practically is to formally advise the practitioner that in the event of a liquidation, such creditor would be willing to buy out all of the assets at a market-related value (considerable higher than liquidation value). In that event, the practitioner will have no alternative but to determine that creditor's claim at the considerably higher market related value, and not at liquidation value.

What is meant by a "concurrent creditor" who would be "subordinated in a liquidation" has been subject to debate.[695]

693. Section 145(5)(b) of the 2008 Companies Act.
694. Section 145(5)(c) of the 2008 Companies Act.
695. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 508–509 state:

Jeremy Muller SC of the Cape Town Bar[696] considered whether the reference to a "concurrent creditor" in section 145(4)(b) refers to all concurrent creditors, i.e. creditors that are neither secured nor preferent creditors, or whether concurrent creditors other than those contemplated in section 145(4)(b) fall within a category of "unsecured creditor" in section 145(4)(a). Muller was of the view that a contrary view would be grossly unfair to concurrent creditors if their voting interests were to be valued in accordance with section 145(4)(b) in circumstances where, on liquidation, they would receive no, or a negligible, dividend. Such an interpretation, in Muller's view, would not

> be consonant with the purpose of providing for the efficient rescue and recovery of financially distressed companies "in a manner that balances the rights and interests of all relevant stakeholders" as contemplated in section 7(k), read with section 5(1).

Muller is of the view that the term "unsecured creditor" should be read as including concurrent creditors since the legislature must be assumed to have intended these terms to bear their ordinary meaning unless a contrary intention is evident. Sections 150(2)(a)(ii) and 155(3)(a)(ii) strengthen this contention. Both subsections deal with the prescribed "Background" sections which must be included in the business rescue plan and a compromise. These sections require the plan or proposal to contain, *inter alia*, "an indication as to which creditors would qualify as secured, statutory preferent and concurrent in terms of the laws of insolvency …". In addition to secured creditors, therefore, "statutory preferent" and "concurrent" creditors, in terms of the laws of insolvency, are recognised in Chapter 6 as specific categories of creditors.

Another confusing term that is used in sub-s (4)(*b*) is the reference to a "concurrent creditor who would be subordinated in a liquidation". Under South African insolvency law one does not refer to concurrent creditors' claims being "subordinated in a liquidation', although this is in reality what transpires as a result of the order of preference in terms of which claims are paid. Consequently it is submitted that the term is of no particular significance; all it refers to is the claims of creditors that would be treated as concurrent in a liquidation (which would be subordinate to the payment of all the other claims).

In terms of sub-s 4(b) concurrent creditors can only vote on the amount that they could reasonably expect to receive if the company was in liquidation. While there is no formal procedure contained in Chapter 6 for the proof of claims, sub-s (4)(*b*) goes further and states that the amount in question has to be independently and expertly appraised and valued at the request of the business rescue practitioner. From the wording of sub-s (5)(*b*) it is clear that the practitioner must have the value of the voting interest appraised and valued, and consequently it is submitted that the cost of doing so will form part of the costs of the business rescue in terms of s 135(3) read with s 143(1) (see further the notes on ss 135 and 143). This appears to be an unnecessary additional expense placed upon a company that is already financially distressed, especially when one considers the purpose of having the claims appraised in this manner. It is not clear why concurrent creditors' voting rights have been limited to the amounts that they could reasonably be expected to receive if the company was in liquidation. Exactly what these creditors would receive in a liquidation is the subject of conjecture, and would be difficult to ascertain with any accuracy, even by an expert. Also, in many cases of winding-up the concurrent creditors do not receive a dividend at all; if this were so in any given instance, it would result in the concurrent creditors having no vote at all as their claims would be valueless. It seems grossly unfair that concurrent creditors should be deprived of their voting rights in this way, as they too have an interest in the company eventually being rescued. In fact, concurrent creditors probably have more of an interest in the company being rescued than secured creditors, as the latter still have their security to fall back on should the company eventually be wound up. The position set out in sub-s (4) is the exact opposite of what transpires in insolvency where secured creditors only have a vote on the amount of their claim which will not be covered by the proceeds of their security, i.e. on the concurrent portion of their claims.

696. Opinion by Jeremy Muller SC (15 June 2012).

Muller is of the firm view that it would be completely inconsistent with the purpose and scheme of the 2008 Companies Act that all concurrent creditors should be "penalised" by almost certainly having their voting interest reduced and quite possibly entirely emasculated, if section 145(2)(b) was intended to include all concurrent creditors. In Muller's view, each concurrent creditor, save for that category of concurrent creditors referred to in section 145(4)(b), has a voting interest equal to the value of the amount owed to that creditor by the company.[697]

In Chapter 6 proceedings, creditors remain fundamental role players in the rescue proceedings. Although they cannot "instruct" the practitioner, they can "consult" the practitioner on aspects of the plan and the development thereof. Creditors' buy-in is essential. Ultimately it is a plan approved by 75 per cent of creditors' voting in value (50 per cent of such creditors being independent).[698] The buy-in of creditors needs to be established even before the plan is put to the vote.

It is submitted that more often than not, creditors vote in favour of the plan, as long as they are persuaded that they are able to receive a business rescue dividend that is better than a liquidation value (which is generally at zero or at some negligible amount).

Creditors in a business rescue are crucial participants. Concerns have been raised as to the general low level of knowledge and awareness of certain creditors in the business rescue process. Studies have shown that there are many discrepancies in creditors' knowledge of the Chapter 6 legislation. Furthermore there is little understanding of the role and methodology of the practitioner's appointment, the expected skills and expertise and the manner in which the legislation aims to rescue the debtor. Clearly, South African creditors require training and access to proper business and legal expertise in respect of the rescue procedures set out in Chapter 6 of the 2008 Companies Act. This knowledge is vital if creditors are expected to use the rescue legislation to their benefit. It might very well be

697. However, see below for the views expressed in the case of *Commissioner of South African Revenue Services v Beginsel NO and Others* 2013 (1) SA 307 (WCC).in respect of the distinction between "preferent" and "concurrent" creditors in a business rescue. See Chapter 7, para 7.8.1.

698. Section 152(2) of the 2008 Companies Act. See Chapter 5, para 5.5.4.1 for the role of creditors in international jurisdictions.

left to the business rescue practitioners to inform creditors of their roles, powers and liabilities in the business rescue process.[699]

The friction between creditors and debtors (companies) is a delicate balancing act and one which must be carefully dealt with by the practitioner. As South Africa moves (albeit slowly) towards a more enlightened approach to the position of the debtor that is financially distressed, there will be a need for all stakeholders to accept that a stronger focus on the needs of the debtor is required.

The historical focus on creditor needs (refer to discussion above)[700] and the South African view on the principle of "advantage to creditors" makes the new legislation, insofar as creditors are concerned, part of the aforementioned balancing act between the interests of debtors and creditors.

Like in the US, the preservation of the debtor company makes complete sense, for a host of reasons. In South Africa, creditors still get to "call the shots", particularly when it comes to voting on the plan.[701]

7.6.2 EMPLOYEES

Employees are dealt with very specifically in a business rescue proceeding. In addition to the fact that they rank as superpriority creditors in the ranking of claims,[702] they also have an opportunity to participate in the business rescue proceedings themselves.[703]

The status of employees in business rescue is dealt with in section 136 as follows:

> (1) Despite any provision of an agreement to the contrary –
>
> (a) during a company's business rescue proceedings, employees of the company immediately before the beginning of those proceedings continue to be so employed on the same terms and conditions, except to the extent that –
>
> (i) changes occur in the ordinary course of attrition; or

699. Le Roux and Duncan "The Naked Truth: Creditor Understanding of Business Rescue: A Small Business Perspective" (2013) *SAJESBM* 71.
700. See Chapter 2, paras 2.2 to 2.4.
701. Section 152 of the 2008 Companies Act.
702. Section 135(1) of the 2008 Companies Act.
703. Section 144 of the 2008 Companies Act.

(ii) the employees and the company, in accordance with applicable labour laws, agree different terms and conditions; and

(b) any retrenchment of any such employees contemplated in the company's business rescue plan is subject to section 189 and 189A of the Labour Relations Act, 1995 (Act No. 66 of 1995), and other applicable employment related legislation.

(2) Subject to subsection (2A), and despite any provision of an agreement to the contrary, during business rescue proceedings, the practitioner may –

(a) entirely, partially or conditionally suspend, for the duration of the business rescue proceedings, any obligation of the company that –

(i) arises under an agreement to which the company was a party at the commencement of the business rescue proceedings; and

(ii) would otherwise become due during those proceedings; or

(b) apply urgently to a Court to entirely, partially or conditionally cancel, on any terms that are just and reasonable in the circumstances, any obligation of the company contemplated in paragraph (a).

(2A) When acting in terms of subsection (2) –

(a) a business rescue practitioner must not suspend any provision of –

(i) an employment contract; or

(ii) an agreement to which section 35A or 35B of the Insolvency Act, 1936 (Act No. 24 or 1936), would have applied had the company been liquidated;

(b) a Court may not cancel any provision of –

(i) an employment contract, except as contemplated in subsection (1);

(ii) an agreement to which section 35A or 35B of the Insolvency Act (Act No. 24 of 1936), would have applied had the company been liquidated; and

(c) if a business practitioner suspends a provision of an agreement relating to security granted by the company, that provision nevertheless continues to apply for the purpose of section 134, with respect to any proposed disposal of property by the company.

(3) Any party to an agreement that has been suspended or cancelled, or any provision which has been suspended or cancelled, in terms of subsection (2), may assert a claim against the company only for damages.

(4) If liquidation proceedings have been converted into business rescue proceedings, the liquidator is a creditor of the company to the extent of any outstanding claim by the liquidator for any remuneration due for work performed, or compensation for expenses incurred, before the business rescue proceedings began.

In terms of section 128(1)(a)(iii), employees are defined to be included in the definition of "affected person". There has been debate as to whether employees should have been included as affected persons in the context of the business rescue legislation. Loubser was of the view that employees stood to gain substantial benefits from business rescue proceedings as the legislation prescribes that the company must continue to employ them on the same terms and conditions as before.[704] In addition, section 135(1) classifies any payments that become due and payable by the company to its employees during business rescue proceedings as post-commencement finance.[705] Loubser warns that there is a real risk of abuse of the proceedings by employees to gain the benefits of this superpriority status within the business rescue process. Loubser suggests that this can be curbed by the court ordering the employee, who initiated business rescue proceedings in a malicious, vexatious (self-gain) manner, to be ordered to pay costs and damages to the company.[706]

Further argument can be made that an imbalance exists in the overt protection of employees when compared to the protection of creditor interests during business rescue proceedings. The perceived imbalance is evident in the preference given to employee claims, particularly where they rank above post-commencement finance claims.[707] Argument has been made that such superpriority preference may result in creditors and other providers of loan finance to become hesitant in providing post-commencement finance to companies in business rescue.[708]

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704. Section 136(1)(a) of the 2008 Companies Act. See Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions (Part 1)" (2010) 3 *TSAR* 501 510. Also see comments by Swart "Business Rescue: Do employees have better (reasonable prospects) of success? Commentary on employees of Solar Spectrum Trading 83 (Pty) Limited v Afgri Operations Limited (North Gauteng High Court, Pretoria (unreported) 2012 – Case No 6418/20111, 18624/2011, 66226/2011, 66226A/11" (2014) *Obiter* 406.

705. See discussion below on section 135(1) of the 2008 Companies Act, Chapter 7, para 7.7.

706. Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions (Part 1)" (2010) 3 *TSAR* 501 510.

707. See section 135(3)(a) of the 2008 Companies Act.

708. See discussion in Joubert, Van Eck and Burdette *The Expected Impact of Labour Law Principles on South Africa's New Corporate Rescue Mechanism (including a comparison with the position in the EU)* (2009) available at http://www.ntu.ac.uk/nls/document_ uploads/ 100222.doc accessed 20 March 2015 84. Also see comments by Swart "Business Rescue: Do employees have better (reasonable prospects) of success? Commentary on employees of Solar Spectrum Trading 83 (Pty) Limited v Afgri Operations Limited (North Gauteng High Court, Pretoria (unreported) 2012 – Case No 6418/20111, 18624/2011, 66226/2011, 66226A/11" (2014) *Obiter* 408. The author submits that the legislature has gone too far in the protection of employees and that such protection erodes the interests of creditors, especially those that provide post-commencement finance.

Certain arguments have been that the privilege and protection provided to employees in the new South African rescue procedures has undermined many of the key elements that are necessary for a successful business rescue.[709] It is argued that the empowerment of employees in this process has introduced uncomfortable levels of participation ill-suited to the current climate of industrial relations in South Africa, which have possibly exacerbated inherent conflict between employers and employees.[710] The potential for abuse of certain of the provisions has inherent the risk of destabilising delicate power balances within the work environment, which tension could result in delaying the rescue process which is, after all, reliant on speed and flexibility.[711]

However, despite these concerns, a corporate rescue mechanism cannot lose sight of the effect that a restructuring process will have on employees. Employees are, after all, the lifeblood of the company and particularly when such company is trying to trade its way out of its financially distressed situation.[712] Good management and skilled employees must be retained if the company is going to have any chance of survival through difficult and challenging business rescue proceedings. Joubert, Van Eck and Burdette point out that South African insolvency law traditionally favoured creditors and considered the *pari passu* distribution of realisations to creditors once preferential payments had occurred to certain classes of creditors. Whilst insolvency law protected creditors, labour law looked after the interests of employees. As the common law of contract did not adequately regulate the unequal bargaining status as between employer and employee, such inequality could lead to the exploitation of employees.[713] Job preservation is thus a crucial feature of the legislation. The provisions of Chapter 6 and the manner in which employee rights are considered and protected is a strong and much lauded feature of the legislation.

Unlike in a liquidation, where all service contracts are suspended from the date of the winding-up, section 136(1)(a) allows employees to continue to be employed on the same

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709. See Faul *The Impact and Origin of Employee Rights in Chapter 6 of the Companies Act 71 of 2008* (LLM, University of KwaZulu-Natal, 2015).
710. Ibid 66.
711. Ibid.
712. For the importance of employees in the context of corporate South Africa, see Botha "Responsibilities of Companies Towards Employees" (2015) 18 *PER* 2–54.
713. Joubert, Van Eck and Burdette *The Expected Impact of Labour Law Principles on South Africa's New Corporate Rescue Mechanism (including a comparison with the position in the EU)* (8 April 2009) available at http://www.ntu.ac.uk/nls/document_uploads/100222.doc 65–66. See Rushworth "A Critical Analysis of the Business Rescue Regime in the Companies Act 71 of 2008" (2010) *Acta Juridica* 387–388.

terms and conditions except to the extent that changes occur in the ordinary course of attrition[714] or the employees and the company, in accordance with applicable labour laws, agree on different terms and conditions. In terms of section 136(1)(b), any retrenchment of any such employees, as set out in the business rescue plan, is subject to section 189 and 189A of the Labour Relations Act 66 of 1995 (the "LRA") and other applicable legislation.[715]

In 2002, significant amendments to the LRA and Basic Conditions of Employment Act 75 of 1997 (the "BCEA") were made. Pressure had come to bear from the labour movement in South Africa, in particular on the insolvency fraternity at that time. The Congress of South African Trade Unions ("COSATU") had given notice to the National Economic Development and Labour Court ("NEDLAC") that it intended to commence with protest action to reverse the effects that liquidation was having on workers and their financial security.[716]

The amendments came in the form of a new section 38 of the Insolvency Act and section 197A of the LRA. Before 1 January 2003, section 38 of the Insolvency Act had the effect that all contracts of employment between the insolvent employer and its employees automatically terminated on the effective date, subject to the right of employees to claim compensation for any damages sustained as a result of such termination.[717] After the amendment to section 38, the new section 38 provided that contracts of employment of employees whose employer had been sequestrated (placed into liquidation) are suspended with effect from the date of the granting of the sequestration (winding-up order). However, after the initial suspension of the contracts of employment, they may either be terminated by the trustee or liquidator in terms of section 38(4) or they will automatically terminate by

714. The word "attrition" is not defined. It is submitted that the business rescue practitioner is entitled to restructure the workforce in terms of the business rescue plan and where such restructuring is in the best interests of the company.

715. Section 189 and 189A of the LRA. See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-58 at para 18.9.3. Chapter 6 of the 2008 Companies Act is quite sensitive to the protection of employees during business rescue proceedings. In the matter of *Clarke v EH Walton Packaging* 2014 JOL 31234 (CCMA) No. ECPE714-13, the Commissioner noted that the 2008 Companies Act specifically provides that during business rescue proceedings, practitioners are empowered to remove from office persons forming the pre-existing management of the company. Since the company was under business rescue at the time of the applicant's dismissal, the practitioner was the authority who should have terminated the employee's services. At the time, the practitioner was unaware of the disciplinary proceedings against the employee and thus the termination of the employee's services was held to be in breach of the 2008 Companies Act. See Joubert, Van Eck and Burdette *The Expected Impact of Labour Law Principles on South Africa's New Corporate Rescue Mechanism (including a comparison with the position in the EU)* (8 April 2009) available at http://www.ntu.ac.uk/nls/document_uploads/100222.doc 15.

716. See Boraine and Van Eck "The New Insolvency and Labour Legislative Package: How Successful was the Integration?" (2003) 24 *ILJ* 1840.

717. Section 98A of the Insolvency Act provides for the preferent claims in favour of employees.

operation of law in terms of section 38(9) of the Insolvency Act. Any termination of these contracts may only ensue after the appointment of the final trustee or liquidator and after consultation with the persons envisaged by section 38(5) of the Insolvency Act. Should the final trustee or liquidator decide not to initiate the termination of any of the contracts, they will automatically terminate 45 days after the appointment of the final trustee or liquidator, unless agreed to the contrary.[718]

Additionally, with effect from 1 August 2002, the LRA was amended by the substitution of the previous section 197 of the LRA with a new section 197. The new section 197 deals specifically with the transfer of a solvent business. A number of provisions contained in the general section 197 also apply to section 197A that deals with the transfer of insolvent businesses. In terms of section 197A(1) of the LRA, if the whole or part of a business, trade or undertaking was transferred as a going concern where the old employer was insolvent and being wound up or sequestrated, all contracts of employment that were in existence immediately before the winding-up, are automatically transferred to the new employer (being the new owner of the business).[719] The new section 197 and 197A of the LRA automatically substitutes the new employer in all contracts of employment unless otherwise agreed. This applies equally to the transfer of a solvent and insolvent business.[720]

These amendments, drawn and motivated by labour, introduced a new way of thinking within the context of insolvent businesses. Employees were now recognised as a special-interest group within liquidations. Although worker rights had been elevated within the liquidation context, it was recognised that with the possible introduction of a new business rescue regime, a proper balance had to be struck between the interests of all stakeholders, namely creditors, labour and business in general.[721]

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718. In terms of section 38(9) of the Insolvency Act, all suspended contracts would terminate 45 days after the date of the appointment of the final liquidator (except where employees have contracted with the liquidator for the continuation of services). During winding-up the liquidator is entitled to terminate contracts during the period of suspension, but must consult with the trade unions and employees. The purpose of these consultations is to reach consensus on measures to save a portion of the business (section 38(4)). Section 98A regulates the order of preferential payments to employees for arrear salaries and leave pay where their contracts of employment were terminated by virtue of section 38. Also see Boraine and Van Eck "The New Insolvency and Labour Legislative Package: How Successful was the Integration?" (2003) 24 *ILJ* 1846.

719. Section 98 of the LRA. Also see Van Eck, Boraine and Steyn "Fair Labour Practices in South African Insolvency Law" (2004) *SALJ*; Joubert, Van Eck and Burdette *The Expected Impact of Labour Law Principles on South Africa's New Corporate Rescue Mechanism (including a comparison with the position in the EU)* (8 April 2009) available at http://www.ntu.ac.uk/nls/document_uploads/ 100222.doc 6–8.

720. See Boraine and Van Eck "The New Insolvency and Labour Legislative Package: How Successful was the Integration?" (2003) 24 *ILJ* 1854.

721. Ibid 1868.

The new section 38 and section 197 of the LRA have up till now played an important role in liquidations and continue to do so in the business rescue context.

Business rescue practitioners need to be aware of section 197 as any portion of the company's' business sold as a going concern in terms of the business rescue plan would always be subject to the terms of section 197 where there is an automatic transfer of employees to the acquirer of the business.

Section 136(2)(a) of the 2008 Companies Act particularly prohibits a business rescue practitioner from attempting to suspend any provision of an employment contract.

It is submitted that the more enlightened approach which had commenced with the abovementioned amendments to the LRA and Insolvency Act, acted as a precursor to the preservation of employee rights within the business rescue context. Workers (employees) were seen to have a significant role to play in the successful rescue of a company in financial distress and where they were seen to be critical to a successful plan being proposed, approved and thereafter implemented. Joubert, Van Eck and Burdette state as follows:

> It is doubtful whether anyone will argue with the fact that corporate rescue has the noble underlying intention of maintaining the life of a business enterprise when it is faced with the prospect of closure. There can also be no doubt that it is almost without exception in the best interest of workers to save the distressed corporate entity by whom they are employed. The same can be said of the shareholders of the distressed entity, who hope to maintain their capital investment in the company and who may still harbour hopes of future dividends. Governments also abhor the demise of corporate taxpayers as it reduces the tax base when companies go into liquidation.[722]

It is further submitted that one of the main objectives of the new business rescue legislation is to ensure that job preservation is paramount. Business and corporate failure (in particular in the liquidation scenario) would always result in retrenchments and cessation of employment contracts. The idea of the new business rescue legislation is to allow the

722. See Joubert, Van Eck and Burdette *The Expected Impact of Labour Law Principles on South Africa's New Corporate Rescue Mechanism (including a comparison with the position in the EU)* (8 April 2009) available at http://www.ntu.ac.uk/nls/document_uploads/100222.doc1.

workforce to continue to work, under business rescue, and at the same time be elevated to a "special category" of creditor.[723]

Clearly, one of the first objectives of any restructuring (in terms of the first part of the definition) is to assess the possibility of downsizing the workforce, either to alleviate the burden of financial distress or as part of selling off loss-making divisions and/or subsidiaries. Chapter 6 and the legislature have recognised that "attrition" of the work force is highly tempting for the business rescue practitioner and this must be tempered and controlled.

Job preservation and the special rights afforded to employees in business rescue can lead to abuse. In terms of section 31(3) of the 2008 Companies Act, trade unions must, through the CIPC, and under conditions as determined by the CIPC, be given access to company financial statements for purposes of initiating a business rescue process.[724]

Trade unions, once having demanded access to the financial statements of the company, would be in a very strong position to argue that the company is financially distressed. During a wage dispute, trade unions could quite successfully launch business rescue proceedings (or threaten to do so) in an effort to obtain for their members the benefits of superpriority status as afforded in terms of sections 134 and 135 of the 2008 Companies Act.

All in all, it appears that employees are in a better position under business rescue than they would have been in a liquidation.[725] It will be up to trade unions to use the relevant provisions of the 2008 Companies Act to benefit their members when their employer files for business rescue. The objective must be to save the company and ensure that it continues to trade on a solvent basis, thus ensuring the preservation of jobs. Balancing employees' rights against those of other stakeholders, particularly creditors, will be one of the

723. In international jurisdictions, the need to retain key employees is paramount in securing a successful restructuring. See Chapter 5, para 5.5.4.2.

724. See section 31 of the 2008 Companies Act – such access appears to be limited to shareholders, judgment creditors and trade unions. Section 31(4) creates an offence on the part of a company that withholds delivery of such financial statements. See Loubser "Tilting at Windmills? The Quest for an Effective Corporate Rescue Procedure in South African Law" (2013) *SA Merc LJ* 450–452.

725. See Joubert, Van Eck and Burdette *The Expected Impact of Labour Law Principles on South Africa's New Corporate Rescue Mechanism (including a comparison with the position in the EU)* (8 April 2009) available at http://www.ntu.ac.uk/nls/document_uploads/100222.doc 15–17. It is argued by the authors that the legislature might have gone too far in protecting employees and that not enough emphasis was placed on the primary objective of the legislation, namely that of saving the company or business. The provisions support a very rigid approach to the protection of employees. A more flexible approach, especially regarding the business rescue practitioner's right to downsize the workforce without having to comply with rigid and time-consuming formalities, would have gone a long way to making the resuscitation of companies more viable.

challenges of business rescue practitioners going forward. However, Joubert, Van Eck and Burdette express a note of caution if one goes too far in looking after the interests of employees:

> This, added to the vastly improved situation of employees during the period of business rescue when compared to the situation that they would have faced had the company gone into liquidation (their contracts are maintained and not suspended), and the favourable status of their claims during business rescue compared to those of the providers of post-commencement finance, suggests that employees or their legal advisors could be tempted to exploit the process for their own gain. In our view, the employee-friendly provisions of South Africa's new corporate rescue procedure do not strike an appropriate balance between the economic and social rights of all of the relevant stakeholders. Ultimately, the overprotection of employee rights may have the unintended result of being to the detriment of the employees and essentially weaken the underlying efficiency of South Africa's new corporate rescue mechanism.[726]

Employees are dealt with as superpriority creditors in the ranking of their claims. Section 136(1) of the 2008 Companies Act allows employees to continue to be employed on the same terms and conditions except to the extent that changes occur in the ordinary course of attrition or the employees and the company, in accordance with applicable labour laws, agree on different terms and conditions. Job preservation is paramount in South Africa and thus the legislation reflects careful consideration of the rights of employees.

It is submitted that the ongoing role of employees in the company must not be underestimated. Like in international jurisdictions, key personnel (and experienced management) must be retained if there is any chance of implementing a successful rescue. Such key employees will allow the practitioner to step into the "running of the business" seamlessly, and with the least possible disruption. The retention of essential employees will be key to the successful implementation of the rescue process.

Employees are an integral part of the business rescue process and their level of participation is inclusive and important.

Section 144(1) of the 2008 Companies Act sets out the involvement of employees in the business rescue process as follows:

> (1) During a company's business rescue proceedings any employees of the company who are –

726. Ibid 84.

(a) represented by a registered trade union may exercise any rights set out in this Chapter –

(i) collectively through their trade union; and

(ii) in accordance with applicable labour law; or

(b) not represented by a registered trade union may elect to exercise any rights set out in this Chapter either directly, or by proxy through an employee organisation or representative.

As affected persons, trade unions and employees who are not so represented may apply to the court for compulsory business rescue. Trade unions are entitled to demand access to a company's financial statements for the purpose of initiating a business rescue.[727] The ability of trade unions to drive the business rescue process in a financially distressed company should not be underestimated. In particular where a company is in a position that it cannot pay weekly wages or monthly salaries, trade unions could call for the company's financial statements, bring an application to court and appoint their nominated practitioner. Once appointed, the practitioner could properly assess the need for retrenchments, and terminate jobs in the ordinary course of attrition.[728] This could be effected in a controlled fashion during which massive job losses could be avoided, unlike what would occur in a liquidation. Negotiations could further involve discussion on different terms and conditions of employment.[729]

In *National Union of Metal Workers of South Africa obo Hlongwane and Others v Wilro Supplies CC*,[730] the labour court had ordered the dismissals of certain employees to be unfair and granted a reinstatement award against the close corporation, with a monetary value of R1,7 million. The company's members brought an application to place the close corporation into liquidation. NUMSA brought a counter-application against the close corporation to stay the liquidation proceedings and place the close corporation under

727. Section 31(3) of the 2008 Companies Act.

728. See section 136(1)(a)(i) of the 2008 Companies Act.

729. Section 136(i)(a)(ii) of the 2008 Companies Act as read with section 136(1)(b). Levenstein "Business Rescue Underutilised in Job Saving Efforts" (12 February 2014) *Business Report* available at http://www.iol.co.za/business/opinion/business-rescues-underutilised-in-job-saving-efforts-1.1645579#. VkG2HdIrLIU. Also see Levenstein *Business rescue slow to catch on in SA* (17 February 2014) *Business Day*; Levenstein "Job Losses and Business Rescue – A Lost Opportunity?" (19 February 2014) available at http://www.werksmans.com/virt_e_bulletins/job-losses-business-rescue-lost-opportunity/; Levenstein "Why isn't Business Rescue Legislation Preventing Job Losses" (11 March 2014) *HR Pulse* available at http://www.hrpulse.co.za/editors pick/230657-why-isn't-business-rescue-legislation-preventing-job-losses.

730. *National Union of Metal Workers of South Africa obo Hlongwane and Others v Wilro Supplies CC* JS 207/12 [2015] ZALC JHB 96 (16 March 2015). See comments by Elliot and Nkaiseng ""Rescued" by the Trade Union" (2015) *Without Prejudice* 39. As the authors state, it is hoped that this decision will herald an era of embracing business rescue as an opportunity for labour and not as a threat to jobs and membership.

business rescue. The court found that liquidation was not in the best interests of the close corporation's employees, who were the largest creditors, and that a practitioner should investigate the affairs of the close corporation and establish whether creditors could be offered a better return than in a liquidation.

This was the first case since the introduction of business rescue in 2011, where a trade union had succeeded in placing an employer in business rescue – saving jobs in the process.

Employees play an important role in the roll-out of a business rescue proceeding and in particular become "preferent" in respect of the claims if they render services during the course of the proceedings.[731]

In addition, they are "preferred unsecured creditors" of the company for remuneration and expenses incurred prior to the date of the commencement of the business rescue proceedings.[732]

Henochsberg deals with the term "preferred unsecured creditor" as follows:

> The term "preferred unsecured creditor" is not defined for the purposes of Chapter 6 or under the Act generally, and is not the term generally used in South Africa to describe unsecured creditors that receive priority treatment. It would appear that the term has been imported from another jurisdiction, but in the context of the section seems to be the equivalent of a preferent/preferential unsecured creditor under South African insolvency law. The actual use of the term in the context of Chapter 6 generally is a little confusing due to the fact that no provision is made in Chapter 6 for the payment of creditors' claims in any particular order, or in any predetermined format. Clearly the term envisages an order of preference for the payment of employee claims, but this is not spelt out anywhere in Chapter 6 and no formatting or content requirements for the business rescue plan are laid down in the Act.[733]

731. Section 135 of the 2008 Companies Act elevates remuneration and expense claims of employees who provide services to a company under business rescue to that of "post-commencement financiers". It has been said that Chapter 6 provides the most progressive/liberal business rescue system with regard to employees' rights in the world. See Van der Walt "A Turnaround Practitioner's View of New Business Rescue Legislation" in Harvey (ed) *Turnaround Management and Corporate Renewal: A South African Perspective* (2011) 152–153. Also see comments by Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions (Part 1)" (2010) 3 *TSAR* 501 510.

732. Section 144(2) of the 2008 Companies Act. See comments by Van Eck, Boraine and Steyn "Fair Labour Practices in South African Insolvency Law" (2004) *SALJ* 902–905. Also see Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-64–18-71 at para 18.11.

733 Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 502.

Employees receive priority as post-commencement financiers, as set out in section 135, for claims incurred after the commencement of business rescue. In addition, section 144(2) preserves claims of pre-commencement employees to "preferred unsecured creditors".

Employee claims in a business rescue are set out in section 144(2) as follows:

> (2) To the extent that any remuneration, reimbursement for expenses or other amount of money relating to employment became due and payable by a company to an employee at any time before the beginning of the company's business rescue proceedings, and had not been paid to that employee immediately before the beginning of those proceedings, the employee is a preferred unsecured creditor of the company for the purposes of this Chapter.

It is not clear whether employees' claims pre-commencement receive any real priority other than as unsecured creditors. This contrasts with section 98A of the Insolvency Act where employees' claims are restricted once a company is placed in liquidation.

Employees would generally be represented by their trade unions in interacting with the practitioner, and particularly with respect to lodging claims. Employees (individually or through their employee committee)[734] are entitled to participate in court proceedings should they believe that it is necessary to do so, and would be consulted by the practitioner during the development of the business rescue plan.[735]

Additionally, employees are entitled to vote on the business rescue plan (together with creditors) on any motion to approve a plan (and at a meeting convened for that purpose in terms of section 151 of the 2008 Companies Act). In line with government's objectives in providing the opportunity to employees to approve the business rescue plan, it is submitted that employees (to an extent) have a role to play in determining their destiny in the rescue process. Employees, however, vote "as creditors", and their vote must be taken into consideration together with all other creditors. Employees do not get any "special vote" or a "veto vote" which could result in a plan being blocked by employees as a class.

In practice, it is submitted, depending on the size of retrenchments, employees would far rather support the business rescue plan, than allow the company to be placed into

734. Section 144(3)(c) of the 2008 Companies Act: Employees are entitled to form a committee of employees' representatives to represent employees during the business rescue proceedings.

735. Section 144(3)(d) of the 2008 Companies Act. See Rushworth "A Critical Analysis of the Business Rescue Regime in the Companies Act 71 of 2008" (2010) *Acta Juridica* 395–397.

liquidation. The resultant loss of jobs in a liquidation would generally be a disastrous outcome for employees.

Employees are very much an important component in the roll-out and implementation of the business rescue plan. In terms of section 136(1), the practitioner can suggest changes to the work force "in the ordinary course of attrition".[736] In the preparation of the plan, the practitioner can suggest retrenchment packages to existing employees, or agree new terms of employment with such existing employees in accordance with current labour laws.[737] Any retrenchments must be effected in accordance with sections 189 and 189A of the LRA[738] and other applicable employment-related legislation.

It is submitted that such a scenario allows a practitioner to "restructure" the workforce in a controlled "rescue" environment with the benefits allowed by the moratorium on claims. Although it may transpire that the company is not able to keep all employees in the restructured company, generally a significant portion of employees would get to keep their jobs; again, a far better prospect than in a liquidation. The political driver of business rescue, namely the interests of labour (trade unions), must surely recognise the benefits of rescue as opposed to liquidation.

A practitioner may not suspend any provision of an employment contract nor cancel an existing employment contract without compliance with section 136(1).

In terms of section 148, the practitioner must convene a meeting of employee representatives within 10 business days after having been appointed. At such meeting, the practitioner must offer all employees the opportunity to appoint an employees' representative committee and confirm the employees representatives, whether or not the practitioner believes that there is a reasonable prospect of rescuing the company.[739]

Generally speaking, no practitioner can afford not to engage properly with employee representatives from the outset of the business rescue proceedings. If the practitioner is contemplating delivering an outcome as set out in the first part of the definition of business

736. Section 136(1)(a)(i) of the 2008 Companies Act.
737. Section 136(1)(a)(ii) of the 2008 Companies Act.
738. Labour Relations Act 66 of 1995.
739. Section 148(1)(a), (b) of the 2008 Companies Act.

rescue[740], that is, to rescue the company, employees and their continued role as employees during the business rescue process will be essential to the successful outcome of the business rescue plan.

Statistics made available by CIPC indicate that since 1 May 2011, being the date of the commencement of Chapter 6, the number of jobs that have been saved as a result of successful business rescue proceedings is 4256 (out of 5680). Only 25 per cent of jobs have in fact been lost as a result of rescue proceedings. In liquidation, all jobs are lost unless the business of the company is bought as a going concern.[741]

In the memorandum on the objectives of the Companies Bill, 2008,[742] it was clearly spelt out that the interests of workers were protected by the new procedure. In 2015, South African unemployment remains of considerable concern.[743]

It is further submitted that the general view is that companies will start shedding jobs as soon as they reach positions of financial crisis. Business rescue clearly saves jobs and presents a far better outcome than that of liquidation. In business rescue, any successful acquirer of the company would take over all employee contracts as well as all obligations owed by the company to such employees. The fact that employees generally go along with the company (despite some attrition)[744] can prejudice the practitioner's ability to find a buyer for the company, as in liquidation employment contracts come to an end.

7.6.3 CONTRACTS

Business rescue practitioners have an opportunity to deal with the existing agreements to which the company is a party once they are appointed. The purpose would be to identify which agreements are "prejudicial" and/or "detrimental" to the ongoing viability/solvency of the company going forward. If the business rescue practitioner is contemplating a plan

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740. Section 128(1)(b) of the 2008 Companies Act.

741. Statistics provided by a CIPC representative: Lotheringen *CIPC Statistics – Advanced Course in Business Rescue* (PowerPoint LSSA, May 2013).

742. The Memorandum was annexed to the Companies Bill: B61 (2008) 192 at para 10.

743. Current unemployment rates in South Africa are at 25,5 per cent (November 2015). See http://www.tradingeconomics.com/southafrica/unemployment-rate.

744. Section 136(1)(a)(i) of the 2008 Companies Act.

in terms of the first part of the definition, then it would be necessary to consider variations of agreements that would make the achievement of a restructuring possible.[745]

All existing contracts remain in place subsequent to the commencement of the business rescue proceedings. However, the practitioner has the opportunity to suspend (partially or conditionally) for the duration of the business rescue proceedings, any obligation of the company that arises under an agreement to which the company was a party at the commencement of the proceedings. The practitioner may only terminate agreements by making application to court.[746]

Lease agreements (with very high rentals), loan agreements (with excessive interest payment terms), supply agreements (with unfair pricing arrangements), service or maintenance agreements and the like, would all be the possible subject of suspension during the course of the business rescue proceedings.

In terms of section 136(2)(b) contracts can only be cancelled (entirely, partially or conditionally) if the business rescue practitioner applies to court[747] on an urgent basis. This can only be done on grounds that are just and reasonable. This allows the practitioner to extricate the company, whether temporarily or permanently, from onerous contractual provisions that are preventing or may prevent the company from becoming a successful concern.[748] It is submitted that if the practitioner delays in making the choice to cancel the contract, thus increasing damages incurred by the counterparty, a court may very well refuse to cancel the particular contract. Any failure to act urgently may thus result in prejudice to the affected contracting party. For example, stock being held on behalf of a company may deteriorate and become obsolete or diminish in value as a result of such delay. A belated cancellation would leave the counter party in a far worse position than would have been the case had the practitioner acted timeously and on an urgent basis. The

745. On incomplete contracts see Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 2 (2010) 4 *TSAR* 690–692.

746. See section 136 of the 2008 Companies Act. Section 136(2) was dealt with in the matter of *Homez Trailers and Bodies (Pty) Ltd v Standard Bank of South Africa Ltd* (35201/2013) [2013] ZAGPPHC 465 (27 September 2013). The issue as to whether a practitioner can use section 136(2) of the 2008 Companies Act to enforce obligations against a company to be effective, even though the company is under business rescue, was considered. The court held that only the obligations of the company in distress are susceptible to being suspended by the practitioner. The court was of the view that the practitioner was within its rights to suspend the overdraft facility of the company during the period of business rescue.

747. To date there have been no reported judgments relevant to section 136(2)(b) of the 2008 Companies Act. It is submitted that these decisions are important as section 136 has an effect on the South African common law of privity of contract. The Roman Dutch Law principle (maxim) of *"pacta sunt servanda"* (sanctity of contract) is watered down by the ability of the practitioner to cancel contracts in terms of section 136(2)(b). For an analysis of the maxim in the context of business rescue, see Chapter 5, para 5.4.

748. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 478(14)–478(15).

court will always have a discretion to determine what is "just and reasonable" in the circumstances of each case.[749]

In terms of section 136(2)(a) of the 2008 Companies Act, a business rescue practitioner, during business rescue proceedings, may entirely, partially or conditionally suspend for the duration of the business rescue proceedings any obligation of the company that arises under an agreement to which the company was a party at the commencement of the business rescue proceedings and would otherwise become due during those proceedings.

It is submitted that section 136(2)(a) effectively allows a practitioner to suspend or cancel an agreement/contract that is prejudicial to the ongoing trading ability of the company or where the continued existence of such contract would diminish the practitioner from his or her ability to rescue/restructure the company in terms of the business rescue plan.

The suspension provision would also allow a practitioner to suspend onerous obligations of the company for the period of the business rescue proceedings. Once a suspension notice is provided, the counterparty would not be in a position to cancel the agreement. If a creditor purports to cancel the agreement after the notice of suspension has already been provided by the practitioner, such cancellation would be unlawful.[750] Further, once an agreement is cancelled, the creditor (counterparty) cannot take any steps to prevent the company in business rescue from occupying the property in its possession in terms of a lease agreement. Further, property (goods) that remains in the possession of the company after cancellation cannot be interfered with by the creditor. In *LA Sport 4 X 4 Outdoor CC and Another v Broadsword Trading 20 (Pty) Limited and Others*,[751] the court held that as the cancellation of the contract was valid, the company in business rescue was in unlawful

749. This is in line with the attitude adopted in international jurisdictions in that prejudicial contracts cannot be left unaffected if they would have the effect of continuing to prejudice the company. See Chapter 5, para 5.5.4.2.

750. See Weyers "Cancellation or Suspension of Agreements During Business Rescue" (May 2015) *Without Prejudice* 16–17. In this article, the author submits that subsequent to the cancellation of an agreement, a creditor is precluded from initiating legal proceedings for the return of property by section 133(1) and 134(1)(c) of the 2008 Companies Act. A creditor could not therefore bring an eviction application against a company in business rescue to enforce the cancellation of a lease or to return property in terms of a contract of supply. To allow legal proceedings to be instituted to recover property or payments pursuant to the contract being lawfully cancelled, would not only be contrary to sections 133(1) and 134(1)(c), but would entirely undermine the purpose of business rescue proceedings. Also see *Ellerine Brothers (Pty) Limited v McCarthy Limited* 2014 (4) SA 22 (SCA) and *178 Stamfordhill CC v Velvet Star Entertainment CC* (1506/15) 2015 ZAKZDHC 34 (1 April 2015). The latter case supports an argument that a landlord can cancel a lease during business rescue and seek the ejectment of the tenant where such tenant did not honour its obligations incurred *prior to* commencement of the business rescue. See para 27 of the judgment, where the court accepted that the suspension of the lease by the practitioner did not allow the practitioner and the company to remain in occupation of the premises if there had been a pre-commencement breach of the lease agreement.

751. *LA Sport 4 X 4 Outdoor CC and Another v Broadsword Trading 20 (Pty) Limited and Others* (A513/2013) [2015] ZAGPPHC 78 (26 February 2015).

possession of the property. The court did not specifically determine whether the property fell to be returned to the creditor. This decision places the business rescue process in jeopardy. If this is correct, then property enabling the company to trade would have to be returned to the creditor, disabling the practitioner from effectively rescuing the company. This would frustrate the business rescue process and result in a failed process.[752]

In the case of *178 Standfordhill CC v Velvet Star Entertainment*,[753] the court ruled that it is competent for the landlord to cancel a lease during business rescue and seek the ejectment of the tenant (in business rescue) where the tenant did not honour its obligations in terms of the lease, incurred prior to the commencement of the business rescue. The court found that the position of the business rescue practitioner vis-à-vis the contract is akin to that of a liquidator or a trustee in insolvency, and notwithstanding the establishment of a *concursus creditorum*, the contract with the respondent could be cancelled. The so-called "supervision" of the lease in section 136(2) cannot amount to anything more than the practitioner's right not to be compelled to perform in terms of the contract. The court held that the applicant was entitled to an order for the ejectment of the respondent from the premises. This is an important decision in that, despite section 133 (the moratorium), landlords can seek the ejectment of a tenant in business rescue when such tenant remains in occupation while in business rescue, and suspends the obligation to pay rental to its landlord.

In terms of section 136(3), any party to an agreement that has been suspended or cancelled, or any provision which has been suspended or cancelled, in terms of subsection (2), may assert a claim against the company only for damages.

The manner in which a claim for and calculation of damages as contemplated in section 136(3) will be dealt with, is also open for debate.

There is no definition of what constitutes "damages". Consequently, the extent of damages that can be claimed in a situation where the bank's agreements are suspended or indeed cancelled, remains uncertain.

752. See Weyers "Cancellation or Suspension of Agreements During Business Rescue" (May 2015) *Without Prejudice* 16–17.
753. *178 Standfordhill CC v Velvet Star Entertainment* 1506/15 [2015] KZD (1 April 2015) (unreported) at paras 27–31.

In a liquidation scenario, where there is a surplus for distribution to creditors and if the bank is a secured creditor, interest on its secured claim would continue to be earned notwithstanding the liquidation order. However, in a business rescue scenario, any loss of interest or any other form of damages (contractual or in delict) would in all probability be provided for as part of the plan. More often than not the plan would compromise the claim of a creditor for damages and the bank would, in all likelihood, have to concede and accept such compromise on its damages claim.

There are various categories of damages that can be claimed. A distinction is generally made between direct or consequential damages. Direct damages or general damages can be defined as damage which occurs as a direct consequence of the wrongful act. Consequential damages can be defined as damage that does not flow directly and immediately from an injurious act, but that results indirectly from the act.

In all cases, the bank will have to show that, as a result of the suspension and/or cancellation of an agreement or any term thereof, there is a direct causal link to the economic loss or damage suffered. In such event –

- the bank can insist on an indemnity being provided in terms of which the third party indemnifies the bank against any and all losses or damages suffered by the bank as a result of such suspension or cancellation of a contract by the business rescue practitioner. Such an indemnity clause should be drafted in a manner which covers all potential losses or damages that could be caused by such suspension or cancellation;

- the bank would be entitled to vote on a plan in respect of its claim and in addition on the portion which constitutes its damages claim, for example, a loss of interest arising as a result of the terms proposed in the plan. In our view, a business rescue practitioner may very well contest the right of a creditor to vote on a claim for consequential damages, for example, as a result of the commencement of the business rescue proceeding and in respect of a contract that has been suspended or terminated by the business rescue practitioner and in terms of section 136 of the 2008 Companies Act.

Section 136(3) expressly provides relief to the party whose contract has been suspended or cancelled to assert a claim against a company for damages. These parties generally have such contracts suspended or cancelled after the commencement of business rescue. These post-commencement creditors are expressly given the right to a claim for damages and so the practitioner should, in principle, not be able to limit these claims for damages in a business rescue plan in which these creditors do not have a vote.[754] In practice, practitioners seek to have post-commencement claims compromised in the plan.[755]

In section 136(4), if liquidation proceedings have been converted into business rescue proceedings, the liquidator is a creditor of the company to the extent of any outstanding amounts owing to him or her for any remuneration due for work performed or compensation for expenses incurred before the commencement of business rescue proceedings. Henochsberg finds that this provision is peculiar in that a liquidator's claim for remuneration and expenses before business rescue would be treated as a normal claim, while the business rescue practitioner's remuneration and expenses receive preferential treatment as dealt with in section 135(4).

It is submitted that the ability of a practitioner to suspend and/or cancel contracts that might be prejudicial to the company is an essential feature of rescue. Like in foreign jurisdictions, the value and sustainability of contracts will determine the ongoing ability of the company to trade. The practitioner must ascertain the nature and effect of these contracts from an early stage of the business rescue process (both for contracts that are beneficial and those that are prejudicial). Not only will this analysis assist him or her in negotiations for PCF, it will also enable the practitioner to identify which contracts (urgently) need to be suspended or terminated.

It is clear that this decision will, from an early stage, set the stage for either a successful business rescue or a possible failed process. The practitioner might have to engage with existing management (and directors) to enable him to meaningfully decide on these issues.

754. It is submitted that post-commencement creditors, as the law presently stands, do not have a vote on the plan. Only pre-commencement creditors may vote on the plan in terms of section 152(2) of the 2008 Companies Act.

755. It is further submitted that such creditor would be entitled to seek leave from the court in terms of section 133(1)(b) of the 2008 Companies Act to institute proceedings for the recovery of damages. In terms of such application, the court is specifically empowered (in terms of section 133(1)(b)) to give such leave to litigate "in accordance with any terms the court considers suitable". This would provide the creditor (claimant) with the opportunity to request the court to exercise its discretion as to how to deal with such damages claim and to direct the practitioner to deal with such damages claim as the court deems appropriate. The court may, in its discretion, grant leave subject to such damages claims being limited or perhaps leave it to the subsequent court to decide how the damages claim should be so limited. This would in practice assist landlords who have their lease agreements suspended or cancelled in terms of section 136, and then have their damages claims compromised, in the sole discretion of the practitioner, in the plan. In respect of the court's discretion to address categories of claims, see the English Court of Appeal in re *Atlantic Competitor Systems plc* 1992 (1) ALL ER 476 CA.

7.7 FINANCING THE RESCUE – POST-COMMENCEMENT FINANCE

Once a company is under supervision in terms of Chapter 6, it will almost immediately require some level of ongoing finance in order to continue functioning in the marketplace.[756] Without some level of statutory intervention to protect the status of such funding, there would be very few, if any, lenders that would be prepared to continue financing the company in circumstances where the company is financially distressed and where it has been placed under formal supervision.[757]

PCF is the life-blood of the company while it is undergoing its restructuring process under business rescue. It refers to funding that is provided to the company after the date of commencement of business rescue proceedings. Loubser points out the following:

> Attempting to rescue a business without adequate capital is like trying to drive a car without fuel: no matter how well-designed and strong it is, there is only one way you can go, and that is downhill. Because rescuing a business requires that the business should continue trading, and that, in turn, requires working capital: employees must be paid to prevent them from leaving, suppliers will not deliver unless they are paid in cash and the providers of essential services such as water and electricity have to be paid to ensure uninterrupted services.[758]

> Rushworth stressed the importance of PCF while the plan was being prepared by the practitioner. PCF facilitated the continued operation of the company, particularly where existing lenders were not prepared to provide additional funding to the company once proceedings had commenced.[759]

It is submitted that the need for access to PCF is a critical factor in ensuring that the ship does not sink and that the company has access to ongoing funding to ensure that the business is kept alive while the restructuring of the company takes place within the business rescue context. Du Preez emphasises the difficulty of obtaining access to PCF

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756. Post- business rescue finance is an innovation that has not yet been fully capitalised. Practitioners are allowed to raise finance in the post-business rescue environment and this finance enjoys precedence over pre- business rescue credit. Security for post-commencement finance can be provided over unencumbered assets belonging to the company. Assets that are already encumbered will not be available for security for post-commencement finance and will be dealt with in terms of sections 134 and 135(2)(a) of the 2008 Companies Act. The difficulty lies in securing such finance – traditional institutions are reluctant to lend and other finance can only be obtained at rates that may worsen the situation. There is an opportunity for creative financiers to build a market in this area, since their finance will enjoy precedence in repayment over existing lenders. See Marcus "South Africa Reforms Business Rescue Laws: New Objectives, New Opportunities" (30 September 2013) available at https://www.dlapiper.com/en/global/insights/publications/ 2013/09/south-africa-reforms-business-rescue-laws-new-o_/.

757. Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-53 at para 18.8.1.

758. Loubser "Post Commencement Financing and the Ranking of Claims: A South African Perspective" in Parry (ed) *European Insolvency Law: Current Issues and Prospects for Reform* (2014) 29. Sources of post-commencement financing come from similar avenues as are available in international jurisdictions. These include funding from shareholders, the company's ongoing trade, third party (distressed) funders or from potential offerors for the business or the company itself. See Chapter 5, para 5.5.5.

759. Rushworth "A Critical Analysis of the Business Rescue Regime in the Companies Act 71 of 2008" (2010) *Acta Juridica* 385–386.

once the company is financially distressed. Already the company is facing a position where it is "over-leveraged" and thus access to finance becomes increasingly difficult, if not virtually impossible. PCF is a critical component of the success of business rescue and is of utmost importance in the turnaround attempt.[760]

In any rescue regime, there will be a need for financial support by the provision of additional funding. Ironically, when rescue is most needed, businesses struggle to obtain additional credit. Therefore, one of the critical components of the business rescue plan involves securing turnaround finance to meet short-term trade obligations (such as working capital requirements), covering turnaround/restructuring costs, and restoring the company's balance sheet to solvency.[761]

Obtaining turnaround finance and ensuring that the business returns to liquidity will always present a challenge for financially distressed organisations. Generally, the first port of call is internal funding (from shareholders) which are mostly non-existent in a distressed situation. Distressed organisations in South Africa also seem to have experienced increased difficulty in attracting turnaround finance in the form of loan capital and private equity capital. Thus, the inability to obtain the necessary funding may contribute to the ultimate demise of their turnaround prospects.[762]

Since 1 May 2011, many financial institutions have amended their standard form loan documentation (facility letters) so as to include the commencement of business rescue in a company as an event of default. This would entitle the financial institution to immediately terminate the overdraft/loan facility thus far available to the company – the result being the immediate freezing/cessation of the company's access to finance to pay ongoing expenses in the ordinary course of its business. Without ongoing funding, the preservation of the company's business and goodwill is diminished. The result would almost inevitably be liquidation.

760. Du Preez and Pretorius "Constraints on Decision Making Regarding Post-commencement Finance in Business Rescue" (2013) 182 *SAJESBM* 169. Also see Vriesendorp and Gramatikov "Funding Corporate Rescue: The Impact of the Financial Crisis" (2010) *International Insolvency Review* 209–237. Also see Vriesendorp and Gramatikov "Impact of the Financial Crisis" (2010) *INSOL International Survey*. The difficulty in obtaining PCF funding was recognised and considered – see Wessels and De Weijs *International Contributions to the Reform of Chapter 11 U.S. Bankruptcy Code* (2015) 140.

761. Du Preez and Pretorius "Constraints on Decision Making Regarding Post-commencement Finance in Business Rescue" (2013) 182 *SAJESBM* 170.

762. Ibid.

Thus, most companies will find that traditional avenues of obtaining working capital are closed to a company in business rescue. Avenues such as the issuing of new securities is not a realistic option. The banks (as seen above) tend to react to business rescue in the same way as they react to a winding-up, by immediately cancelling all credit and loan facilities. The problem is exacerbated by the fact that in most cases there are no or almost no unencumbered assets left to provide security.[763]

Traditional funding options for distressed businesses are limited and difficult to obtain as existing lenders are concerned in having to put new money in a situation where they would risk further funds in an already distressed situation. Existing risk exposure limits the provision of such further funding. Further, if additional funds have already been invested, lenders would have very little opportunity to take further unencumbered assets as security because these are often no longer available.[764]

It is submitted that if traditional funding is not available, then companies in distress would have to seek additional funding from prospective offerors for the company or from venture capital funds that might be interested in taking up a position in a company as post-commencement financiers. In South Africa, private equity funding in a business rescue is gaining momentum and the more good-value assets become available, the greater will be the interest for investors to provide such funding.

Another important aspect is the manner in which post-commencement funding will be dealt with in the event that the debtors company goes into liquidation. In what manner is the post-commencement finance "converted" into a "claim" in the liquidation?

Certain jurisdictions provide that any security or priority provided in respect of new lending can be set aside in a subsequent liquidation and may give rise to liability as a result of the commencement of liquidation and potentially damaging the interests of creditors. Such an approach can only serve as a huge disincentive to commencing reorganisation. A more desirable approach is to provide creditors with a clear indication in respect of priority

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763. Loubser "Post-Commencement Financing and the Ranking of Claims: A South African Perspective" in Parry (ed) *European Insolvency Law: Current Issues and Prospects for Reform* (2014) 29–30. Also see Levenstein "Banks are cautious not reluctant over rescues" (7 August 2014) *Business Day*.

764. Du Preez "The Status of Post-Commencement Finance for Business rescue in South Africa" (November 2012) *Gordon Institute of Business Science* 35. For an international analysis of the adequacy of credit facilities in a restructuring, see Vriesendorp and Gramatikov "Impact of the Financial Crisis" (2010) *INSOL International Survey* 8–17.

in a liquidation. Post-commencement financing might be placed after the supervisors' fees and administration claims, but before secured creditors; or it might rank *pari passu* with all administration expenses.

What is clear is that lenders need to have a proper understanding of the priority of their claims in a liquidation so as to encourage post-commencement lending in the first place.

Section 135(2) of the 2008 Companies Act states the following in this respect:

> During its business rescue proceedings, the company may obtain financing other than as contemplated is subsection (1), and any such financing –
>
> (a) may be secured to the lender by utilising any asset of the company to the extent that it is not otherwise encumbered; and
>
> (b) will be paid in the order of preference set out in subsection (3)(b).

Essentially, this provision amounts to allowing the company to obtain new loans from lenders after the business rescue proceedings have commenced, the purpose of which is to allow the company to continue to trade.[765]

Mongalo emphasised the importance of "post-commencement finance" and suggested that the source for such financing should come from the company's existing bankers, its shareholders and third party financiers (such as venture capitalists).[766]

The importance of PCF is substantiated by provisions set out in the 2008 Companies Act which enhances the preferential priority of PCF in the waterfall (ranking) of payments in a

765. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 478(10)–478(12) state:

> It is difficult to think of circumstances where a company under supervision will be able to continue to trade without new money being injected into the business; by the same token it is difficult to imagine lenders rushing in to make new money available in circumstances where pre-commencement loans have not yet been repaid. Lenders would be wary of throwing good money after bad in circumstances where the company is already financially distressed, and it is for this reason that the legislature has provided a mechanism whereby new lenders can receive preferential payment for post-commencement loans, and also take security for such loans should this be possible. Preferential provisions such as these are often referred to as "super preferences". Although security may be given to new lenders for the provision of post-commencement finance loans, this can only be done with assets that have not already been given to pre-commencement creditors as security for their claims. Despite the preferential treatment accorded to post-commencement lenders, it is likely that these types of loans will attract a high rate of interest; not only because of the high risk involved in providing the funding, but also because of the preference accorded by the business rescue procedure to payment of the business rescue practitioner's expenses, and thereafter the claims of employees, prior to any repayment to the lenders (this is the case even if the post-commencement lender has security for its claim).

766. See Mongalo "Two Steps Forward and One Step Back is better than One Step Forward and Two Steps Back: A Limited Comparative Analysis of Business Rescue in South Africa" Opening address for *Business Rescue – First three years* University of Pretoria (7 October 2014) 6–7. In overseas jurisdictions, the provision of finance to financially distressed companies is significant and the buying in of "distressed debt" has developed into a lucrative industry. Australia and the US have companies that only deal with the provision of loan finance on this basis. The business rescue practitioner now automatically has the power to obtain secured or unsecured post-commencement financing for the company. This ability had been severely curtailed under the old judicial management provisions of the 1973 Companies Act. See Loubser "Post-Commencement Financing and the Ranking of Claims: A South African Perspective" in Parry (ed) *European Insolvency Law: Current Issues and Prospects for Reform* (2014) 34.

business rescue. The ranking of PCF is an attempt by the legislators to stimulate turnaround financing for distressed companies (like in the US, where DIP financing (debtor-in-possession financing) is the norm).[767]

The sophisticated mechanisms available to distressed companies in the US to enable them to acquire post-commencement financing by the provision of security to such lenders is, to an extent, mirrored in South Africa.[768] The challenge however for South African lenders of post-commencement finance, is the ability to source or identify available assets (many of which are already encumbered) to securitise for the provision of such finance. Often lenders have little choice but to provide post-commencement finance without taking security.

The post-commencement status of employees' remuneration is dealt with in section 135(1)as follows:

> To the extent that any remuneration, reimbursement for expenses or other amount of money relating to employment becomes due and payable by a company to an employee during the company's business rescue proceedings, but is not paid to the employee –
>
> (a) the money is regarded to be post-commencement financing; and
>
> (b) will be paid in the order of preference set out in subsection (3)(a).

Thus, any employee who provides service to the company in business rescue will rank as a superpriority creditor (like the provider of post-commencement finance) in the ranking of claims under business rescue. Availability of finance thus becomes even more complicated. Payment of salaries and of all employment-related amounts such as bonuses, payments for leave etc. are included as a preference in section 135(1) as read with section 135(3)(a) of the 2008 Companies Act. Considering that section 136 of the 2008 Companies Act maintains the position that while a company is in business rescue, employees must

767. Ibid 170. For an excellent analysis of post-commencement finance theory and a literature review, see pp. 172–191. On the importance of PCF (and its ranking) in a business rescue, see Wessels and De Weijs *International Contributions to the Reform of Chapter 11 U.S. Bankruptcy Code* (2015) 204.

768. See comments in Chapter 7, para 7.7 on DIP lending in the US.

remain employed on the same terms and conditions as before, this constitutes a substantial burden on a company already in financial distress that is struggling to survive.[769]

Both employees and providers of post-commencement finance will be paid in order of preference as set out in section 135(1)(a) and (b).

The ranking of claims is set out in section 135(3) as follows:

> After payment of the practitioner's remuneration and expenses referred to in section 143, and other claims arising out of the costs of the business rescue proceedings, all claims contemplated:
>
> (a) in subsection (1) will be treated equally, but will have preference over –
>
> (i) all claims contemplated in subsection (2), irrespective of whether or not they are secured; and
>
> (ii) all unsecured claims against the company; or
>
> (b) in subsection (2) will have preference in the order in which they were incurred over all unsecured claims against the company.

Section 135 sets out the manner in which the claims of employees that arise during business rescue, the fees of the practitioner and the claims of post-commencement financiers will be satisfied during business rescue proceedings. These claims are payable from the cash flow of the company, if the company is profitable during business rescue, or alternatively from the free residue of the estate.

In accordance with section 134, the claims of secured creditors remain protected during business rescue proceedings, in that the company and/or the business rescue practitioner cannot sell any asset over which a secured creditor holds security without such creditor's consent, unless the proceeds from that sale would be sufficient to cover the full liability owing to such creditor.

Thus, the first expenses to be paid in a business rescue proceeding are those of the business rescue practitioner and the expenses arising from the business rescue proceedings itself. The expenses of the practitioner include his or her remuneration and the expenses referred

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769. Loubser "Post-Commencement Financing and the Ranking of Claims: A South African Perspective" in Parry (ed) *European Insolvency Law: Current Issues and Prospects for Reform* (2014) 35. See discussion on ranking in business rescue in Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-54–18-56 at para 18.8.2.

to in section 143. To the extent that the practitioner's remuneration and expenses are not fully paid, the practitioner's claim for those amounts will rank in priority before the claim of all other secured and unsecured creditors. The costs referred to here include all the costs that are necessarily incurred in the running of the company under business rescue, including the costs incurred in bringing an application to place the company under supervision in terms of section 131.[770]

This section does not appear to differentiate between secured and unsecured post-commencement financing but mentions only the order in which they were incurred as the determining factor for the order of payment. It remains unclear as to whether the legislature assumed that secured claims will always enjoy a preference or whether it was intended that security should be dealt with together with all creditors (secured or unsecured). It is clear, however, that unsecured pre-commencement claims will automatically rank below claims for post-commencement financing.[771] The situation is further exacerbated by the provisions of section 135(3)(a), as it provides that these employee claims, without any limit on the total amount payable, will all rank equally and will also have preference over all claims by the lenders of post-commencement financing, irrespective of whether a claim is secured or not, and over all unsecured claims against the company. This further diminishes the prospect of available PCF. Even in the rare cases where a company is fortunate enough to have unencumbered assets available to provide security, thereby increasing its chances of obtaining finance, this advantage is substantially reduced by the fact that the company has to pay its employees first. It might even transpire that the post-commencement finance is used for paying these amounts, rather than for the conduct of the company's business. Furthermore, these preference rights will survive if the company is subsequently liquidated which, as we know, occurs in about 80 per cent of cases.[772]

770. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 478(12). See *Cape Point Vineyards (Pty) Ltd v Pinnacle Point Group Ltd and Another (Advantage Projects Managers (Pty) Ltd Intervening)* 2011 (5) SA 600 (WCC). The court held that the costs of the business rescue application qualify as "costs arising out of the costs of the business rescue proceedings". Such costs are to be taxed on an attorney-client scale.

771. Loubser "Post-Commencement Financing and the Ranking of Claims: A South African Perspective" in Parry (ed) *European Insolvency Law: Current Issues and Prospects for Reform* (2014) 34.

772. Loubser "Post-Commencement Financing and the Ranking of Claims: A South African Perspective" in Parry (ed) *European Insolvency Law: Current Issues and Prospects for Reform* (2014) 35. It seems a possibility that at least as far as the payment of salaries is concerned, employees were better off under the old judicial management procedure, in that the judicial manager was instructed to pay the costs of running the business before other claims, and this would include the remuneration payable to employees. See p. 36.

As it stands, the general understanding and practice is that claims of creditors during business rescue will be paid in the following order of preference (from the free residue of the estate, i.e. after secured creditors are paid out of their security, if their security is sold during business rescue). Interestingly, if the assets over which creditors hold security is not sold during the business rescue process, then section 135 of the 2008 Companies Act does not deal with the manner in which secured creditors, who were secured prior to the commencement of business rescue, will be paid during business rescue.

In practice, business rescue practitioners are ranking claims in the business rescue proceedings in the following order of preference[773] –

- Business rescue practitioners' remuneration, expenses and claims (incurred in terms of section 143) arising out of the costs of the business rescue proceedings (inclusive of disbursements such as legal and other professional costs);
- remuneration for employees from date of commencement of the business rescue proceedings;[774]
- secured lenders/creditors for any loan/supply of goods or services made after business rescue proceedings commenced (secured post-commencement finance);
- unsecured lenders/creditors for any loan/supply of goods or services made after business rescue proceedings began (unsecured post-commencement finance);[775]
- secured lenders or other creditors for any loan or supply of goods made before business rescue proceedings commenced;[776]

773. For comments on the ranking of claims in a business rescue see De Klerk "Can a company in liquidation avoid the voidable?" (2015) *Without Prejudice* 15–16. The author also considers the effect that section 129 of the Insolvency Act has on any security that may be provided to a post-commencement financier in terms of section 135(2)(a).

774. Remuneration claims for employees are specifically defined as post-commencement finance in terms of section 135(1) of the 2008 Companies Act. It is surprising that the legislature ranks these claims ahead of secured lenders (see below) and in respect of assets encumbered prior to the commencement of business rescue. It is submitted that it was the legislature's clear intention, when introducing business rescue legislation into our law, to favour employees and labour above secured lenders (see section 7(k) of the 2008 Companies Act).

775. Both secured and unsecured post-commencement lenders will have preference in the order in which such loans were incurred, over all unsecured claims. See Mongalo "Two Steps Forward and One Step Back is better than One Step Forward and Two Steps Back: A Limited Comparative Analysis of Business Rescue in South Africa" Opening address for *Business Rescue – First three years* University of Pretoria (7 October 2014) 6:

> The last aspect which needs to be considered is the post-Commencement Finance. Inasmuch as the statutorily prescribed time period for the formal completion of the business rescue process is unsatisfactorily inadequate, so are the provisions that are aimed at facilitating the re-emergence of the business as a going concern after financial distress. While the intention here is not to point out to everything that is wrong about post-commencement finance, I would merely like to show how this phenomenon could be used to optimally benefit a company in financial distress. It is important to note that while I am not advocating that everything is right about the US Chapter 11 proceedings, I am also not lambasting the SA Chapter 6 proceedings as being irretrievably unworkable.

- employees for any remuneration which became due and payable before business rescue proceedings commenced;
- unsecured lenders or other creditors for any loan or supply of goods and services made before business rescue proceedings commenced.

In *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company Limited*,[777] the court ruled in the ranking of claims in a business rescue. The court confirmed the abovementioned ranking of claims. Although the issue of ranking of claims was not before the court, Judge Kgomo pronounced on the ranking of claims.

The decision in the *Merchant West* case is controversial and has been criticised by many as being *obiter* and which fails to take into account the position of secured creditors, both prior to and during business rescue. Many disagree with the judgment. Some are of the view that the court's exposition of the ranking of claims is incorrect. The argument is that the court fails to recognise the basic distinction between encumbered assets and free residue and as a result prejudices secured creditors. This distinction, which is trite in our insolvency law, is supported by provisions in business rescue. For instance, section 134(3) expressly regulates the rights of secured creditors during business rescue proceedings and makes it clear that, if the property is sold, the secured claim must be "promptly" paid from the proceeds or otherwise (alternative) security for its payment must be provided to the satisfaction of the secured creditor. This principle applies throughout the business rescue proceedings. Additionally, section 135(3) which sets out the ranking of claims, makes no mention of secured pre-commencement claims. This must be so, as these claims are paid

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776. The debate relevant to whether or not unsecured post-commencement financiers rank ahead of secured pre-commencement financing remains an issue. In Stein and Everingham *The New Companies Act Unlocked: A Practical Guide* (2011) 421, the authors rank unsecured post-commencement finance above secured pre-commencement financing. There is a strong argument that rights of secured creditors are protected in terms of Chapter 6. In this regard, section 135(2)(a) of the 2008 Companies Act allows security to be taken by a loan financier "by utilising any asset of the company that is not otherwise encumbered". Section 134(3) recognises that any property held as security by any person cannot be sold without the consent of such security holder. Any proceeds realised from the sale of such secured property must be paid to such security holders. Therefore, it is submitted that there is a strong argument that secured pre-commencement financing should rank before unsecured post-commencement finance. For a summary of the ranking of creditors' claims in a business rescue, see *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Limited* 2013 JDR 1019 (GSJ). The waterfall or ranking of payments concurs with what is set out in the text above. See Levenstein and Barnett "Where do you stand in the Business Rescue queue?" (June 2011) *Without Prejudice* 10–11. In practice, it is submitted, in business rescue proceedings, pre-commencement secured creditors will not be paid in terms of the aforesaid waterfall of payments and they are generally treated like all other pre-commencement creditors. Their position as secured creditors is preserved in business rescue and they are not prejudiced by the process.

777. *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Limited* 2013 JDR 1019 (GSJ).

separately from the proceeds of the security. Post-commencement claims of employees are expressly said to enjoy priority over other post-commencement claims, whether secured or not. This would support an exception to the general principle of separation between secured and unsecured claims. If post-commencement employee claims also enjoyed priority over pre-commencement secured claims, it would have been necessary to include another stipulation in section 135, especially if the interpretation supports a deprivation of the existing rights of security.

In terms of section 135(4), if a business rescue proceeding is superseded by a liquidation order, the preference conferred in terms of section 135 will remain in force, except to the extent arising out of the costs of liquidation.[778]

The only claims against the company which enjoy preference over the post-commencement claims of the employees, are those for the business rescue practitioner's remuneration and expenses (as set out in section 143) as well as for other claims arising out of the costs of the business rescue proceedings.[779]

The Act does not specify what the words "costs" or "expenses" mean, but Regulation 128(3)[780] stipulates that the practitioner will be entitled to the basic remuneration in terms of the prescribed fee plus any further remuneration, without any limit, as agreed by the company. In addition, the practitioner is entitled to be reimbursed for the actual cost of any disbursement made by the practitioner, or expenses incurred by the practitioner that are reasonably necessary to carry out the practitioner's functions and to facilitate the conduct of the company's business rescue proceedings.[781]

Section 135(4) of the 2008 Companies Act therefore confers a preference on the remuneration and costs of a business rescue practitioner both during and after business rescue, the latter being when a company has been subsequently liquidated. To the extent that the business rescue practitioner's remuneration and expenses are not fully paid during the business rescue, the practitioner's claim for those amounts will rank in priority before the claims of all other secured and unsecured creditors in a liquidation. This preference

778. Sections 96–101 claims in terms of the Insolvency Act.
779. Section 135(3) of the 2008 Companies Act.
780. Made in terms of section 143(6) of the 2008 Companies Act.
781. Loubser "Post-Commencement Financing and the Ranking of Claims: A South African Perspective" in Parry (ed) *European Insolvency Law: Current Issues and Prospects for Reform* (2014) 35–36.

therefore remains in force even if business rescue proceedings are superseded by a liquidation order.

The issue arises as to whether a business rescue practitioner must submit a further claim to the liquidator. This could possibly result in him or her having to make a "contribution" to the estate if there is a shortfall in the assets of a company after administration. It is submitted that a practitioner's claim would not rank as one of an ordinary creditor but would rank together with the costs of the business rescue practitioner or alternatively as a "super-preference" claim ranking just after the remuneration and costs of the liquidator.

There has been much debate surrounding the status and make-up of business rescue practitioners' claim for fees and remuneration once the company has been placed into liquidation. In terms of section 135 (4), preferences applicable in a business rescue would remain intact in the ranking of claims in a liquidation. There has been some debate as to whether or not fees and expenses incurred by a practitioner during business rescue proceedings (such as practitioner's fees, legal costs, costs of court proceedings and the costs of having to bring an application to court to wind up the company)[782] are all recoverable as a statutory preference in a liquidation. Would such fees and costs be paid after the liquidation costs and administrative expenses but before post-commencement finances, employee claims, statutory preferent creditors and all concurrent/unsecured creditors? Alternatively would a practitioner have to file a claim as a concurrent/unsecured creditor with the strong possibility of receiving a negligible dividend? The Act is ambiguous in this regard as certain provisions refer to these fees and expenses as "costs" in the business rescue (see section 135(3) and others refer to these expenses as "claims" in the business rescue (see section 143(5)). Section 135(3) appears to blur these two references as it deals with section 143(5) "claims" and makes references to "expenses".

There is therefore an argument that during business rescue proceedings, the practitioner's remuneration and expenses are "costs" in the business rescue and that once a company is placed into liquidation, subsequent to a business rescue, the remuneration and costs of the practitioner will be a "claim" in the liquidated estate. Thus, the practitioner will be forced

782. Section 141(2)(a)(ii) of the 2008 Companies Act: if at any time during business rescue proceedings a practitioner concludes that there is no reasonable prospect of rescuing the company, the practitioner must apply to the court for an order discontinuing the business rescue proceedings and placing the company into liquidation.

to prove his or her claim in the liquidation, together with all other unsecured/concurrent creditors.[783]

The next question is then: What is the nature of the claim of the practitioner in the liquidated estate? Section 143(5) of the 2008 Companies Act provides that:

> (j) to the extent that the practitioner's remuneration and expense are not fully paid, the practitioners *claim* for those amounts rank in priority before the claims of all other *secured and unsecured* creditors [emphasis added].

Whilst this section does not stipulate when in the process (i.e. during business rescue or subsequent thereto) the practitioner's claim would rank ahead of the secured and unsecured creditors, it is apparent that in terms of section 135(3) of the 2008 Companies Act, the practitioner's remuneration and costs would ordinarily, in business rescue, rank ahead of all other creditors and thus this provision (i.e. section 143(5)) must be a reference to liquidation.[784]

Accordingly, it is submitted that section 143(4) as read with section 135(4) provides that the practitioner's remuneration and costs should rank behind the costs of the liquidation but ahead of the claims of secured and preferent creditors. A further gloss on the topic is that it follows that because the provisions of section 135(3) which places the remuneration, costs and expenses of the practitioner at the top of the list of preferred creditors, there is no reason as to why this ranking should be changed in a liquidation. If a business rescue is followed by a liquidation, the costs of liquidation must and should rank at the top, followed by the claim of the practitioner insofar as he or she has not been paid.[785] It is a separate claim and not incorporated as a cost of liquidation. In any event, a practitioner in the course of running the business rescue will pay him- or herself because the claim for fees and disbursements are not subject to a taxation by the Master of the High Court as in a

783. This creates an anomaly in the context of business rescue. Why would any practitioner want to run the risk of not being paid (or being paid a negligible amount) if his or her claims rank as concurrent in a liquidation? There would be no real incentive to taking on an appointment as a practitioner. Proponents of this view however argue that practitioners must as a result be even more circumspect in their pre-assessment process and *not* take on a business rescue without having access to sufficient post-commencement finance to cover fees, disbursements and expenses and further having a firm view on the company's reasonable prospects of being rescued. If these are not in place, the practitioner should not take an appointment and should rather allow the company to go into liquidation from the outset.

784. In Bertelsmann et al. *Mars*: *The law of Insolvency in South Africa* (2008) 454 it is submitted by the authors that various statutes confer special rights or privilege in several instances on certain types of creditors. No single rule can be laid down as to how to deal with such statutory rights, as it will depend upon the particular terms of the statute creating the specific right. In general though, it can be said that if a statute does not specifically state that the holder of the right has a preferential right, it must be accepted that such a holder is a mere concurrent creditor. However, if the statute states that a creditor is given a secured claim, the trustee must deal with the claim accordingly.

785. It would further appear to be a logical that if a practitioner is forced to bring a liquidation application in terms of section 141(2)(a)(ii) of the 2008 Companies Act, those costs (the costs of having to bring the application for the winding up to court) would be recoverable as costs in the liquidation. This would be applicable and recoverable by any creditor in a similar situation.

liquidation. It is therefore only any unpaid part of the practitioner's claim that will rank below liquidation costs in a liquidation. Since the liquidation costs rank higher, a practitioner would only be paid after a liquidation and distribution account has been approved and where there are sufficient funds to pay this claim. Thus, such costs/fees are preferent, remain a claim but are not costs in the liquidation.

In the matter of *Murgatroyd v Van Den Heever and Others NO*,[786] the entitlement of a business rescue practitioner to be reimbursed for expenses and disbursements incurred in the business rescue once the company has been placed in liquidation was dealt with by the court. Meyer J was of the view that the entitlement for a practitioner's reimbursement for expenses and disbursements in a business rescue must be linked to whether or not they were "reasonably necessary to carry out the practitioner's functions and to facilitate the conduct of the business rescue procedure". The question is a functional one and must be assessed on the facts and circumstances of each case. Factors that should be taken into account are the size of the company, the functionality of its management, the accuracy of its financial data, the complexities involved and the scope of the work to be undertaken by the practitioner. Expenses should be market related and reasonable.[787]

The Judge ruled that the applicant (business rescue practitioner) was entitled to full recovery from the estate of the company in liquidation, in priority before the claims of all other secured and unsecured creditors in terms of section 143 as read with section 135 and regulation 128(1) of the 2008 Companies Act. In addition, the court ruled that the liquidators were obligated to make payment of the practitioner's costs and expenses incurred prior to confirmation of his appointment.

As set out above, the nature of the practitioner's claim in a liquidation remains unclear and open to debate. Are his or her costs deemed to be included in the costs of administration or as a separate claim? If there is no free residue after secured creditors have been paid, there might be the possibility that the practitioner does not receive payment of his or her fees. This is a most unsatisfactory position for all business rescue practitioners considering an appointment in terms of Chapter 6. On what possible basis can the practitioner go on risk for his or her fees when the ultimate result could be a shortfall in the liquidation? This

786. *Murgatroyd v Van Den Heever and Others NNO* 2015 (2) SA 514 (GJ).
787. Ibid 13 at para 21.

cannot be necessarily remedied by a contribution by creditors as the practitioner's fees are not necessarily seen to be a cost of administration (see above). The legislature failed to deal with this position in any meaningful way.

The other complication could be where there was a liquidation prior to the commencement of a business rescue. In what manner does the practitioner deal with the liquidator's claim for fees due while he or she conducted the administration in the prior winding-up procedure? It is submitted that a liquidator's fees should rank at the same level as that of the practitioner's claim for fees. This question however remains open to debate.

Another debate is whether "creditors" in a business rescue should be distinguished from "creditors" in a liquidation? This question is of particular importance when a rescue is converted into a liquidation. Should creditors that were created in the business rescue merely be carried over into liquidation as contemplated by section 135(4)? The legislature certainly contemplated practitioners' claims and employee claims being treated on a preferential basis in a liquidation.

So, to clarify the position, in a liquidation following a failed business rescue, the ranking of claims could be as follows –

- the proceeds of any security realised in the winding-up will be applied to settle all secured creditors' claims (this refers to pre-commencement security only);
- the free residue (excess funds) would then be applied in the following manner –

(a) costs and administrative expenses incurred in the winding-up;

(b) practitioner's claim for unpaid remuneration, costs and expenses in terms of section 135(3) (it is submitted that a liquidator's fees should be included here);

(c) any secured post-commencement finance;

(d) outstanding employees' claims which arose during the conduct of the business rescue proceedings;

(e) all unsecured post-commencement finance;

(f) sections 96 to 101 Insolvency Act preferences (statutory preferent creditors);

(g) all concurrent/unsecured creditors.

It is submitted that the ranking of post-commencement finance in a business rescue is becoming increasingly important. In South Africa, the business rescue process has provided venture capitalists, private equity funds and foreign investors with opportunity to buy into distressed companies in order to leverage good-value assets at relatively cheap prices.

As an emerging market, South Africa is currently being targeted by investors who seek to use the business rescue process to their advantage. These investors have identified companies with high-value assets but which are financially distressed. Such investors have offered practitioners, creditors and shareholders alternatives to liquidation, namely the purchase of either the shares or business of companies in business rescue.

The negotiations would either commence prior to the company formally entering into the business rescue process, or subsequent to the practitioner being appointed. The negotiations might include the provision of post-commencement finance coupled with the opportunity to make an offer for the shares (or a portion thereof) of the business (assets) of the company.

The final acquisition proposal is concluded between the investor/offeror and the company (represented by the practitioner), which is generally subject to the final approval of a business rescue plan in terms of the 2008 Companies Act.[788] The plan is published and includes details of the transaction. The plan is then placed before affected persons (mainly creditors) to approve. In the event that the plan is approved, the practitioner will implement the transaction with the investor exiting from the business recue process with either the shares of the company or the business (assets).[789]

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788. Section 152 of the 2008 Companies Act.

789. Levenstein "Opportunities Arising from the New Business Rescue Provisions of the South African Companies Act, 2008" (November 2013) available at http://www.werksmans.com/legal-briefs-view/opportunities-arising-new-business-rescue-provisions-south-african-companies-act-2008/.

As a result, business rescue has provided new opportunities for merger and acquisition activity in South Africa. It has become common for investors to put up post-commencement finance and then consummate an acquisition of the company's shares.[790]

Interest in the purchase of distressed companies in South Africa has also attracted interest in the UK. It was reported in the *Financial Times* in April 2013[791] that private equity finders and investors had begun to consider South Africa and Africa as a potential market for distressed fund investing. Workshops were held jointly by the South African Venture Capital Association (SAVCA) and the law firm Werksmans to consider distressed debt investing through the business rescue process.[792] The author was quoted:

> "Our financial distress market in South Africa is quite new," says Eric Levenstein, head of the business rescue practice at Werksmans, "we are running seminars on the opportunities in business rescue to take up a position with either the introduction of post-commencement finance or investing in a distress debt situation to take the upside."[793]

In particular, the manner in which post-commencement finance is ranked will influence parties who wish to fund a company under business rescue. If there is no firm indication that such post-commencement financier will rank before secured creditors, the enthusiasm to introduce such finance will quickly diminish.[794]

In recent business rescues, we have seen prospective acquirers approach practitioners and submit offers to purchase the shares or business/assets of distressed companies in business

790. Ibid 2. Often, the investor or offeror pays R1 for the shares and offers creditors a percentage dividend in the Rand, which dividend is better than what would be achieved in a liquidation. The acquisition is therefore achieved at a normal purchase price. Examples include: Star Times' (Chinese) acquisition of Top TV (ODM), the acquisition by Paramount of South Africa's older aerospace company, Advanced Technologies and Engineering (ATE), the purchase by the HUB of the Meltz Success retail clothing chain, the purchase by the Standard Bank of SA Ltd of the Pearl Valley Gold Estate in the Western Cape and the purchase by Wits Gold Ltd of the Southgold mine.

791. Madongo "South Africa, Private Equity Eyes Distressed Assets" (19 April 2013) *Financial Times* available at http://blogs.ft.com/beyond-brics/2013/04/19/south-africa-private-equity-eyes-distressed-assets/.

792. In April 2013, at a joint seminar run by Werksmans Incorporated and the South African Venture Capital Association (SAVCA) in Cape Town and Johannesburg, various venture capital funds, private equity groups and hedge funds expressed an interest in possibly participating in the provision of finance to distressed companies, in terms of the provisions of section 135. The seminars were held in Cape Town and Johannesburg and were attended by asset managers and private equity representatives.

793. The author was quoted by Madongo in "South Africa, Private Equity Eyes Distressed Assets" (19 April 2013) *Financial Times* available at http://blogs.ft.com/beyond-brics/2013/04/19/south-africa-private-equity-eyes-distressed-assets/. Also see Madongo "Private Equity in Africa: Warming up for 2014" (31 December 2013) *Financial Times* available at http://blogs.ft.com/beyond-brics/2013/12/31/private-equity-in-africa-warming-up-for-2014/. During a visit in June 2014 to London, the author met with numerous US- and UK-based private equity firms, all interested in investing in financially distressed companies through the business rescue process.

794. Gilson *Creating Value through Corporate Restructuring: Case Studies in Bankruptcies, Buyouts and Breakups* (2001) 187 states the following:

> In the USA and the UK, several billions of Dollars are made available by funds set up specifically to provide financing to distressed companies in Chapter 11 or under UK administration. The practice of investing in distressed companies is popularly known in the USA as "vulture" investing. The risks of investing in this market are highly idiosyncratic. Investors who are adept at managing these risks, who understand the legal rules that must be followed in corporate bankruptcy, and who are skilled at identifying or creating value in a distressed situation, consistently earn the highest returns in this market.

rescue. These acquisitions are often accompanied by the provision of post-commencement finance while the acquisition transaction is being finalised where such acquisition is conditional upon a business rescue plan being adopted in terms of section 152 of the 2008 Companies Act.[795]

Thus, there is a strong need for these transactions to have available post-commencement finance for such distressed companies to ensure that ongoing administration, overhead and running costs are paid, while the transaction for the acquisition of the company and the finalisation of the business rescue plan is in progress.

In a thorough analysis of the current status of post-commencement finance by Wanya du Preez,[796] she *supports* the need for such offering in South Africa and the reasons for the lack of such funding to date. Du Preez is adamant that the success of business rescue is "intricately linked to the ability to raise PCF successfully". There is a concerningly low level of interest in providing PCF, probably due to "ambiguity and uncertainty still surrounding the interpretation of the rescue provisions set out in the 2008 Companies Act". PCF should, ideally, be secured way before and as part of management's decision to file for business rescue.[797]

It is submitted that if post-commencement funders rank below secured creditors in the ranking of claims in business rescue, then there will be a substantial reduction in the willingness to provide funding to companies urgently requiring post-commencement finance in business rescue. Without post-commencement funding, the business rescue process will be stunted, which would result in many companies that were candidates for business rescue ending up in liquidation.[798]

795. See Levenstein "Investor Upside in Distressed Assets?" (1 April 2015) *Business Brief* available at http://www.bbrief.co.za/resources/magazine-articles/investor-upside-in-distressed-assets 52. Also see Terblanche "Business Rescue Process Offers Investment Avenue" (11 May 2015) *Business Day* available at http://www.bdlive.co.za.

796. Du Preez *The Status of Post Commencement Finance for Business Rescue in South Africa* Gordon Institute of Business Science (November 2012).

797. Du Preez "Post-commencement Finance – The Silver Bullet for business rescue" (25 April 2013) available at http://www.deloitteblog.co.za/post-commence-finance-the-silver-bullet-for-business-rescue/ accessed 13 October 2014. Also see Pretorius "Post Commencement Finance in Business Rescue – Part 1–6" (June 2013) available at http://www.brportal.co.za/ForumRetrieve.aspx?ForumID=679&topicID=15401. In order for post-commencement funding to be obtained successfully, critical processes needs to be followed prior to a business rescue filing for rescue. These include, *inter alia*, upfront consultation and collaboration with key stakeholders (especially financiers) in order to advise them of the situation and need for post-commencement finance. This should occur at the pre-filing stage so that various alternatives and options can be discussed and to ensure the buy-in from all parties and stakeholders.

798. If someone can be persuaded to provide financing under these circumstances, the ranking of this claim in a subsequent liquidation will obviously be a very important consideration, especially since the overwhelming majority of companies going into business rescue, end up in liquidation. See Loubser "Post-Commencement Financing and the Ranking of Claims: A South African Perspective" in Parry (ed) *European Insolvency Law: Current Issues and Prospects for Reform* (2014) 30.

The protection afforded to creditors who are secured prior to the commencement of business rescue will be rendered nugatory in a liquidation, in that if their claims are not satisfied out of the security that they hold, such creditors will only receive payment of their claims after post-commencement financiers. This would in effect render secured creditors' claims further down the waterfall and would result in an undermining of the very reason as to why secured creditors take security for their claims, particularly if a company ends up in liquidation.

If post-commencement financiers rank higher than secured creditors, secured creditors might prefer the company to go into liquidation rather than business rescue. This would work against the intention of Chapter 6 in that the focus should be on rescuing companies rather than liquidating them.[799]

The case of *Merchant West Working Capital Solutions (Pty) Limited v Advanced Technologies and Engineering Company (Pty) Limited*[800] left the question of the waterfall of payments in a business rescue open (obiter judgment). In terms of the judgment, the ranking of claims is as set out in the text above: post-commencement financiers rank ahead of secured creditors in a business rescue. In terms of section 135(4), such ranking would remain in place in a liquidation.

There is no doubt that this judgment has not been welcomed by the banks as secured creditors. As a result, lenders might now start applying stricter lending requirements as a result of the above ruling.

As the law is currently settled (to a degree) on whether post-commencement financiers rank ahead of secured creditors, there should be an upturn in the enthusiasm for venture capital financiers and the like to provide post-commencement finance to companies in business rescue. It is however submitted that the ranking of claims in a restructuring is a fundamental principle in every international jurisdiction. Whether DIP lenders should be ranked above secured creditors will always be assessed on the extent to which secured creditors might be adversely affected. In South Africa, secured lenders have always had an advantageous position in a liquidation with the result that secured lenders generally receive

799. See Levenstein and Barnett "Where You Stand in the Business Rescue Queue" (June 2013) *Without Prejudice* 10–11.
800. *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Limited* 2013 JDR 1019 (GSJ).

full dividends and concurrent creditors end up with negligible or zero dividend pay-outs. In a business rescue, secured creditors are treated on the same basis as all other creditors when voting on a business rescue plan. The practitioner, in his or her discretion, can choose to deal with secured creditors (or any other class of creditor) in a manner that he or she believes to be justified in the course and scope of the plan to rescue the company.

Section 135(3) refers to "other claims arising out of the expenses of the business rescue proceedings". Although not defined, these expenses include all costs and expenses incurred in the running of the company under business rescue and include the costs of bringing an application for business rescue proceedings.

In practice, and although not specifically dealt with in the 2008 Companies Act, business rescue practitioners recognise that all provision of services by suppliers to the company are recognised as "post-commencement finance". For example, where landlords allow the company to continue to rent premises, such rental is regarded as post-commencement finance. Any suppliers providing goods or services to the company on credit after the commencement of business rescue proceedings are regarded as post-commencement financiers.

The dangers of being "locked up" into having the obligation to contractually continue to provide services to the company after the commencement of business rescue proceedings is of concern to existing funders and suppliers.[801] The post-commencement financier might have to continue to supply either loan capital, premises to rent and/or services essential to the continuation of the company while the company is subject to the business rescue proceedings. These post-commencement financiers will have preferent claims in the business rescue in terms of section 135(3). However, such preference would only be useful if ultimately the company has excess cash to ultimately meet these post-commencement obligations. If not, the best such post-commencement funders can hope for is a recovery in the liquidation of the company if there is sufficient residue to pay these obligations.

801. Note that once business rescue intervenes, contractual arrangements remain extant (undisturbed) for the duration of the business rescue proceedings. The practitioner is entitled to entirely, partially or conditionally suspend, for the duration of the business rescue proceedings, any obligation of the company arising in terms of any agreement or apply to Court to cancel such agreement – section 136 of the 2008 Companies Act. If not suspended, these agreements, with all obligations flowing therefrom, continue on the terms set out in the agreement.

Consequently, it is suggested that suppliers of finance, goods and services and landlords consider including a standard event of default clause in their standard term contracts, enabling them to terminate their agreements, at their discretion, once a business rescue resolution is filed *or* when a business rescue order is granted by a court. This will enable such party to, at their election, to discontinue the "bleed" of possible post-commencement finance with little or no prospect of recovery.

Prior to funding, potential PCF funders (such as the existing company's bankers, creditors and shareholders) would normally require an opportunity to investigate the company to establish whether they believe in its viability and whether they want to provide the business with finance to ensure its prospects of survival. For financiers, the nature and extent of the PCF will depend on the type of business, the company's current financial situation (as well as its prospects of success) and the level of risk appetite when it comes to lending to a company in financial distress.[802]

Typical providers of PCF[803] are the following:

- Banks
- Trade creditors
- Customers
- Shareholders
- Development finance institutions[804]
- Alternative financiers – distressed lenders and private equity firms.[805]

802. Du Preez and Pretorius "Constraints on Decision Making Regarding Post-commencement Finance in Business Rescue" (2013) 182 *SAJESBM* 174.
803. Ibid 174–175.
804. For example the Development Bank of South Africa (DBSA) and the Industrial Development Corporation (IDC).
805. These alternative funders include venture capital firms and distressed lenders. The future of PCF might lie with these firms, as the traditional financiers do not currently display a sufficient appetite to provide PCF to distressed companies. These entities generally have a higher risk appetite. Such entities would typically buy out distressed debt and/or have PE/VC funds available to utilise for this purpose. The potential incentive for them to enter this industry is the higher risk-return investment, buying debt or assets at depressed prices, higher payment priority in terms of the PCF rankings, and potential debt-to-equity swaps in cases where they have identified available business with long-term prospects. See Du Preez and Pretorius "Constraints on Decision Making Regarding Post-commencement Finance in Business Rescue" (2013) 182 *SAJESBM* 175.

Another source of funding, it is submitted, is the prospective offeror who seeks to acquire the business assets or the company itself. In many instances, it is the offeror who is prepared to "prop" up the business of the company while it is being restructured in the business rescue process. This is effected by the provision of PCF. After all, there would be no point in allowing the business of the company to die, while a protracted negotiation ensues between the offeror, the practitioner, creditors, shareholder and other stakeholders.[806]

Despite the above, formal PCF structures are non-existent in South Africa. There are no distressed lenders and few products have been designed to accommodate the high level of risk associated with this type of financing. Practitioners and management do not currently have ready access to this financing option. However, interest in this field is growing as investors become more comfortable with the concept and the risks involved.[807]

It is submitted that the provision of PCF is a fundamental requirement for a successful business rescue. It is the lifeblood of any business rescue process, and without it, all efforts made by the practitioner to rescue the company are in vain. DIP finance and access to ongoing finance in a Chapter 11 is a necessity in the US. In South Africa, there is a recognised need that the debtor company's business must have access to finance to allow it to continue to operate and in order to preserve ongoing concern value of the enterprise. As seen above, access to PCF comes from various sources. However, it is submitted that the urgent need for PCF from the initial commencement of a rescue process would best be provided by existing financial institutions and banks already providing loans or finance to the company. In South Africa, we see a continued reluctance on the part of banks to provide PCF, although this trend appears to be changing. Banks and financial institutions

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806. Ibid. For findings relevant to the reasons for PCF being non-existent in South Africa see pp. 180–189. Also see Du Preez *The Status of Post-commencement Finance for Business Rescue in South Africa* (GIBS) (Turnaround Management Association, 26 March 2014).

807. In the acquisitions of ATE, Southgold, Meltz and Moyo, all of the prospective offerors provided PCF while the acquisition transaction was being negotiated. The fact that section 134 of the 2008 Companies Act provides a preference in business rescue assisted in encouraging these offerors to provide PCF knowing that such PCF would be repaid in preference to all other creditors. Also see Holtzhauzen "Turnaround funding and financial restructuring – issues and challenges" Presentation (5 March 2014) at GIBS *Corporate Renewal, Business Turnaround and Rescue – Challenges, Pitfalls and Remedies*. The importance of post-commencement finance is best illustrated by the Senyati example. Senyati Holdings Ltd was a large construction company concern that built roads for both the national and provincial governments. These government departments were notoriously bad debtors who would generally take months, if not years, to pay their debts. The company had outstanding payments due to it of some R79 million by three provincial government departments. The company went into business rescue but needed substantial post-commencement finance to survive and in order to enable it to complete its existing contracts. Delays resulted in many contracts being cancelled and a failure by the provincial governments to meet their obligations to the company. As a result, the company terminated the business rescue proceedings and went into liquidation. See Loubser "Post-Commencement Financing and the Ranking of Claims: A South African Perspective" in Parry (ed) *European Insolvency Law: Current Issues and Prospects for Reform* (2014). Also see Odendaal "Struggling Senyati Set to Initiate Liquidation" (11 July 2012) *Business Report (The Star)* available at http://www.iol.co.za/business/news.

are beginning to realise that without immediate access to PCF, the prospect of resuscitating a distressed company is unlikely.[808]

Increasingly, in business rescue matters in South Africa, we have seen opportunities arise for venture capital funds, hedge funds and potential investors in taking up position in companies that are in financial distress and that are subject to a business rescue process.

These role players become particularly interested in providing post-commencement finance during the business rescue process in order to prop up the asset while the restructuring of the business is being undertaken by the business rescue practitioner.

There are a multitude of transactions that can occur during the business rescue process, all of which are ultimately sanctioned by a business rescue plan, voted in by all creditors.[809]

These transactions could result in a sale of assets of the company, a sale of the business of the company or a sale of the shares of the company. Generally, respective offerors would partner with a post-commencement financier or would themselves put up post-commencement finance in order to ensure that the asset remains viable during negotiations for the purchase of either the shares or a portion of its business.

While the negotiation is ongoing, post-commencement finance must be provided in order to ensure that the company continues to trade and pays its expenses, management and employees.

It is common for third parties to acquire shares in the distressed company. In such an instance, the shares are often sold for nominal value, with funds made available to pay creditors' claims at a reduced and compromised amount. More often than not, the third party that acquires the shares of the company in distress, is able to acquire valuable assets for a fairly reasonable price.[810]

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808. See Levenstein "Banks are cautious, not reluctant, over rescues" (7 August 2014) *Business Day* Live. Also see Levenstein and Nickig "Business in Distress: Making it attractive and bargain hunting" presented at *GIBS Corporate Renewal, Business Turnaround and Rescue: Challenges, Pitfalls and Remedies* (5 March 2015).

809. Section 152 of the 2008 Companies Act. Directors can be held criminally liable for reckless conduct: see section 214(1)(b) and (c) as read with section 216 of the 2008 Companies Act. See comments in Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 635 on both of these sections.

810. Examples are the restructuring and reorganisation of Southgold (Pty) Limited (a subsidiary of Great Basin Gold Limited, a Toronto Stock Exchange listed company); Advanced Technologies and Engineering Company (Pty) Limited; Meltz Success (Pty) Limited; Pearl Valley Golf Estate (Pty) Limited, Moyo Restaurant Group. Also see Levenstein "Opportunities to Acquire Distressed Assets from Companies in Business Rescue in South Africa" (21 November 2013) available at http://www.kwm.com/en/uk/knowledge/insights/opportunities-

More recently international investors, many based in China, have expressed an interest in buying up distressed companies (assets) in South Africa by using the business rescue process. Chinese investors appear particularly interested in acquiring companies with natural resource assets, such as those in the mining sector. The author held a presentation on this topic in Beijing, Peoples Republic of China, in March 2014.[811]

It is submitted, however, that South Africa remains an unsophisticated market in respect of the provision of post-commencement finance when compared to markets in Australia and the US. Although there has been discussion of a bespoke "distressed debt fund" being set up in South Africa to provide post-commencement finance, this has not yet occurred. There remains a sense of the "unknown", where the risk level remains too high for the formal setup of such a distress fund.

It is difficult to imagine lenders rushing to make new money available in circumstances where pre-commencement lenders have not been repaid. Lenders would generally be wary of throwing good money after bad in circumstances where the company is already financially distressed. It was for this reason that the legislature provided a mechanism whereby new lenders can receive preferential payment for post-commencement loans, and also provided the opportunity for such new lenders to take security for such loans, if possible. The "super-preference" class created for post-commencement lenders will hopefully attract the provision of such financing, as without it, the business rescue process will fail.[812]

acquiring-distressed-assets-from-companies-in-business-rescue-in-south-africa-20131121; Levenstein "Opportunities Arising from the New Business Rescue Provisions of the South African Companies Act, 2008" (November 2013) available at http://www.werksmans.com/legal-briefs-view/opportunities-arising-new-business-rescue-provisions-south-african-companies-act-2008/; Levenstein "New Companies Act and Business Rescue" (8 November 2013) *Bizcommunity* available at http://www.bizcommunity.com/Article/196/547 /103121.html; Levenstein "Private Equity Eyeing Distressed Assets in Business Rescue" (26 April 2013) *Moneyweb* available at http://www.moneyweb.co.za/archive/r-1065/; Elliot "Business Rescue Offers Asset Bargains" (17 March 2013) *Business Day* available at http:// www.bdlive.co.za/businesstimes/2013/ 03/17/business-rescue-offers-asset-bargains?.

811. In this regard see Levenstein "Opportunities for Chinese Investors arising from the New Business Rescue Provisions of the South African Companies Act, 2008" available at http://www.werksmans.com/legal-briefs-view/opportunities-chinese-investors-arising-new-business-rescue-provisions-south-african-companies-act-2008. Also see Madongo "South Africa, Private Equity Eyes Distressed Assets" (19 April 2013) *Financial Times* available at http://blogs.ft.com/beyond-brics/2013/04/19/south-africa-private-equity-eyes-distressed-assets/. Also see the following article: Kang Lim and Gui Qing "China Firm Plans USD 1 Billion Distressed Asset Fund for Foreigners" (20 April 2014) *Chicago Tribune* available at http://articles.chicagotribune.com/2014-04-20/business/sns-rt-us-china-debt-npl-20140420_1_housing-market-china-firm-foreigners.

812. Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-55 at para 18.8.2.3.

7.8 THE BUSINESS RESCUE PLAN

After consulting with all affected persons and stakeholders, the business rescue practitioner is obligated to prepare a business rescue plan for consideration and possible adoption at a meeting to be held in terms of section 151.[813] This is the most significant part of business rescue proceedings, as the plan ultimately, if voted in and approved, delivers the "second chance" to the company to trade its way out of financial distress.[814]

The Act is not prescriptive or overtly limiting on what needs to be included in the plan. However, the plan must have sufficient information to enable creditors and other affected persons to decide whether to adopt or reject such plan.[815]

In terms of section 150(1), the practitioner should "consult" with creditors, other affected persons and the management of the company when preparing the business rescue plan. The "management of the company" will by and large be the same persons that were running the company prior to the commencement of the business rescue proceedings, and so they would be well placed to express an opinion on the workability of the plan being developed by the practitioner. The "management of the company" would include the directors of the company.[816]

In *Hlumisa Investment Holdings (RF) Ltd and Another v Van der Merwe NO and Others*,[817] the applicants contended that there had been no meaningful consultation on the business rescue plan to enable the reader to meaningfully consider the proposed plan.[818] Certain critical documents, it was alleged, had not been made available and the applicants had not been consulted on items relevant to the preparation of the business rescue plan as contemplated by section 150(1) of the 2008 Companies Act.[819] Acting Judge Thobane was

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813. Section 150(1) of the 2008 Companies Act as read with section 151.

814. Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18.16.1 at para 18.16.

815. For a synopsis of the development of a business rescue plan see Van der Walt "A Turnaround Practitioner's View of New Business Rescue Legislation" in Harvey (ed) *Turnaround Management and Corporate Renewal: A South African Perspective* (2011) 157–158. Also see Rushworth "A Critical Analysis of the Business Rescue Regime in the Companies Act 71 of 2008" (2010) *Acta Juridica* 402–403. It should also be emphasised that the turnaround period for consultation and the proposal of a plan is very short. Consequently, a business rescue practitioner will be hard pressed to achieve a workable plan within the set time limits. On the other hand, this is one of the most positive aspects of the business rescue procedure as it compels all interested parties to cooperate to find a solution in order to rescue the company. The practitioner can extend the time frames but this should be avoided if possible. See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-98–18-99 at para 18.16.1.

816. Ibid 18-100 at para 18.16.2.1.

817. *Hlumisa Investment Holdings (RF) Ltd and Another v Van der Merwe NO and Others* (77351/2015) [2015] ZAGPPHC 1055 (14 October 2015).

818. See section 150(2) of the 2008 Companies Act.

819. *Hlumisa Investment Holdings (RF) Ltd and Another v Van der Merwe NO and Others* paras 21–24.

of the view that there had been, *prima facie*, unfair treatment by the business rescue practitioner of the applicants and granted the applicants an interdict preventing the holding of the section 151 meeting to consider the plan.[820] The judge ordered the practitioner to provide further relevant documents to the applicants to enable them to properly and meaningfully consider the proposed business rescue plan.[821]

It is submitted that this case assists in understanding the extent of the "consultation" that must occur between the practitioner and affected persons in terms of section 150(1). The court supported the view that section 150(1) must be read with section 150(2) in that, as a precursor to distributions made pursuant to a plan to creditors and shareholders, a proper and effective exchange of information must occur to enable affected persons to properly interpret and consider a proposed business rescue plan.

In South Africa, provision has been specifically made for what should be included in a plan.[822] Further, the voting regime on the approval of a plan has been set out specifically in the 2008 Companies Act with the provisions made for a cram-down on dissenting creditors, including a buy-out of dissenting creditors that vote down a plan at liquidation value.[823]

Section 150(2) sets out the information that must be included in the business rescue plan.[824] The objective is to ensure that as much relevant information as possible is included in the plan so as to ensure that all affected persons are placed in an informed position to enable them to decide whether or not to accept or reject the plan.[825] The plan is divided into three parts: *Background*, *Proposals* and *Assumptions and Conditions*.[826]

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820. Ibid para 25.

821. Ibid.

822. See section 150(2) of the 2008 Companies Act. The business rescue plan should contain full and complete details of the difficulties the practitioner is immediately faced with, when conducting the investigation of the affairs of the company in terms of section 141. If he or she finds, for instance, that there is a disastrous situation with regard to essential data, figures and information of whatever nature, this must explicitly be set out in the plan. This detail should be set out as Part A in the business rescue plan as being "Background" – see section 150(2)(a). See Braatvedt "Costs of Business Rescue" (October 2014) *Without Prejudice* 23.

823. See sections 152–153 of the 2008 Companies Act. A full analysis of these sections and the content of the plan is dealt with in Chapter 7, paras 7.8.1 and 7.8.2.

824. The full scheduled list of items to be included is set out in the section and is not repeated here. A business rescue plan is a contract between the company and its creditors. The plan will set out the manner in which the practitioner foresees returns being made to creditors through a systematic set of actions as set out in the plan. See Pretorius and Rosslyn-Smith "Expectations of a Business Rescue Plan: International Directives for Chapter 6 Implementation" (2014) 2 *SABR* 108–139.

825. Section 150(2) of the 2008 Companies Act. See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-100–18-101 at para 18.16.2.2.

826. Section 150(2)(a), (b) and (c) of the 2008 Companies Act.

In *Commissioner of South African Revenue Service v Beginsel NO and Others*,[827] the court ruled that substantial compliance with the provisions of section 150(2) was sufficient and that there was no need for the business rescue plan to contain a precise description of each element set out in section 150(2), as long as there was sufficient information, along the lines prescribed by section 150(2), which enabled interested parties to make an informed decision on the business rescue plan.

Most business rescue plans published by practitioners follow the format of section 150(2) and should contain all the information required.[828]

Section 150(2)(a)(iii) refers to the inclusion of "the probable dividend that would be received by creditors, in their specific classes, if the company were to be placed in liquidation". This is an important calculation and is significant in that creditors must be in a position to decide whether the dividend being offered by the practitioner in the plan would result in a better return than the liquidation dividend set out in the plan.

Section 150(2)(b) – Part B requires the practitioner to set out the proposals envisaged by the plan. It should include details of the nature and duration of the moratorium, the extent of the release of debt, debt conversions to equity, treatment of contracts/agreements and property that will become available to pay creditors' claims.

Section 150(2)(b)(v) requires the practitioner to set out the order of preference in which the proceeds of property will be applied to pay creditors if the business rescue plan is adopted.[829] Clearly, the legislature contemplated that certain claims, of necessity, would have to be paid in preference to other claims within the context of the business rescue procedure.[830]

Section 150(2)(b)(vi) provides that, most importantly, the practitioner must set out the benefits of adopting the business rescue plan as opposed to the benefits that would be received by creditors if the company were to be placed in liquidation. It is submitted that this information, which is often included as a comparative schedule between the two

827. *Commissioner of South African Revenue Services v Beginsel NO and Others* 2013 (1) SA 307 (WCC).

828. For an analysis of the prescribed contents of the plan as set out in section 150(2) of the 2008 Companies Act, see Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 2 (2004) 4 *TSAR* 692–693.

829. Refer to section 135 of the 2008 Companies Act and the order of preferences required to be set out in the plan.

830. See Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 518–522.

possible outcomes, is the most fundamental aspect of the plan. Creditors will want to know what their alternatives are insofar as comparative dividends are concerned. This will, in most cases, be the most critical piece of information that will cause creditors to vote for or against a plan.

According to Section 150(2)(c), Part C of the plan must provide the key assumptions and conditions" fundamental to the plan. This must include a statement of the conditions that must be satisfied, if any, for the business rescue plan to come into operation and be fully implemented, the effect on employees and the terms and conditions of employment and the circumstances in which the business rescue plan will end. Most importantly, the plan must include a projected balance sheet for the company and a statement of income and expenses for the ensuing three years prepared on the assumption that the proposed plan is adopted. It is submitted that this element of the plan is very difficult to complete on an accurate basis. It calls for "crystal ball gazing" and some form of future actuarial analysis. However, these projected balance sheets are absolutely essential for the practitioner in his or her efforts in obtaining post-commencement finance,[831] and accurate projections can only be made if the information given has been empirically tested, checked and verified. If after the checking process, the information is patently incorrect, then the restructured balance sheet can obviously only be prepared on the strength of restructured or corrected information.[832] Braadvedt states:

> A further benefit of the practitioner doing this is to make his position and that of the company transparent and upfront to the affected persons. It would also be sensible to state in the business rescue plan that interim reports on how the additional expenditure is being allocated should be circulated to affected parties. There are the normal participatory mechanisms in the Act but the writer believes that incurring expenses in respect of experts required to determine the actual situation is so fundamentally important that all affected parties must be kept abreast of what is happening.[833]

It is further submitted that one of the critical elements of the business rescue plan is to carefully deal with the allocation of existing funding and post-commencement funding in the implementation of the plan. If creditors are presented with a detailed breakdown of

831. Section 135 of the 2008 Companies Act.
832. Braatvedt "Costs of Business Rescue" (October 2014) *Without Prejudice* 23–24.
833. Ibid 24.

where such monies are to be allocated, they will feel far more comfortable and in all likelihood will support and vote in the plan.

A proposed business rescue plan must conclude with a certificate by the practitioner stating that any actual information provided appears to be accurate, complete and up-to-date, and that all projections provided are estimates made in good faith on the basis of factual information and assumptions as set out in the statement of income and expenses.[834] Any practitioner signing off such a certificate must ensure that he or she has, to the best of his or her ability, verified the information set out in the plan. If there are errors or misstatements in the plan which ultimately result in the plan failing in its implementation this could result in the company being placed into liquidation. Once the company is in the hands of the duly appointed liquidator, it is possible that the liquidator (a person other than the business rescue practitioner) and creditors (in the liquidation) could institute proceedings against the business rescue practitioner for losses or damages caused by an inaccurate plan and a certificate which should never have been issued by the practitioner.[835]

In terms of section 150(5), the plan must be published within 25 business days after the date on which the practitioner is appointed, or within such longer time period as may be allowed by the court, on application by the company or the holders of a majority of the creditors' voting interest.[836] In practice, plans are generally not being published within the 25-day period, and creditors are granting extensions to the practitioner to publish plans well after the 25-day period deadline.[837]

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834. Section 150(4)(a), (b) and section 150(2)(c)(iv) of the 2008 Companies Act. See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-105 at para 18.16.22.4.

835. Section 140(3)(c)(i) and (ii) of the 2008 Companies Act should however be noted:

> …the practitioner … –
>
> (i) is not liable for any act or omission in good faith in the course of the exercise of the powers and performance of the functions of practitioner; but
>
> (ii) may be held liable in accordance with any relevant law for the consequences of any act or omission amounting to gross negligence in the exercise of the powers and performance of the functions of practitioner.

836. Section 150(5) of the 2008 Companies Act. See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-105–18-106 at para 18.16.3.

837. In *DH Brothers Industries (Pty) Ltd v Gribnitz NO and Others* 2014 (1) ALL SA 173, Gorven J ruled that the failure to publish a plan within the given or extended period resulted in the termination of the business rescue proceedings. Gorven J's decision was not followed in Shoprite *Checkers (Pty) Limited v Berryplum Retailers CC and Others* (47327/2014) [2015] ZAGPPHC 255 (11 March 2015). Judge Tuchten concluded that the failure by the company under business rescue to publish a proposed business rescue plan within the 25 business day period prescribed by section 150(5) does not of itself put an end to the business rescue process. The court's finding in *DH Brothers Industries (Pty) Ltd v Gribnitz NO and Others* 2014 (1) SA 103 (KZP) held that once the 25 day period had elapsed without consent of creditors or an extension allowed by the court upon an application as interpreted by section 150(5) of the 2008 Companies Act, the business rescue proceedings lapsed by operation of law. Judge Tuchten disagreed with the dictum of *DH Brothers*. No provision is

In *Absa Bank Ltd v Golden Dividend 339 (Pty) Ltd*,[838] the practitioner had, with the consent of the holder of a majority of the creditor's voting interests, published a revised plan which he put to the creditors for approval at a resumed meeting of creditors. The bank contended that the plan was unlawful and invalid because it was not published within the time period stipulated in section 150(2), (4) or (5) of the 2008 Companies Act. They contended that the section 129 resolution be set aside, and the company placed into liquidation. The court held that compliance with section 150(2) had occurred due to the majority creditor having agreed to the extension of time within which to publish the plan and thus "publication" had been validly extended.[839]

In practice, many plans are now incorporating dispute resolution provisions within the plan itself. In the event that there are any disputes which might arise from the terms of the plan, such disputes would be sent to a dispute resolution forum for resolution on an expedited basis. Such dispute resolution mechanisms are useful as they can prevent business rescue plans from failing (particularly where there are tight time lines on implementation). Issues such as disputes on creditors' claims, the manner in which the practitioner deals with voting rights, decisions at meetings, and issues surrounding the implementation of the plan could fall to be determined by way of a dispute resolution process. Whether one can bind creditors and affected persons to such a dispute resolution procedure remains a moot point. Of course, it is submitted that such a provision could not prevent a complainant from instituting court proceedings as contemplated by the provisions of Chapter 6.

Section 151(1) states that once a business rescue plan has been published and within 10 business days after such date of publication, the practitioner must convene and preside over a meeting of creditors and any other holders of a voting interest, called for the purpose of considering the plan.[840] Notice of such meeting[841] must be given five business days before the date of the meeting.[842]

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made in section 132(2) for the termination of the business rescue process as a result of failing to file a plan within the time periods prescribed by section 150(5). See Jordaan "Business Rescue Plan not published timeously" (July 2015) *De Rebus* 60.

838. *Absa Bank Ltd v Golden Dividend 339 (Pty) Ltd* 2015 (5) SA 272 GP.

839. Ibid 286.

840. Section 151(1) of the 2008 Companies Act. See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-106–18-108 at para 18.17.1–18.17.2.

841. The notice must include an agenda, date, time and place of meeting and a summary of rights of affected persons, thus enabling such affected persons to determine their right to participate in and vote at the meeting.

842. Section 151(2) of the 2008 Companies Act.

In terms of section 151(3), the "section 151" meeting may be adjourned from time to time as necessary or expedient, until a decision regarding the company's future has been taken in accordance with section 152 (voting on the plan) and section 153 (the failure of the plan). Some practitioners are taking advantage of this section in that they continually postpone the section 151 meeting without any resolution on the plan or putting the plan to the vote. The words "as is necessary or expedient" are fairly vague and thus any practitioner can use the section to his or her advantage, stretching out the time period for a final determination of the future of the company and ensuring that his or her hourly charge rate continues to be applicable in the intervening period.

In such event, creditors (as affected persons) would be entitled to launch proceedings to force the practitioner to place the plan before creditors in terms of section 153 or, alternatively, if there is little prospect of rescuing the company, requesting the court to direct the practitioner to place the company into liquidation.[843]

South African business rescue plans have included certain of the international principles for business rescue plans.[844] The Act contemplates two kinds of plans –

- a turnaround plan;[845] or
- a plan delivering a better return (controlled wind-down proposal).[846]

Pretorius and Rosslyn-Smith distinguish between two different (distinct) types of plans that can be proposed by practitioners to affected persons. A plan can be aimed solely at achieving a better return, more accurately referred to as a "controlled wind-down proposal". This process, which is quite controversial, has as its objective the achievement of a higher return for the creditors than would result from a liquidation.[847] This type of plan, which can be seen as nothing more than a disposal of assets, is often referred to as a

843. Section 132(2)(a) of the 2008 Companies Act as read with section 141(2)(i), (ii).

844. See Rosslyn-Smith and Pretorius "Stakeholder Expectations of the Business Rescue Plan from a South African Perspective" (2015) 146 *SAJESBM* 7–9.

845. See section 128(1)(b)(iii) of the 2008 Companies Act: "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 maximises the likelihood of the company continuing in existence on a solvent basis."

846. Section 128(1)(b)(iii) of the 2008 Companies Act: "… or if it is not possible for the company so to continue in existence, results in a better return for the company's shareholders than would result from the immediate liquidation of the company".

847. Rosslyn-Smith and Pretorius "Stakeholder Expectations of the Business Rescue Plan from a South African Perspective" (2015) 146 *SAJESBM* 16. On the challenges and expectations in respect of the two alternative plans and compliance with the aforementioned international principles, see pp. 17–31.

"disguised" liquidation. The plan offers no opportunity for salvaging the company as a going concern with no publication of a feasibility analysis for the company unless to substantiate the view that any turnaround plan would be an unviable option.[848] An alternative plan, and one more supportive of the business rescue objective, is that of a turnaround plan where the aim is to save the entity as a whole and where various strategies would be deployed to achieve such a result. Clearly, the second of the two options is significantly more complex and difficult to achieve.[849]

Other than what is set out in section 150(2), there is no other guideline or satisfactory framework that exists to assist in the business rescue plan's formulation. Business rescue practitioners have been left to draft their own "versions" of a plan with little guidance from the existing legislation.[850]

It is submitted that what is important is that business rescue plans must be drafted in a manner which enables creditors to make informed decisions on the future of the company, subsequent to its discharge from business rescue. The detail and extent of the suggested restructuring plan should not leave the reader in any doubt as to the manner and mechanism that will be adopted to rescue the company from its position of financial distress and further allow it to continue to trade on a solvent basis into the future.[851]

Preliminary analysis of business rescue plans in South Africa suggests that a significant contrast exists between international reorganisational plans and those being published in terms of Chapter 6.[852] Local criticism of the content of plans reveals particular shortcomings when compared to the key principles that govern rescue plans worldwide. International regimes indicate that the rescue plans should adhere to a broader, more

848. Ibid.

849. Ibid.

850. See comments by Rosslyn-Smith in *Critical Elements for Decision Making in Business Rescue Plan* (MCom dissertation, 2014).

851. See comments by Snyman-Van Deventer and Jacobs "Corporate Rescue: The South African Business Plan Examined" (2014) *Nottingham Insolvency and Business Law E-Journal* 6 103–115. The authors suggest that the legislation should be amended to set out what is required in the plan. The 2008 Companies Act should stipulate only the bare minimum level of information that will be required to include in the business rescue plan. These prescripts should mostly focus on the objectives of the plan and how they are proposed to be achieved. Creditors need to be provided with sufficient information in order to make decisions in the plan – see 115.

852. For the international benchmark set for rescue plans, see Chapter 5, para 5.5.6.

intensive set of expectations that those explicitly provided for by the 2008 Companies Act.[853]

Criticism includes the conclusion that Chapter 6 falls significantly short of addressing the key international principles associated with business rescue plans. Sections 150 to 154 do not include elements of turnaround strategy, cash flow projections and make no use of any mechanisms or tests to ensure transparency, fairness or feasibility.[854]

It is further submitted that not unlike plans submitted in foreign jurisdictions, section 150 sets out fairly detailed parameters of what should be included into a business rescue plan submitted in terms of Chapter 6 of the 2008 Companies Act. Although, as stated above, there has been some criticism on the content of plans, in practice, detailed and competent plans are being submitted and are being voted on by creditors (and shareholders).

It is clear that much thought has gone into the content of section 150 by the legislators.[855] If the expectations and content are carefully set out in a duly submitted plan, it is submitted that there is no reason for such plans not being clearly understood and thus being able to be voted on at the section 151 meeting.

7.8.1 CONSIDERATION OF AND VOTING ON THE PLAN

At the section 152 meeting, the plan would be considered and dealt with on the basis set out in section 152 of the 2008 Companies Act. Again, this is a most critical and important phase of the business rescue process.

In terms of section 152(1), the following is required:

(1) At a meeting convened in terms of section 151, the practitioner must –

853. Pretorius and Rosslyn-Smith "Expectations of a Business Rescue Plan: International Directives for Chapter 6 Implementation" (2014) 2 *SABR* 108. This article focuses on the expectations of a plan set by international counterparts in corporate rescue regimes. The study is useful as it establishes a set of principles that can be used to develop local expectations of business rescue plans. The aim is to ultimately construct a foundation for an effective and objective tool to interpret the contents of business rescue plans in South Africa. See also p. 110. See further analysis of the expectations required for business rescue regimes in international jurisdictions in Rosslyn-Smith *Critical Elements for Decision Making in Business Rescue Plans* (MCom dissertation, 2014). The author researched a number of international jurisdictions and reference is made to international principles which offer legitimate direction for reorganisational plans. These principles are analysed to ascertain if these international principles are applicable to the South African context and to what extent they are applied in Chapter 6.

854. Ibid 133.

855. Note that section 155(3)(a)–(c) of the 2008 Companies Act almost mirrors that set out in section 150(2)(a)–(c) in respect of what should be contained in a section 155 proposal.

(a) introduce the proposed business rescue plan for consideration by the creditors and, if applicable, by the shareholders;

(b) inform the meeting whether the practitioner continues to believe that there is a reasonable prospect of the company being rescued;

(c) provide an opportunity for the employees' representatives to address the meeting;

(d) invite discussion, and entertain and conduct a vote, on any motions to –

   (i) amend the proposed plan, in any manner moved and seconded by holders of creditors' voting interests, and satisfactory to the practitioner; or

   (ii) direct the practitioner to adjourn the meeting in order to revise the plan for further consideration; and

(e) call for a vote for preliminary approval of the proposed plan, as amended if applicable, unless the meeting has first been adjourned in accordance with paragraph (d)(ii).

In practice, many plans, after discussion at the section 151 meeting, would be postponed or adjourned for the purposes of amending the plan. A decision to amend the plan must be moved by a creditor (holding a voting interest) and seconded by another creditor (similarly holding a voting interest).[856] The decision to amend must be consented to by the practitioner. The amendment can then occur at the meeting and the plan then voted on in terms of section 152(1)(e). Alternatively, if there is a motion moved to direct the practitioner to adjourn the meeting in order to revise the plan for further consideration, the practitioner must do so. If there is disagreement on these motions, then the practitioner must put such motions to the vote. Creditors would vote in terms of section 145(4).

In terms of section 145(4), voting would be by creditors (secured or unsecured) with a voting interest equal to the value of the amount owed to that creditor by the company (concurrent creditors who had agreed to be subordinated would vote at liquidation value). There is some debate if this is so. Section 147(3) states that, other than the meeting held in terms of section 151, all decisions of creditors must be voted on by way of a simple

856. Since a creditor can only have a voting interest, it is unclear who the other holders of voting interests could be. Shareholders whose rights will be affected are referred to as having "voting rights". The common view is that it must be a reference to shareholders with voting rights, because only one meeting is convened for creditors and shareholders with voting rights, where creditors get the first opportunity to vote, followed by shareholders who have voting rights. See Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 2 (2010) *TSAR* 693.

majority. It is unclear if a motion to adjourn or postpone the section 151 meeting should be voted on by way of a simple majority or in terms of section 152(2), i.e. by way of 75 per cent creditors' voting interest, with at least 50 per cent being that of independent creditors.[857]

Does a simple majority of votes suffice in order to adopt a motion as alluded to in the subsection quoted above or is something more than just a simple majority vote is required?

One argument is that the need to adjourn a meeting for the purposes of amendment of the proposed plan must envisage a vote by *all* of the parties voting at the meeting, i.e. a simple majority (and not the 75 per cent required by section 152(2)(a) – see below). At a section 151 meeting, all the votes should be taken into account for the purpose of an adjournment as the plan will ultimately and materially affect *all* creditors.

The complicating factor in this interpretation is the wording of section 147(3). Certain interpretations go the other way:

> Subsection (1)(d) – It is not clear from this provision as to what majority is required in order to carry any motion proposed in terms thereof. In section 147(3) the rule of a motion (at a meeting of creditors) being carried by a simple majority of the independent creditors' citing interests is specifically excluded at a meeting held in terms of s 151, and so it would appear that the same majority required by s 152(2) would apply also to a vote conducted in terms of this subsection.[858]

Section 152(2) deals with the voting on a business rescue plan, and states as follows:

> (2) In a vote called in terms of subsection (1)(e), the proposed business rescue plan will be approved on a preliminary basis if –
>
> (a) it was supported by the holders of more than 75 percent of the creditors' voting interests that were voted; and
>
> (b) the votes in support of the proposed plan included at least 50 percent of the independent creditors' voting interests, if any, that were voted.[859]

857. See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-109–18-112 at para 18.18.3.

858. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 525. Also see Rushworth "A Critical Analysis of the Business Rescue Regime in the Companies Act 71 of 2008" (2010) *Acta Juridica* 403–405.

859. It should be noted that classes of creditors are not ranked when it comes to voting in a business rescue plan. Creditors vote in accordance with the rand value of their claims. Secured creditors vote with all concurrent creditors on the full value of their claims.

Clearly the voting process contemplates two distinct phases; firstly the vote of the general body of creditors at value (75 per cent); and the second the vote of the independent creditors in value (50 per cent). There has been debate as to what is meant by "the votes in support of the proposed plan must include at least 50% of the independent creditors' voting interest if any, that were voted". Is the requirement merely that out of 75 per cent of the votes cast in favour of the plan, 50 per cent of those voting interests must include the votes of independent creditors? The alternative interpretation is that out of the 75 per cent who voted in favour of the plan, a plan will have been adopted if at least 50 per cent of the independent creditors' interests were voted.[860]

The interpretative difficulty arises from the words "the votes in support of the proposed plan included…". If one looks at the purpose of the provision in the context of the business rescue regime, the requirement is that there must be a 50 per cent independent aspect of the vote. The requirement is clearly to prevent a cram-down on the will of non-independent creditors in relation to a plan that benefits them unduly. Thus, the provision gives the majority of (voting) independent creditors the final say, whatever the composite 75 per cent majority may think about the content of the plan.[861]

Conversely, proponents of the first interpretation would argue that a minimum level of protection is required for independent creditors, i.e. that where the majority of total voting creditors can overwhelm the independent creditors, such a plan, although rationally put to the vote, could never get off the ground. If the latter result was intended, the legislature chose a very strange way to achieve it, because the section indeed requires the plan to be put to the vote of creditors for approval.

It is submitted that section 152(2) could not have intended to have the second interpretation. Thus –

860. That is, if R100 represents the independent creditors of the company in business rescue, section 152(2) of the 2008 Companies Act only requires R50 worth of independent creditors to be voted. Put differently, if the independent creditors of a company represent 20 per cent of the creditors (i.e. they can never represent 50 per cent or more), only 10 per cent would need to cast their votes in favour of the adoption of the plan in order for it to be approved. In the above example, one can see how the second interpretation of the provision creates an absurdity. In a company where the voting independent creditors are not at least 37,5 per cent of the total voted voting interests, no plan can be passed. Conversely, the same plan would be passed where the independent voting creditors do constitute 37,5 per cent of the total voted voting interests.

861. It has been argued that the additional requirement that 50 per cent in value of independent creditors must vote in favour of the plan is unnecessary. There is no requirement that they must at least hold a specified minimum percentage of total claims, and the provision could result in a small number of creditors, holding an even smaller percentage of the claims against the company, being able to undermine the rescue attempt. It has been suggested that the requirement be scrapped and that section 152(2)(a) of the 2008 Companies Act be amended to require the approval of only a simple majority in value of creditors based on the value of the unsecured portion of their claim. See Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 2 (2014) 4 *TSAR* 695.

- More than 75 per cent of all creditors; voting interests (limited to those that are actually voted) must be voted in favour of the plan; and

- At least 50 per cent of all independent creditors' voting interests (limited to those that are actually voted) must be voted in favour of the plan; and

- It is not necessary for 37,5 per cent (i.e. 50 per cent of the 75 per cent) of all creditors' voting interests that are voted in favour of the plan to be cast by independent creditors.

Section 152(2) requires that the votes in support of a plan refer only to the creditors voting interests that were actually voted. Voting interests of creditors who are not present, or who do not vote, are not taken into consideration in determining whether or not the plan has been approved on a preliminary basis. It is not clear whether the exercise of a creditor's voting interest under this section may be exercised by proxy through a representative.[862]

The plan would only be approved on a preliminary basis at this stage. If it is not approved on a preliminary basis the plan is rejected and would be considered further in terms of section 153.[863]

In terms of section 152(3)(b), if the terms of the plan do not alter the rights of the holders of any class of the company's securities (shareholders), approval of that plan on a preliminary basis would also constitute the final adoption of the plan, but subject to the conditions on which that plan is contingent.[864] The plan would still have to be implemented in accordance with its terms. The plan would have to indicate the conditions that must be satisfied, if any, for the plan to come into operation and be fully implemented.[865] The plan would also set out the circumstances in which the plan would end.[866] The company's business rescue proceedings should terminate within three months after the commencement

862. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 526.

863. Section 152(3)(a) of the 2008 Companies Act. On voting in a business rescue see Levenstein "Where the Value Breaks: Voting Procedures in South African Business Rescue Proceedings" (2013) *INSOL World* available at http://www.werksmans.com/wp-content/uploads/2013/04/Voting-Procedures-in-SA-Business-Rescue-Proceedings.pdf 36–37. On voting rights in a business rescue plan as compared to that in a Chapter 11 process, see Wessels and De Weijs *International Contributions to the Reform of Chapter 11 U.S. Bankruptcy Code* (2015) 268–276.

864. Section 152(3)(b) of the 2008 Companies Act.

865. Section 150(2)(c)(i)(aa) and (bb) of the 2008 Companies Act.

866. Section 150(2)(c)(iii) of the 2008 Companies Act.

of such proceedings or such longer time period as the court, on application by the practitioner, may allow.[867]

It has been argued that the proviso in section 152(3)(b) that the approval be subject to any conditions on which the plan is contingent is nonsensical. The Act does not provide for conditional approval by the creditors and if this is a reference to the conditions that must be satisfied before the plan may come into operation, these conditions are part of the plan itself and thus are also subject to the approval.[868] It is only after the plan has been approved that these conditions, if any, must be fulfilled. Therefore it is not the approval, but the implementation of the approved plan that is contingent on fulfilment of the conditions.[869]

In practice, three months is too short a period. Practitioners would have to apply to Court for an extension whether or not the business rescue proceedings commenced by way of a section 129 resolution or by way of a court application in terms of section 134 of the 2008 Companies Act. The practitioner must submit status reports on the implementation of the approved plan (and must update such reports on a monthly basis), to the court if the proceedings were commenced in terms of section 131, and to the CIPC if the process was commenced by way of a section 129 resolution.[870]

In terms of section 152(3)(c), if the plan does alter the rights of any class of holders of the company's securities:

(i) the practitioner must immediately hold a meeting of holders of the class, or classes of securities who rights would be altered by the plan, and call for a vote by them to approve the adoption of the proposed business rescue plan; and

(ii) if, in a vote contemplated in subparagraph (i), a majority of the voting rights that were exercised –

(aa) support adoption of the plan, it will have been finally adopted, subject only to satisfaction of any conditions on which it is contingent; or

(bb) oppose adoption of the plan, the plan is rejected, and may be considered further only in terms of section 153.

867. Section 132(3) of the 2008 Companies Act.

868. In terms of section 150(2)(c)(i) of the 2008 Companies Act.

869. See Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 2 (2014) 4 *TSAR* 695.

870. Section 132(3)(a) and (b) of the 2008 Companies Act; see Form CoR125.

Thus, if the plan does alter the rights of a "class of holders of the company's security", the plan must then be put to the vote in such class. A vote would be carried on a simple majority. What constitutes a "class" is open to debate. If, for example, the plan suggests a buy-out of the shareholding in the company, then clearly that would affect the "right/s" of such shareholder and the plan must then be put to the vote of the shareholders in that class. If the plan suggests a "dilution" of a shareholding, would that constitute an effect on a right of a shareholder? Section 152(3)(c)(i) was considered by senior counsel as follows:

> In our view, the sub-section contemplates a change or modification to the rights attaching to the relevant security or class of security, to be effected by the proposed plan. This is the clear import of the words used. We agree that section 137(1) which refers to the alteration to the "classification or status" of issued security supports that view.
>
> We do not consider that a "rights issue" proposed as part of a plan, would have the effect of altering the rights attaching to securities.[871]

To date, we have no clarity as to what is meant by "shareholders rights being altered" by a business rescue plan. It is submitted that the extent of the rights of shareholders being affected by proposals suggested in a plan, will have to be determined on a case by case basis. The uncertainty of such a position leaves practitioners in a difficult position, as they remain unsure as to whether they are required to call for a shareholders vote on the plan as envisaged by section 152(3)(b) and 152(3)(c).

The binding nature of the plan is dealt with in section 152(4)as follows:

> A business rescue plan that has been adopted is binding on the company, and on each of the creditors of the company and every holder of the company's securities, whether or not such a person –
>
> (a) was present at the meeting;
>
> (b) voted in favour of adoption of the plan; or
>
> (c) in the case of creditors, had proven their claims against the company.

This is where the "cramdown" (as referred to in international jurisdictions) occurs. Once adopted, the plan is "crammed down" on the company itself and all creditors and the

871. Opinion of Slomowitz SC and Blou SC (2 September 2011). Counsel were of the view that the rights issue does nothing to change or modify the status or classification of any rights which continue to exist precisely in the form that they did prior to the proposed plan. While it is correct that a rights issue, if a relevant shareholder does not follow its rights, would result in a dilution, counsel did not believe that that is a result contemplated by the word "alter". Of course, the relevant shareholder is at liberty to follow its rights.

holders of the company's securities (including shareholders). This would include all creditors and holders of company securities who were not present at the meeting, or those that were present at the meeting but voted against the adoption of the plan. It also binds all creditors who did not prove claims against the company.

Although section 152(4) provides that every creditor will be bound by the adopted business rescue plan, it is unclear as to what extent the rights of secured creditors may be altered in a plan. It is difficult to believe that a rescue plan could reduce the amount of a secured claim or place any restriction on the enforcement of this security without the specific consent of the relevant creditor. The question then has to be asked whether secured creditors have full voting powers on a plan to which they are not bound, as this would be patently unfair. If, on the other hand, secured creditors are finally bound to an approved plan, there would be no reason for them to vote in favour of a plan that postpones payment of their secured claims or converts these claims into equity or releases the company from payment of the debt or part of it.[872]

Implementation of the plan, once approved, is dealt with in terms of section 152(5):

> The company, under the direction of the practitioner, must take all necessary steps to –
>
> (a) attempt to satisfy any conditions on which the business rescue plan is contingent; and
>
> (b) implement the plan as adopted.

Section 152(6) states further:

> To the extent necessary to implement an adopted business rescue plan –
>
> (a) the practitioner may, in accordance with that plan, determine the consideration for, and issue, any authorised securities of the company, despite section 38 or 40 to the contrary; and
>
> (b) if the business rescue plan was approved by the shareholders of the company, as contemplated in subsection (3)(c), the practitioner may amend the company's Memorandum of Incorporation to authorise, and determine the

872. The company's major creditors will in most cases hold security for their claims and will therefore almost always be in a position to prevent approval of the rescue plan. See Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 2 (2014) 4 *TSAR* 694. It is suggested that the relevant provisions should be amended, preferably to exclude the votes of creditors on any secured portions of their claims, or to make it clear to what extent secured creditors are bound by the plan. See also p. 695.

> preferences, rights, limitations and other terms of, any securities that are not otherwise authorised, but are contemplated to be issued in terms of the business rescue plan, despite any provision of section 16, 36 or 37 to the contrary.

In terms of section 152(7):

> Except to the extent that an approved business rescue plan provides otherwise, a pre-emptive right of any shareholder of the company, as contemplated in section 39, does not apply with respect to an issue of shares by the company in terms of the business rescue plan.

Thus, all existing pre-emptive rights (sections 38, 39 and 40) would not be applicable.

Substantial implementation of the business rescue plan is dealt with in section 152(8) as follows:

> When the business rescue plan has been substantially implemented, the practitioner must file a notice of the substantial implementation of the business rescue plan.

There is no definition of substantial implementation. Once the practitioner has implemented the plan within the terms and conditions set out in the plan, it is submitted that the plan would have been "substantially implemented". A notice of "substantial implementation" would then be prepared by the practitioner and filed with the CIPC.

Once a notice of substantial implementation has been filed by the practitioner with the CIPC,[873] the company would exit from the business rescue proceedings and continue trading on a solvent basis. In terms of regulation 6, the practitioner must notify all stakeholders and affected persons, by delivery of a copy of the notice of substantial implementation, that the company has exited from its business rescue proceedings (the first part of the definition set out in section 128(1)(b)(iii)).

If the plan results in a "controlled liquidation" scenario, that is, selling off the assets or business of the company in order to deliver a better return for the company's creditors or shareholders than would result from the liquidation of the company (second part of the definition), then the three-month period would, in principle, be far easier to achieve. However, for example, in a property-owning company, sales of units and/or properties

873. See Form CoR125.3: Notice of substantial implementation of a business rescue plan.

might require extensive marketing and it is possible that the three-month period would need to be prolonged.[874]

Voting of preferent, concurrent and contingent creditors on a business rescue plan has been debated in our courts.

On 31 October 2012, Fourie J, in the Western Cape High Court, handed down a seminal judgment in the matter of *Commissioner of South African Revenue Services v Beginsel NO and Others*,[875] which dealt with, among other things, the manner in which concurrent creditors will be treated in business rescue proceedings.

Judge Fourie, in his judgment, dealt with the treatment of SARS and concurrent creditors in business rescue proceedings and the manner in which such creditors would vote on a business rescue plan; the validity of business rescue plans for their failure to comply with certain provisions in the 2008 Companies Act and the sustainability of the company subsequent to the commencement of business rescue proceedings.

Section 145(4)(a) and (b) of the 2008 Companies Act deal with the voting interests attributed to creditors for purposes of voting on a proposed business rescue plan. In this matter, SARS averred that, on its interpretation of these provisions, it was of the view that the decision taken to adopt the business rescue plan was unlawful and invalid. While SARS agreed that the 2008 Companies Act did not oblige a business rescue practitioner to confer a preference on SARS over unsecured creditors, it also averred that the 2008 Companies Act did not oblige a practitioner to treat SARS as a concurrent creditor. In the circumstances, SARS held that it is in the discretion of the practitioner (by virtue of section 150(2)(b)(v)) to determine the order of preference for the payment of creditors subject, of course, to the order of preference conferred by section 135 of the 2008 Companies Act.

SARS further argued that all preferent creditors, as contemplated by the Insolvency Act 24 of 1936 (Insolvency Act), should be categorised as unsecured creditors in terms of section 145(4)(a) of the 2008 Companies Act and should therefore be entitled to vote at the value of their claim, whilst all other concurrent creditors (as envisaged by the Insolvency

874. An example is *Cape Point Vineyards (Pty) Ltd v Pinnacle Point Group Ltd and Another (Advantage Projects Managers (Pty) Ltd Intervening)* 2011 (5) SA 600 (WCC).

875. *Commissioner of South African Revenue Services v Beginsel NO and Others* 2013 (1) SA 307 (WCC).

Act) should be categorised as concurrent creditors who would ordinarily be subordinated in a liquidation, as envisaged by section 145(4)(b) of the 2008 Companies Act, and therefore entitled to vote at their liquidation value (generally a negligible or zero value). If this were the case, SARS would have had a vote at the value of its claim and it would have carried the vote.

The court held that the 2008 Companies Act does not create statutory preferences as set out in the Insolvency Act and that if the legislature had intended to prefer SARS above other creditors in business rescue proceedings, it would have explicitly stated so. Accordingly, the court held that SARS is not a preferent creditor in business rescue as it would be in a liquidation.

To support its contention, the court stated that the 2008 Companies Act differentiates between secured and unsecured creditors in section 145(4)(a) with concurrent creditors forming part of the latter group. The court then went further to state that concurrent creditors can further be divided into "preferent" or "concurrent" unsecured creditors. The court held that the term "preferent creditor" generally refers to a creditor whose claim is unsecured but which ranks above the claims of concurrent creditors (i.e. unsecured preferent creditors). The court held that in assigning the phrase its ordinary meaning, it could not interpret the word "unsecured creditor" to refer only to "preferent unsecured creditors". Accordingly, the court held that, in business rescue proceedings, SARS is to be treated like any other concurrent creditor of the company.

The court held that the reference to a "concurrent creditor" in section 145(4)(b) of the 2008 Companies Act is not a reference to all concurrent creditors but rather a reference to those concurrent creditors who have subordinated their claims in a liquidation pursuant to a formal agreement to that effect.[876]

Accordingly, all concurrent creditors vote at the value of their claim and only those whose claims have been formally subordinated in a liquidation, by virtue of an agreement to that effect, will vote at liquidation value. Accordingly, SARS, together with all other concurrent creditors, whose claims had not been subordinated by agreement on liquidation, would be entitled to vote at value.

876. See discussion in Chapter 7, para 7.6.1 as to the meaning of a "concurrent creditor" subordinated in a liquidation.

SARS further argued that the plan was invalid and unlawful on the basis that it failed to comply with specific provisions in section 150 of the 2008 Companies Act. SARS argued that the plan failed to comply with the 2008 Companies Act; its concerns related to sections 150(2)(a)(ii) (list of creditors of the company and a statement as to which are secured, statutory preferent and concurrent in terms of insolvency law), 150(2)(c)(iv)(aa) and (bb) (a projected balance sheet and statement of income and expenses) and 150(2)(b)(vi) (benefits of the business rescue as opposed to a liquidation).

The thrust of the court's ruling was that section 150(2) of the 2008 Companies Act prescribes the content of business rescue plans in general terms and that the legislature could never have precisely described the content for a business rescue plan as each will differ from case to case. Accordingly, the court held that substantial compliance with the provisions of section 150 would suffice. This would mean that where sufficient information, along the lines of that prescribed by section 150(2) of the 2008 Companies Act, had been provided to enable interested parties to make an informed decision on the plan, there would have been substantial compliance with section 150 of the 2008 Companies Act. The court held that there was no merit in the submissions made by SARS in support of their contention that the plan should fail as a result of its failure to comply with the provisions of section 150 of the 2008 Companies Act.

The Act sets out when a practitioner is to make application to court to discontinue the business rescue process and place the company into liquidation. This would occur when there is no reasonable prospect of rescuing the company.

SARS argued that the business rescue practitioner is obliged, pursuant to section 141(2)(a)(i) and (ii) of the 2008 Companies Act, to apply to court for an order discontinuing the business rescue process and to place the company in liquidation if he or she believes, at any point in the business rescue process, that the company does not have a reasonable prospect of being rescued.

The court considered what is meant by the phrase "rescuing the company". It confirmed that rescuing the company means achieving the goals envisaged by the business rescue process, namely the continuation of the company on a solvent basis or, failing this, the achievement of a better return for the creditors and shareholders of the company than would result from an immediate liquidation of the company.

Both parties agreed that a "better return" would mean more money for distribution to the creditors. Whilst agreeing on the test to be applied, the parties differed in their application of the test to the facts. SARS felt that a liquidation of the company would achieve a better return for the creditors whilst the business rescue practitioners were of the view that a liquidation of the company would in effect give rise to a duplication of costs which had already been incurred in the business rescue process and that the implementation of the business rescue plan would yield a better return for the creditors than would be the case in a liquidation.

The court held that in deciding the matter it had to adopt a practical, common-sense approach. It stated that the court that granted the order for business rescue at the outset must have viewed the company as a viable concern; that the practitioners had taken control of the business and had managed to reduce the losses of the company and that the plan was already in an advanced stage. Accordingly, the court held that nothing would be achieved if the business rescue was converted into a liquidation and that business rescue proceedings would result in a better return for the creditors than would occur in a liquidation.

This judgment clarifies, once and for all, the very important aspect of the manner in which concurrent creditors will vote in business rescue proceedings. Concurrent creditors (including SARS) stand alongside secured creditors and have the opportunity to have their say, namely to vote at value, either for the approval of the plan or for the rejection thereof, the latter probably resulting in the liquidation of the company.[877]

As a result, all creditors in companies facing business rescue will have an equal say about the company's future and the prospect of such company trading its way out of its financial distress and to a position of solvency. What is of concern is that SARS might very well prefer for debtor companies to go into liquidation, thus elevating them to preferent creditors in a liquidation. If SARS adopted this position it would be very difficult for them to justify such an approach, as politically SARS, as part of government, would have to be seen to "toe the line" and follow the noble objectives of section 7(k).[878]

877. Also see Blom "Demoting SARS" (September 2013) *Without Prejudice* 12–13.

878. Section 7(k) confirms that the objectives of the 2008 Companies Act are 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.

In South Africa, secured creditors do not have any controlling vote on a plan, although they participate in the business rescue process with all creditors.[879] The rights of secured creditors are protected in a business rescue in that property over which a security interest is held cannot be disposed of without the prior consent of the security holder, unless the proceeds of the disposal would be sufficient to fully discharge the indebtedness protected by such security holder's security or the title interest.[880]

The South African business rescue process is both "debtor" and "creditor" friendly. Chapter 6 is debtor friendly in the sense that while directors may commence with business rescue voluntarily as well as appoint the practitioner, creditors will in practice find it difficult to overturn these actions, as well as to apply for compulsory business rescue and their own choice of practitioner due to information asymmetry and the costs of court action.[881]

Creditors are the final decision makers in adopting the business rescue plan (although if the business rescue plan entails a change in securities, shareholders play a role in decision making too). Moreover, banks not in agreement with business rescue have the power to cancel credit facilities.[882]

It is submitted that the ranking of creditors in a business rescue, and thereafter in a liquidation (if the business rescue fails) remains a controversial topic and one which concerns secured creditors.[883] The ranking of post-commencement financiers above secured creditors has caused financial institutions to take careful stock of their lending criteria, and particularly where the provision of post-commencement finance impinges on secured creditors' ability to claw back on their security in a business rescue.[884]

It is submitted that creditors, if faced with a credible plan, will generally vote in favour of such plan. Most practitioners engage with creditors on the plan well prior to the date of the

879. Section 145(4)(a) of the 2008 Companies Act.

880. Section 134(3) of the 2008 Companies Act.

881. Van der Walt "A Turnaround Practitioner's View of New Business Rescue Legislation" in Harvey (ed) *Turnaround Management and Corporate Renewal: A South African Perspective* (2011) 145.

882. Ibid.

883. See section 135(1)–(3) of the 2008 Companies Act.

884. For a full analysis of the ranking of creditors in a business rescue, see Chapter 7, para 7.7.

section 151 meeting. Practitioners, for obvious reasons, would prefer the "buy-in" of creditors well prior to the date of voting.

The South African rescue process is robust and practical. It fits well with approval processes applicable in foreign jurisdictions.[885] The procedures that apply, if the plan is not approved, have alternatives for a revision of the plan and cram-down on dissenting creditors.

7.8.2 FAILURE TO ADOPT THE BUSINESS RESCUE PLAN

Section 153 deals with what happens where a business rescue plan has not been adopted. Various steps can be taken by the practitioner or by affected persons which will determine the final outcome.

Section 153(1)(a) states the following:

> (a) If a business rescue plan has been rejected as contemplated in section 152(3)(a) or (c)(ii)(bb) the practitioner may –
>
> (i) seek a vote of approval from the holders of voting interests to prepare and publish a revised plan; or
>
> (ii) advise the meeting that the company will apply to a Court to set aside the result of the vote by the holders of voting interests or shareholders, as the case may be, on the grounds that it was inappropriate.

In *Advanced Technologies and Engineering Company (Pty) Ltd (in business rescue) v Aeronautique et Technologies Embarquees SAS and 4 Others*,[886] Judge Tuchten had to consider the implication of section 153(1)(a)(ii). As the term "inappropriate" was not defined in Chapter 6 or in the 2008 Companies Act, it remained unclear as to what was meant by the term "inappropriate".[887] The essence of a vote is that it reflects the voter's perception of his own interests. The judge did not believe that the legislature intended that it was necessary for the court to substitute its own view for how the members of the class

885. See Chapter 5, para 5.5.6.

886. *Advanced Technologies and Engineering Company (Pty) Ltd (in business rescue) v Aeronautique et Technologies Embarquees SAS and 4 Others* 2012 JDR 0345 (GNP).

887. See comments by Henochsberg in Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 530.

in question ought to have voted to satisfy the requirements of appropriateness.[888] Section 153(7)[889] did not assist, as it required the court to consider whether it is "reasonable and just" to set the vote aside, not to consider whether the result of the vote was inappropriate.[890] The judge was of the view that the section was ill-drafted and difficult to interpret.[891]

Judge Tuchten was of the view that a determination in terms of section 153(1)(a)(ii) required an analysis up front as to whether the vote under attack was inappropriate. If the jurisdictional fact of "inappropriateness" could not be shown, then the application to set aside the vote must fail.[892] If it could be shown that the vote under attack was "inappropriate", then the court must go on to determine, at the date of the hearing, whether it was reasonable and just to set aside the vote. All relevant evidence as to the discussion on reasonableness must be taken into account and as to what evidence was available on the day that the vote was taken.[893]

In *Copper Sunset Trading 220 (Pty) Ltd t/a Build It Lephalale (in business rescue) v Spar Group Limited and Normandien Farms (Pty) Ltd*,[894] the practitioner had launched a section 153(1)(a)(ii) application pursuant to certain creditors voting against the adoption of the practitioner's revised business rescue plan. Makgoba J held that as the secured creditor would probably be the only creditor standing to gain from a liquidation, this rendered its application to the business rescue process "self-serving and unreasonable". The secured creditors would receive a negligible dividend in a liquidation, and other opposing creditors would receive nothing in the event of a liquidation. Accordingly, the court held that their

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888. *Advanced Technologies and Engineering Company (Pty) Ltd (in business rescue) v Aeronautique et Technologies Embarquees SAS and 4 Others* 2012 JDR 0345 (GNP), para 9.

889. Section 153(7) of the 2008 Companies Act, dealt with below, sets out the grounds upon which a court can set aside a vote on the basis that it is "reasonable and just" to do so.

890. *Advanced Technologies and Engineering Company (Pty) Ltd (in business rescue) v Aeronautique et Technologies Embarquees SAS and 4 Others* 2012 JDR 0345 (GNP), para 10.

891. Ibid para 11.

892. Ibid para 11.

893. Ibid para 11. Also see comments by Henochsberg in Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 530 on the meaning of "inappropriate". Henochsberg deals with the tests for the vote being "inappropriate" or "irrational" and argues that it is uncertain as to what is expected of a "reasonable creditor" or alternatively a "reasonable person", when it casts its vote on the plan. Should such creditor take into account the effect of its vote on other affected persons or not?

894. *Copper Sunset Trading 220 (Pty) Ltd t/a Build It Lephalale (in business rescue) and Spar Group Limited and Normandien Farms (Pty) Ltd* 2014 (6) SA 214 (LP). See comments on this case by Schulze "November 2014 (6) South African Law Reports (pp. 1–312); [2014] 4 All South African Law Reports October no 1 (pp. 1–146); and no 2 (pp. 147–278); and [2013] 3 All South African Law Reports no 2 (p. 135)" in *De Rebus* (January/February 2015) 49; [2014] 4 All South African Law Reports October no 1 (pp. 1 – 146); and no 2 (pp. 147 – 278); and [2013] 3 All South African Law Reports no 2 (p. 135)" in *De Rebus* (January/February 2015) 49.

conduct in rejecting the applicant's revised business rescue plan was inappropriate. The court ordered that the proposed rescue plan had been properly adopted.[895]

In an opinion provided by counsel, the following is stated about the term "inappropriate":

> The meaning of "inappropriate" is, in our view, informed by section 153(7) which sets out the type of order that a Court may make upon an application by the business rescue practitioner or an affected person in an application to set aside the result of the vote on the grounds that it was "inappropriate". The Court has the power if it is satisfied that it is reasonable and just to do so, having had regard to –
>
> 1 the interests represented by the persons who voted against the plan;
>
> 2 the provision if any made in the plan with respect to the interests of those persons; and
>
> 3 a fair and reasonable estimate of the return to those persons if the company were to be liquidated.
>
> These sections are clearly designed to permit the Court to override the rejection of a plan if those responsible for its rejection have acted unreasonably in circumstances where, for example their interests properly catered for in the plan, other interested parties are prejudiced by its rejection, but a position cannot be justified on commercial grounds. That is but one example. In our view, however, the principle is that it is a consideration of these factors which will lead a Court to determine whether or not the projection of the plan was "inappropriate". In short, the Court is given a wide discretion to substitute its view of the merits of a plan for that of the parties who voted against it, having regard to the factors set out in section 153(7).[896]

A vote on a plan can be set aside in certain instances. Section 153(7) states that:

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895. The court held the following:

> The provisions of this section amount to a last-gasp attempt to have a proposed business rescue plan approved by (1) attacking the rejection of the plan by the holders of the creditors' voting interests as "inappropriate", (2) by seeking approval for the practitioner to prepare and publish a revised plan, or (3) by purchasing the voting interests of one or more persons who opposed the adoption of the business rescue plan.
>
> If the preparation and publication of a revised plan is approved, such revised plan will have to be published and considered afresh in terms of the provisions of s 152.
>
> It is not clear what is envisaged by the term "inappropriate" in this subsection. If creditors are to be allowed to exercise their votes freely it has to be assumed that they would only do so in supporting the business rescue plan if it would be to their benefit. It is difficult to think of circumstances where the creditors' votes for the rejection of a business rescue plan would be inappropriate; however, sub-s (7)(*a*)-(*c*) does provide some insight as to what the Court should take into account when determining whether it would be reasonable and just to set aside the vote on a business rescue plan on the grounds of the vote being "inappropriate".

Also see Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 530. It should be noted that theoretically speaking, shareholders whose rights are directly affected by the plan and who were not present at the meeting, could rely on this provision to apply to court for the approval of the plan by the creditors to be set aside. Every trade union and unrepresented employee also has this right. Thus a plan could be delayed and even ruined by trade unions and employees if they are not properly consulted and their cooperation and approval secured before the plan is finalised. See Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 1 (2010) 3 *TSAR* 696; Rushworth "A Critical Analysis of the Business Rescue Regime in the Companies Act 71 of 2008" (2010) *Acta Juridica* 406–407; Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-112–18-116 para 18.17.40.

896. Opinion of Slomowitz SC and Blou SC (2 September 2011). Also see Kleitman "When Creditors Reject Business Rescue" (September 2014) *Without Prejudice* 6–7; Rushworth "A Critical Analysis of the Business Rescue Regime in the Companies Act 71 of 2008" (2010) *Acta Juridica* 406–408.

7) On an application contemplated in subsection (l)(a)(ii), or (1)(b)(i)(bb), a Court may order that the vote on a business rescue plan be set aside if the Court is satisfied that it is reasonable and just to do so, having regard to –

(a) the interests represented by the person or persons who voted against the proposed business rescue plan;

(b) the provision, if any, made in the proposed business rescue plan with respect to the interests of that person or those persons; and

(c) a fair and reasonable estimate of the return to that person, or those persons, if the company were to be liquidated.

These sections are clearly designed to permit the court to override the rejection of a plan if those responsible for the rejection of a plan have acted unreasonably in circumstances where, for example, creditors' interests are specifically and adequately dealt with in the plan itself, but there are other creditors or parties that are prejudiced by the rejection of such plan. It might be that such rejection (or voting down of the plan) cannot be justified on commercial grounds:[897]

> In our view, however, the principle is that it is a consideration of these functions which will lead a Court to determine whether or not the rejection of the plan was "inappropriate". In short, the Court is given a wide discretion to substitute its view of the merits of a plan for that of the parties who voted against it, having regard to the factors set out in section 153(7).

In *Shoprite Checkers (Pty) Ltd v Berry Plum Retailers CC and Others*,[898] Judge Tuchten deliberated over the terms "inappropriate" as set out in section 153(1)(a)(ii):

> I respectfully disagree with this approach. The Shorter Oxford Dictionary gives inappropriate the meaning of *not appropriate*; *not suitable to the case*; *unfitting*; *improper*. The same work gives as the meaning of appropriate apposite to the present enquiry; specially suitable; proper. The word "inappropriate" is used in the new Companies Act only in two instances, both in the present context. The word is used once in the Companies Act 61 of 1973 (the old Companies Act) with the meaning of unsuitable and thus in a context that sheds no light on the present interpretational problem.
>
> I do not accept that a vote by a creditor which is cast in good faith, in the sense that the creditor genuinely believes that a vote against the proposed plan would advance that creditor's interests, can be inappropriate. I can see nothing unsuitable, unfitting or improper in a vote that honestly reflects a voter's opinion as to his best interests. I can find, against counsel's submission to the contrary, nothing in the purposes of the

897. Opinion of Slomowitz SC and Blou SC (2 September 2011).
898. *Shoprite Checkers (Pty) Limited v Berryplum Retailers CC and Others* (47327/2014) [2015] ZAGPPHC 255 (11 March 2015).

> new Companies Act and in particular those purposes expressed in s7(k) which supports counsel's contention. Subject to s 146(d), only creditors vote on the proposal that a plan be approved and the meeting is a meeting of creditors, not affected persons in general. Representatives of employees have no more than a right to be heard at such a meeting before a vote is taken. The purposes of business rescue, broadly stated, are to revive faltering companies or achieve improved dividends for those companies which cannot be revived; in short, to put more money in the pockets of affected persons in general. In this context the interests of creditors, whose own money is at risk, are predominant. Whether either of these results can be achieved in a particular case depends on a forecast, which itself is based on one or more assumptions; in short on an assessment of risk. The business of companies and their creditors, in the present context, is the pursuit of monetary profit. I do not think that the purposes of the new Companies Act will be advanced by vesting in the courts a power to impose upon business people financial risks which they, on honest reflection, judge ill advised.[899]

Judge Tuchten concluded by stating that when a court considers an attack under section 153(7), it must first determine whether the vote was inappropriate. Only if it finds that the vote was inappropriate, can the court proceed to consider whether, taking this into account, it would be reasonable and just to set the vote aside.[900]

In the matter at hand, Judge Tuchten was of the view that due to the proposals contained in the plan being so unreasonable, no "reasonable person of business" would approve the plan and that there was no reasonable prospect that any court would find that a vote rejecting the plan would be inappropriate.[901]

In *KJ Foods CC v First National Bank*,[902] Judge Mavundla considered what was meant by the term "inappropriate" in section 153(1)(a)(ii) as read with section 153(7). In deciding the question of "inappropriateness", the judge was of the view that such determination was a "value judgment" where the court had to take into account the general purpose of the 2008 Companies Act as set out in section 7(k).[903] In this case, the judge was of the view that the vote against the plan was indeed inappropriate, having taken into account the nature and reasonable basis of the proposed plan.[904]

899. Ibid at paras 37–38.
900. Ibid at para 40.
901. Ibid para 53.
902. *KJ Foods CC v First National Bank* (75627/2013) [2015] ZAGPPHC 221 (23 April 2015).
903. Ibid para 9.
904. Ibid para 14.

In *Ex Parte Target Shelf 284 CC; Commissioner, South African Revenue Service and Another v Cawood NO and Others,*[905] the court had to consider whether it was reasonable and just to set aside a vote in terms of section 153(7) which was considered to be "inappropriate" in terms of section 153(1)(a)(ii). In the circumstances of the case, the secured creditor had voted against the approval of the plan. The court had to thus consider if such vote was inappropriate in terms of section 153(1)(a)(ii). The court was not inclined to follow the reasoning in the *Shoprite Checkers* judgment *(supra)* where only if a court finds that the vote is inappropriate can it consider whether it would be reasonable and just to set it aside. The court was of the view that a court is enjoined to consider whether it is reasonable and just to set the vote aside, even where it made a finding that the vote is inappropriate.[906] The court was also of the view (like in the *Shoprite* case) that inappropriate must be given its ordinary dictionary meaning of "unsuitable, unfitting or improper".[907] On the facts, the court found that the vote was appropriate. It then turned to the decision as to whether the vote should be set aside – a different enquiry.[908] The court considered the threshold tests set out in section 153(7) to determine whether or not the vote should be set aside.[909] The court found, *inter alia*, that there was insurmountable evidence that the postulated selling price had been manipulated in order to show a better return for creditors under business rescue. Figures were unsubstantiated with no adequate proof of value.[910] The court held that the provision made in the business rescue plan was not sufficient to cover the secured creditors' claim and thus did not support a fair and reasonable return for the secured creditor as is contemplated in section 153(7)(c).[911] In the circumstances, the court found that it was not reasonable to set the secured creditors' vote aside.[912]

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905. *Ex Parte Target Shelf 284 CC; Commissioner, South African Revenue Service and Another v Cawood NO and Others* (21955/14; 34775/14) [2015] ZAGPPHC 740 (13 October 2015).
906. Ibid para 33.
907. Ibid para 34.
908. Ibid para 49.
909. Ibid para 53.
910. Ibid para 63.
911. Ibid para 63.
912. Ibid para 67.

It is submitted that the opportunity for significant litigation by stakeholders who wish to push through a plan which has been rejected, will result in such parties requesting the court to grant appropriate relief, on the grounds that the dissenting vote was "inappropriate".[913]

Notwithstanding, it is submitted that courts will have to deal with such applications (in terms of section 153(1)(a)(ii)) on a case by case basis, with relief being granted where the facts of each case support the notion that a vote needs to be set aside in those peculiar circumstances. It would be difficult for the legislature to provide definitive "guidelines" on what is meant by the term "inappropriate" and beyond what is already prescribed in section 153(7).

The process that follows a rejection of a plan is further dealt with in section 153(1)(b) as follows:

> If the practitioner does not take any action contemplated in paragraph (a) –
>
> (i) any affected person present at the meeting may –
>
> (aa) call for a vote of approval from the holders of voting interests requiring the practitioner to prepare and publish a revised plan; or
>
> (bb) apply to the Court to set aside the result of the vote by the holders of voting interests or shareholders, as the case may be, on the grounds that it was inappropriate; or
>
> (ii) any affected person, or combination of affected persons, may make a binding offer to purchase the voting interests of one or more persons who opposed adoption of the business rescue plan, at a value independently and expertly determined, on the request of the practitioner, to be a fair and reasonable estimate of the return to that person, or those persons, if the company were to be liquidated.

In the event that a business rescue plan has been rejected, the practitioner may seek a vote of approval from the holders of voting interests to prepare and publish a revised plan. The opportunity to propose a revised plan is one given to every affected person. In section 146(e)(i), the holder of securities (a shareholder) would also be entitled to propose the

913. See article by Braatvedt "Reflections by a Court on Whether a Creditor's Vote is Appropriate or Inappropriate" (25 August 2014) *Hogan Lovells* available at http://www.hoganlovells.com/reflections-by-a-court-on-whether-a-creditors-vote-is-appropriate-or-inappropriate-08-25-2014/. Note that although it is not stated specifically that the application to court will seek to have the votes rejecting the plan set aside, it may be assumed that this is the intention. The application brought would probably be in respect of a rejection of the plan by shareholders, and the question is whether the shareholders' rejection of a plan that was approved by the creditors would automatically be regarded as inappropriate. This would obviously be undesirable, because shareholders will lose the power that they have been given to influence the outcome of the business rescue proceedings. See Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 2 (2010) 4 *TSAR* 695.

development of an alternative plan (as contemplated by section 153). This right is fairly limited. Firstly, the right to propose an alternative plan is limited only to affected persons who were present at the meeting (section 153(1)(b)). Since only those shareholders whose rights have been affected by the plan may attend the meeting, it is misleading to phrase this provision as if each shareholder would be entitled to make such a proposal.[914]

The extent of proposing an alternative plan by shareholders is limited. It is only a "proposal". It remains the right of creditors to vote on the proposal. If the creditors have voted in favour of the original plan, they will simply reject the proposal for an alternative plan put forward by a shareholder, so that in reality this provision is meaningless and provides only the illusion that shareholders can influence the rescue plan in some way.[915] Unlike the powerless position of shareholders, employees and trade unions have specifically been given the right to be present at the meeting, enabling them to propose an alternative plan.[916]

The "binding offer" principle is a concept quite new to South African law. It appears that any affected person or combination of affected persons may make an offer to dissenting persons to buy the voting interests at liquidation value (again being appraised by an independent expert). In South African law one would, in the ordinary course, enter into an agreement of sale of something like a "voting interest" which would require an "offer" open to "acceptance" by the offeree.[917] In terms of the provisions of section 153(1)(b)(ii), an offeree can force a dissenting person to sell a voting interest at liquidation value. This is effectively the South African procedure for a "cram-down" on those creditors who voted against the plan.[918]

914. Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 2 (2010) 4 *TSAR* 696.

915. Ibid 696.

916. Ibid 696. See sections 144(3)(g)(i) and 153(1)(b)(i)(bb) of the 2008 Companies Act.

917. Joubert and Faris *The Law of South Africa* Volume 5 Part 1 (2015) 363: An "offer" is defined as "a statement of intention in which the offeror sets out to the person to whom the offer is made what performance and what terms he or she is prepared to bind himself or herself to". An "acceptance" of an offer is defined as "a statement of intention in which the offeree signifies assent to the proposal embodied in the offer". A binding offer does not allow the offeree any opportunity to accept or assent to the offer made to be bought out at liquidation value. The principle of offer and acceptance, it is submitted, is watered down by the inclusion of this principle. The legislature appears to forego this principle in favour of ensuring that plans are "pushed" through and voted upon at the 75 per cent threshold; the objective being to save the distressed company, seemingly at all costs.

918. The author uses the term "cram-down" colloquially in order to describe the mechanism and effect of a binding offer in the South African context and as described by section 153(1)(b)(ii) of the 2008 Companies Act. It is accepted that the concept of "cram-down" in the US Bankruptcy Code is distinguishable from the binding offer process envisaged in section 153(1)(b)(ii). In a US Chapter 11 "cram-down" case, the court must ensure that the plan of reorganisation, to be confirmed is "fair and equitable" in terms of section 1129(b) of Chapter 11 of the US Bankruptcy Code. The court would be requested to use the cramdown laws to ensure that the plan is accepted by all classes of creditors affected by the plan, provided it is indeed fair and equitable and that it is not discriminatory to the objecting classes of creditors. See Ferriell and Janger *Understanding Bankruptcy* (2013) 779-797.

Of course, the aim and purpose of this section is to ensure that those affected persons who wish to vote in favour of a plan that has not been approved, be given the opportunity to buy out voting interests in order to get to the required threshold of 75 per cent as set out in section 152(2). This averts deadlock and forces those dissenting (hold-out) creditors to sell out at negligible value as, by voting down the plan, these creditors have told all stakeholders that the plan (and the dividend offered therein) does not appear to be achievable and therefore not acceptable. Consequently, such creditors should, as a result, be happy to accept a lower or negligible dividend set at liquidation value.

All creditors that opposed the adoption of the plan by voting it down are therefore at risk. If they dissent on the vote, they must realise that there is a possibility that they can be bought out at liquidation value.

Liquidation value refers to a payment for a voting interest that has been independently and expertly determined to be a fair and reasonable estimate of what the holder of the voting interests would receive if the company were to be liquidated. This task is given to the practitioner. Such valuation is subject to review, reappraisal and re-evaluation by the court on application by the holder of the voting interest or the person acquiring it.[919] This provision has been subject to fierce criticism by Loubser:

> This provision can best be described as alarming. The question needs to be asked why the offeror is not allowed to offer more than the liquidation value of the voting interest to make the offer more attractive to the offeree. The liquidation value of a concurrent creditor's claim, for example, would be closer to nil and a share in a company unable to pay its debts would definitely be worthless on liquidation.[920]

The word "binding" has perplexed readers of the legislation. Initially the view was that "binding" in section 153(1)(b)(ii) refers to an offer, which once made, cannot be retracted or changed. Did the words "binding offer" mean that the offer was not necessarily binding on the offeror, but in fact also bound the offeree to the offer? The right of the offeree to apply to court for a review of the liquidation valuation made would support this interpretation – otherwise the offeree could simply refuse the offer.[921]

919. Section 153(1)(b)(ii) of the 2008 Companies Act.

920. Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 2 (2010) 4 *TSAR* 697–698.

921. Loubser "Some Comparative Aspects of Corporate Rescue in South African Company Law" (LLD thesis, University of South Africa 2010) 138. Loubser states that an explanatory memorandum on this aspect would have been of invaluable assistance here.

The issue was dealt with in the matter of *African Bank Corporation of Botswana Ltd and Kariba Furniture Manufacturers (Pty) Ltd 5 others*.[922] Judge Kathree-Setiloane considered the effect of section 153(1)(c)(ii) of the 2008 Companies Act. In this case, the bank voted against a proposed plan and the shareholders advised the practitioner that as a result, they wished to invoke the provisions of section 153(1)(b)(ii) of the 2008 Companies Act and make a binding offer for the bank's voting interest. The practitioner called a short adjournment of the meeting to consider the effect of the binding offer. The practitioner took the view that the offer was immediately and *ipso facto* binding on the bank and treated the offer as having been accepted by the bank. The practitioner duly amended the voting interest of the bank as holding zero per cent and the shareholders as holding 95 per cent of the voting interest of creditors. The plan was then approved on this basis.

The judge confirmed that the concept of a "binding offer" was novel to South African company law. The "binding offer" was a "last gasp" attempt to have a business rescue plan approved. The difficulty of interpretation resulted from the fact that no definition had been provided for the term "binding offer" Was it an offer binding on the offeror only (in the nature of an option) and as a result the offeree was free to accept it or reject it? Alternatively, was it binding on both the offeror and the offeree, such that the offeree is deemed to have accepted the offer once made?[923]

The Judge also considered the need for a US-styled cram-down procedure in the context of business rescue proceedings. After considering the cram-down procedure contained in Chapter 11 of the US Bankruptcy Code, the judge stated as follows:

> "Cramdown" is therefore indispensable to the successful implementation of a business rescue plan because it effectively binds dissenting creditors of the company and every holder of the company's securities, whether or not that person was present at the meeting convened to approve the adoption of the plan, voted in favour of the adoption of the plan or had proved his or her claims against the company. Since "cramdown" is a "process by which creditors are forced to accept a re-organisation or a business rescue plan, even against their wishes", it has the incidental effect of discouraging creditors from resisting or holding out for better treatment and it enables

922. *African Bank Corporation of Botswana Limited and Kariba Furniture Manufacturers (Pty) Limited and 5 others* 2013 (4) All SA 471 (GNP). See decision on appeal to the SCA below. Also see Wesso "Business Rescue: The Position of Secured Creditors" (September 2014) *De Rebus* 35–36; Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-113 at para 18.17.4.

923. *African Bank Corporation of Botswana Limited and Kariba Furniture Manufacturers (Pty) Limited and 5 others* 2013 (4) All SA 432, (GNP) 9–10 at para 19.

> a business recue or re-organisation to proceed despite the objections of one or more disgruntled creditors.[924]

The Judge went on to deal with her view of the meaning of a binding offer and confirmed that the word "binding" as it appears before the word "offer" characterises the nature of the offer which the legislature envisaged under section 155(1)(b)(ii). Once the offer is made it creates a *vinculum juris* or legal obligation on the part of the offeror and may not be withdrawn. The "binding offer" is not an "option" or "an agreement" in the contractual sense of the term, but rather a statutory set of rights and obligations from which neither party may resile. The court held that the binding offer will be binding on both the offeror and the offeree once made, predominantly to ensure compliance with the procedure to revive a business rescue and enforce the business rescue plan within the framework of section 153(4) of the 2008 Companies Act.[925]

The Judge concluded that a binding offer is binding on both the offeror and the offeree once made.[926]

In the further case of *DH Brothers Industries (Pty) Ltd and Karl Johannes Gribnitz NO and 2 Others*,[927] the concept of a binding offer was further considered. The Judge disagreed with the findings in the *Kariba* case and stated that a "binding offer" cannot on its own constitute a "set of statutory rights and obligations". The legislature did not intend to create a specific deeming provision of acceptance on the part of the offeree or stated that the offer, once made, gave rise to binding obligations between the parties. Instead, the legislature used the word "offer". Such "offer" can only emanate from one party. Section 153(1)(b)(ii) appears to be consistent with this approach. In order to give rise to legal obligations on the part of both parties, an offer requires acceptance. The intention is to conclude a legal transaction of purchase and sale, a well-established legal concept. The word "binding" qualifies the word "offer" and nothing else. It specifically does not refer to the opposing creditor, as the offeree. If the legislature had intended this, then the provision would have said that the affected person could make an offer which is "binding" on the

924. Ibid 16–17 at para 28.
925. Ibid 17–18 at para 29.
926. Ibid 20–21 at para 35. The Judge went on to further consider the determination of the value of the voting interest (18 at para 30–31) and the constitutional challenge raised by the bank to its rights to property, access to court and equality (21–32 at paras 37–55).
927. *DH Brothers Industries (Pty) Ltd v Gribnitz NO and Others* 2014 (1) SA 103 (KZP).

opposing creditor. The court held that the words "binding offer" can only mean that the offeror may not retract the offer until it is accepted or rejected.

The court confirmed that an offer under section 153(1)(b)(ii) necessitated an adjournment of the section 152 meeting. As time is of the essence in a business rescue proceeding, an offeror should not be able to make an offer which has the effect of extending the moratorium without being obliged to keep open the offer until acceptance or rejection. Delays could result in a series of offers being made, withdrawn prior to the date of each adjourned meeting, with the intention of keeping the business rescue proceedings alive indefinitely. A new binding offer, in effect, could be made at each consecutive adjourned meeting which does not garner the requisite support of the plan. Further, the outside expert required to fix the price of the voting interest would incur wasted expenditure each time the offer is withdrawn.[928]

The Judge deliberated further over how far the South African process would go to "cram down a plan" on dissenting creditors. As stated in Kariba, the purpose of section 153(1)(b)(ii) is "to enforce a revised business rescue plan". However, the Judge was quick to point out that the purposes of business rescue, as set out in section 7 of the 2008 Companies Act, does not support an interpretation leading to a forced acceptance of business rescue plans at all costs. If that were so, the 75 per cent majority vote would not have been stipulated.[929]

In regard to his final views on the concept of a binding offer, the Judge stated as follows:

> For all of the above reasons, it is my view that the "binding offer" of s 153(1)(b)(ii) is an offer which cannot be withdrawn by the offeror. It is open to acceptance or rejection by the opposing creditors to whom it is made. If accepted, it gives rise to an agreement of purchase and sale. It is a sale of cash because "[i]n the absence of an express term as to the sale being for cash or on credit there is a presumption that it is for cash". The acceptance or rejection need only take place once the value has been finally determined. The independent expert is therefore obliged to reach a determination by the date of the adjourned meeting. The voting interests are transferred on payment of the determined sum. Once this has taken place, the voting interests are settled and the vote on the plan can take place. If adopted, the plan can and must be implemented by the practitioner. Once it has been substantially implemented, the practitioner must file a notice to that effect and the business recue

928. Ibid 27−28 at paras 43–44.
929. Ibid 34 at para 54.

> proceedings come to an end. If it is not approved, it is rejected and, if s 153 is not invoked the business rescue proceedings come to an end.[930]

The debate about what is meant by a "binding offer" in terms of section 153(1)(b)(ii) of the 2008 Companies Act appears to have been finally determined. In an appeal to the SCA, the judgment of the High Court was set aside in the matter of *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd and 5 others*.[931] The SCA held that in order for there to be a binding offer, it had to be accepted by the offeree. Thus a binding offer made to a creditor who opposes a business rescue plan is not automatically binding on the offeree. The offer made to purchase the voting interest of the appellant bank was held not to be binding on the appellant and thus the relevant business rescue plan was set aside.

The judgment does remove the "cram-down at all costs" argument. The court distinguished the position in the US, and the manner in which "impaired" classes of creditors are treated in terms of the US Bankruptcy Code. The court deliberated as follows:

> In finding that the legislature intended to exclude an opposing creditor's consent to a binding offer, the court a quo relied on United States of America (U.S.) Bankruptcy legislation. Indeed Chapter 11 of the U.S. Bankruptcy Code provides for rearrangement of the debt structure of a business and protection of the company from enforcement of claims by creditors whilst its business continues. However it seems to me that certain factors distinguish the process as provided for in our Act from the procedure provided for in the U.S. Bankruptcy Code. First, under the U.S. Bankruptcy Code it is the court that makes the decision as to whether rejection of a business plan by a creditor should be ignored. Obviously that decision would be taken

930. Ibid 38–39 at para 69. For a comparison between the two judgments, see Marquand "Who Does a 'Binding Offer' Bind?" (August 2014) *Without Prejudice* 12–13. Marquand states:

> The practitioner interpreted the term binding offer in terms of the Act to mean "an offer that cannot be rejected once made, and which is binding on the offeree". This is the view as held in the Kariba decision.
>
> Unfortunately this is not an unusual scenario and is being used increasingly by distressed companies in business rescue to write off large debts.
>
> The confusion over the interpretation has not been helpful to creditors and has opened up scope for abuse of the procedure, as foreshadowed by Dr Loubser. The phrase "binding offer" should be given the interpretation which results in the least diversion from the general principles of the law of contract, relating to offer and purchase, as concluded in the DH Brothers decision. However, if the conclusion in the Kariba decision is correct, then the Act may have inadvertently designed a way for debtor companies to escape their liability through the engagement of business rescue with the sole intention of avoiding repayment liability.
>
> The judiciary has the onus of interpreting the business rescue provisions within the context of a s7(s), "to provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the interests of all relevant stakeholders". In my considered view, only one of these judgments balances the interests of all relevant stakeholders.

Also see Wesso "Business Rescue: The Position of Secured Creditors" (September 2014) *De Rebus* 35–36; Gootkin "The Problem of Compelling Shareholders to Approve Business Rescue Plans" (May 2014) *Without Prejudice* 12–13. Further debate on the meaning of a binding offer can be found in comments made by Judge Daffue in *Absa Bank Ltd v John Frederick Kneale Cain NO, CRIR Properties CC* (FB) Case No. 3813/2013 (2 April 2014) (unreported) 30–33. Also see comments by Wessels and De Weijs *International Contributions to the Reform of Chapter 11 U.S. Bankruptcy Code* (2015) 223.

931. *African Banking Corporation of Botswana Limited and Kariba Furniture Manufacturers (Pty) Ltd and Others* (228/2014) [2015] ZASCA 69 (20 May 2015). The judgment provides a good synopsis of the previous cases as well as the manner in which the court came to its finding on the meaning of a "binding offer".

> after due consideration of all relevant facts. In s 1129(a) of the U.S. Bankruptcy Code the requirements that must be satisfied before a court can confirm a rescue plan are listed. And the provisions of this section are peremptory. The requirements include that the plan must have been proposed in good faith, each "impaired" class of creditors must have either accepted the plan or each creditor must stand to receive no less than it would receive under liquidation, each class of creditors must accept the plan or be "unimpaired", and there must be no likelihood of confirmation of the plan being followed by a liquidation or further business "reorganisation".[932]

The court concluded that there is no language in section 153(1)(b)(ii) that should result in a situation where once a binding offer is made to purchase a voting interest, the holder thereof is summarily divested of its voting interest without allowing such holder to have the ability to determine the affordability of such offer on the part of the offeror. Section 153(6) states that a holder of a voting interest or a person acquiring that interest in terms of a binding offer, may apply to court to review, reappraise and revalue a determination by an independent expert in terms of section 153(1)(b)(ii). The legislature has therefore made express provision for two categories of persons: those who are holders of voting interests and those *in the process of acquiring* a voting interest. The court was of the view that this suggests that although a binding offer may have been made (during consideration of the business rescue plan), finalisation of the aspects relating thereto, including transfer of the voting interest is not necessarily immediate. This is consistent with the established meaning of an offer. The court found that the court a quo's interpretation would immediately divest interested holders of their interest once the binding offer is made. This would be untenable. The court ruled that any other interpretation cannot lead to a sensible, business-like result and therefore cannot be supported.[933]

This case does, however, water down the ability to "cram down" the plan on dissenting creditors. The offeree would be in a position to determine if the offer that is made to buy out its voting interest is acceptable or falls to be rejected. In practice, it is submitted, a negotiation will take place between the offeror and the offeree to determine a "fair price" for such voting interest. However, if the offeree does not want to accept the offer, the

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932. Ibid at para 16. Clearly the court was of the view that the court *a quo* had erred when it relied on the US Bankruptcy Code as there were substantial differences between that legislation and section 153 of the 2008 Companies Act. Although this procedure differs from that applied in the US Chapter 11 "cram-down" procedure, it is submitted that the intention and mechanism behind ensuring that a plan is "forced" upon dissenting creditors is echoed (to an extent) in section 153(1)(b)(ii) of the 2008 Companies Act. There is no requirement to define "impaired classes" of creditors as contemplated in the Chapter 11 legislation (section 1123(a)1 of the US Bankruptcy Code) and where such creditors might be faced with a "cram-down" of the plan by the US Bankruptcy Court on such creditors.

933. Ibid 13–14 at paras 24–25. See comments by Van Vuuren "The Concept of a Binding Offer in Business Rescue" (12 October 2015) *Legalbrief* available at www.werksmans.com. Also see Cebisa "Supreme Court to the Rescue" (8 November 2015) *Business Day – Business Law & Tax Review.*

offeror will not be in a position to force the offeree to accept the offer, thus being unable to "cram down" the plan on the dissenting creditor. The judgment goes further to confirm that any offer made must be capable of acceptance. Therefore the offer must cover certain minimum requirements of the proposed contract, such as details of the person or entity who makes the offer, the price or determined value, and where, when and how payment would be effected.

It is submitted that the SCA's ruling in the *African Bank* case has made significant inroads into the cram-down principle.[934]

The US cram-down procedure is distinguishable from that applicable in section 153(1)(b)(ii) of the 2008 Companies Act. Ideally, a Chapter 11 plan would be approved by the requisite majority of creditors in each class. However, even where one or more of the classes rejects the plan, the debtor can still seek confirmation. In the US, confirmation over the objection of a class of creditors is known as a "cram-down" (as it is literally "crammed" down the objecting creditors' throats). Creditors that have a plan imposed on them are referred to as an "impaired class".[935] It is the US Bankruptcy Court that is required to make a ruling as to whether a plan is "crammed down" on such impaired class of creditor.

The plan to be imposed on such impaired class must be "fair and equitable" with respect to the dissenting class of creditor.[936] Further, the "absolute priority rule" prevents a debtor from distributing anything to a junior class of creditor over the objection of a senior class of creditor, unless the senior class is paid in full. Lastly, the plan must not "discriminate unfairly".[937]

A significant further question that flows from the provisions of this section is the following: What is meant by the "purchase of a voting interest of one or more persons"? Is

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934. The contrary view is that the concept of a "binding offer" must mean that any offer made by an offeror binds the offeree. Counsel were of the following view:

> Anything less would defeat the purpose of the sub-section which is clearly to afford "affected persons" the opportunity of getting rid of a recalcitrant creditor who cannot be prejudiced, ex hypothesi, if he receives, by way of the offer consideration equivalent to what such creditor would have received in a liquidation.

See opinion of Slomowitz SC and Blou SC (2 September 2011) 2–3.

935. See Ferriell and Janger *Understanding Bankruptcy* (2013) 779─797. Also see comments in Chapter 5, para 5.5.6.

936. Ibid 779.

937. Ibid 779 – 780. For greater detail on these concepts see 780 – 797.

the opportunity to buy out voting interests limited to creditors buying out dissenting creditors or can it include shareholders? Can a creditor buy out a dissenting shareholder having voted down a plan in its class and in terms of section 152(3)(c) and *vice versa*?

Section 146(e)(ii) might assist, in that a holder of a company's security can make an offer to acquire the interests of any or all the creditors or other holders of the company's securities in the manner contemplated in section 153.

What is meant by "voting interests"? Is the possibility of a buy-out limited only to the voting interests of creditors? The definition of voting interests is described in section 128(1)(j) as being an interest recognised, apprised and valued in terms of section 145(4) to (6). These latter sections only refer to the rights of creditors (secured, unsecured and concurrent) and the manner in which their interests are valued by the practitioner.

It is also necessary to consider the meaning of the balance of section 153. There are numerous references to the "holders of voting interests". Section 153(1)(a)(i) does not appear to be limited to either creditors or shareholders. Section 153(1)(a)(ii), however, distinguishes between the "holders of voting interests or shareholders, as the case may be". In section 153(1)(b)(aa) and (bb), there is again a distinction between holders of voting interests. It remains unclear if this is a reference to creditors or shareholders.

In section 153(b)(i)(aa) and (bb), reference is again made to "a holder of a voting interest or a person acquiring that interest".

The drafting of the section is not clear and is unhelpful in determining the answer to this question. The issues takes on significance where there is tension between creditors and shareholders (who have a right to vote in their class) and the manner in which they exercise their vote on a plan. The question that remains unclear is whether or not a creditor can buy out the voting interest of a dissenting shareholder and *vice versa*.

The key to who may make a binding offer lies in the definition of "affected person".[938] An affected person includes a shareholder or creditor of the company and thus any one of

938. Section 128(1)(ii) of the 2008 Companies Act.

those persons or a combination of those persons may make a binding offer.[939] Insofar as the identity of the offeree is concerned, the section is widely worded to include "the voting interests of one or more persons who opposed adoption of the business rescue plan". Counsel consulted states:

> In our view that means creditors or shareholders (insofar as they have the right to vote – see section 146(d)). There is no reason to read the words as confirmed in the offer to one that would operate only between persons having the same or similar voting interests. Further support for this view may be found in the fact that where the Act wishes to confine its operation to creditors' voting interests, it does so. See, for example, section 145 as compared with section 146.[940]

Counsel went further to argue:

> There is confusion created by section 153 distinguishing between "holders of voting interests" and "shareholders". It does appear that the definition of "voting interests" appears to relate only to the voting interest appraised and valued in terms of section 145 and in relation to creditors only.[941] However, in our view this does not detract from the wide wording used in section 153(1)(b)(ii). Any contrary interpretation, i.e. that would confine voting interests in that sub-section to those of creditors only operable only as between the same class, would undermine the purpose as identified above.[942] Conclusively, the fact that section 146(2)(e) explicitly entitles a shareholder to acquire the interests of a dissenting creditor and other shareholders enforces this view.[943] It would make no sense at all, given the purpose of the sections, for a shareholder to have that right against creditors without the converse applying. Again we emphasise that section 153 refers to "affected persons" as possible offerors, and does not confine this to shareholders.[944]

If the decision in the *DH Brothers* case is correct, then the position of the secured creditor, whether large or small in respect of voting interest, is protected, since it cannot be deprived of its secured right simply by means of a "binding offer"! A secured creditor will have to accede to the discharge of the order for it to be valid. This interpretation of section 153(1)(b)(ii) accords more readily with the law relating to offer and acceptance than does the interpretation in the *Kariba* matter. If the legislature intended for the provision to veer

939. Opinion of Slomowitz SC and Blou SC (2 September 2011) 3.
940. Ibid.
941. Ibid.
942. Ibid 4.
943. Ibid.
944. Ibid.

so significantly from the existing law, as suggested in the *Kariba* matter, it would have done so more clearly.[945]

Thus, both creditors and shareholders have the opportunity to buy out the other if they voted down the plan.[946] Parties need therefore to be very careful when deciding to vote down the plan as they expose themselves to the significant risk of being bought out at negligible (liquidation) values.

It has further been suggested that the business rescue process has provided shareholders/security holders with a mechanism to resolve shareholder disputes. In practice, there has been an increase in the use of business rescue proceedings being used to resolve shareholder disputes (often in favour of the majority and funding shareholder) by placing the company into business rescue on the basis that it has become financially distressed due to the refusal of such funding shareholder to continue providing funds to the company. The plan proposed by the practitioner might include a "forced" buy out provision using the binding offer mechanism set out in section 153(1)(a)(ii).[947]

If a plan has been rejected and the practitioner (in terms of section 153(1)(a)(ii) and affected persons (in terms of section 153(1)(b)(i)(bb)) decide to launch an application to set aside the vote as being inappropriate, the practitioner must inform the meeting that such an application is going to be launched and adjourn the meeting for five business days to allow the contemplated application to be brought to court[948] or until the court has disposed of the application.[949]

945. Wesso "Business Rescue: The Position of Secured Creditors" (September 2014) *De Rebus* 36.

946. If a creditor's voting interest has been bought out by way of a binding offer, is it only the voting interest that is bought out, thus disenfranchising that creditor from voting, or is it that creditor's entire claim in value that is bought out? It is submitted that it must be the latter. A "voting interest" (section 128(j) of the 2008 Companies Act) must be recognised, appraised and valued in terms of section 1445(4) to (6). A determination and valuation of the interest contemplates the claim of a dissenting creditor being purchased at the "value" of such claim, namely, the monetary value of the voting interest itself. See the views on the buy-out of shareholders' "voting interests" in Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 2 (2014) 4 *TSAR* 696–697.

947. See Levenstein "Business Rescue: A New Mechanism to Resolve Shareholder Disputes?" (August 2015) *Legalbrief* available at http://www.werksmans.com.

948. Section 153(2)(a) of the 2008 Companies Act.

949. Section 153(2)(b) of the 2008 Companies Act.

If a decision has been taken at a section 151 meeting to publish a revised plan, the practitioner must prepare and publish a new or revised business rescue plan within 10 business days.[950]

In terms of section 153(4):

> If an affected person makes an offer contemplated in subsection (1)(b)(ii), the practitioner must –
>
> (a) adjourn the meeting for no more than five business days, as necessary to afford the practitioner an opportunity to make any necessary revisions to the business rescue plan to appropriately reflect the results of the offer; and
>
> (b) set a date for resumption of the meeting, without further notice, at which the provisions of section 152 and this section will apply afresh.

In terms of section 153(5):

> If no person takes any action contemplated in subsection (1), the practitioner must promptly file a notice of the termination of the business rescue proceedings.

The notice of termination would bring business rescue proceedings to an end and in all likelihood would bring about the liquidation of the company (such application either brought by the practitioner, a creditor or by the company itself).

It is submitted that the "binding offer" principle ensures that viable plans are ultimately "pushed through" by the provisions of section 153(1)(b)(iii). Again, fitting in with foreign principles of cram-down,[951] dissenting creditors who voted against the plan must be in a position to sell at liquidation value to those creditors who wish to vote in favour of the proposed plan. As the SCA has now ruled, the offeree will be in a position to "negotiate" the liquidation value and price at which such offeree will sell to the offeror.

It is clear that the "binding offer" principle, together with the principle set out in section 154,[952] creates the ability to ensure that a plan (and its terms) becomes binding on all creditors in business rescue.

950. Section 153(3) of the 2008 Companies Act.
951. See Chapter 5, para 5.5.6.
952. Section 154 of the 2008 Companies Act is dealt with in Chapter 7, para 7.9.

7.9 DISCHARGE OF DEBTS AND CLAIMS

Section 154 of the 2008 Companies Act brings about a full discharge of all debts and claims once the business rescue plan is implemented in accordance with its terms. No creditor would be entitled to enforce any debt against the company that existed before the commencement of the business rescue process.[953]

Section 152(4) of the Companies Act provides that a business rescue plan that is adopted is binding on the company, on each of the creditors of the company and every holder of the company's securities whether or not such a person was present at the meeting, voted in favour of the adoption of the plan (therefore, even those persons who voted against the adoption of the business rescue plan) or, in the case of creditors, had proven their claims against the company.[954]

In terms of section 154(1) a business rescue plan *may* provide that once it is implemented in accordance with its terms and conditions, a creditor who has *acceded* to the discharge of the whole or part of the debt owing to that creditor, will be prohibited from proceeding to enforce the relevant debt or part of it against the company. Section 154(1) therefore envisages a compromise of the debt (alternatively, an extension of time to repay the debt) between the company and its creditors who acceded to the business rescue plan and the discharge of the debt owing to that creditor in terms thereof.

It must at this juncture be pointed out that section 154(1) does not refer to the general body of creditors and the compromise envisaged therein is not peremptory as it merely provides that a business rescue plan "may" provide that a creditor who has "acceded" to the discharge of the whole or part of the debt owing to that creditor will lose the right to enforce the relevant debt or part of it. The word "accede" is not defined in the Companies Act. However, *Black's Legal Dictionary*[955] defines it as meaning "to consent or agree".

Section 154(2), as read with section 133, continues to provide that where a business rescue plan has been approved and implemented, a creditor will not be entitled *during the course of the business rescue process* to enforce any debt owed by the company other than to the

953. See the effect of the moratorium dealt with in Chapter 7, para 7.4.

954. The concept of discharge of debt is a fundamental principle required in restructuring proceedings as it enables the debtor company to commence afresh with the so-called "fresh start". See Chapter 5, paras 5.3 and 5.4.

955. Garner *Black's Law Dictionary* (2004).

extent provided for in the business rescue plan. There is accordingly a moratorium on all enforcement actions save for the exceptions mentioned in section 133, and other than for the enforcement of the provisions of the business rescue plan.

In clarification of what are seemingly conflicting provisions, while business rescue proceedings are ongoing, all creditors (whether acceding or dissenting creditors) are bound to the terms and conditions of the business rescue plan in terms of section 154(2) and may as such only enforce those terms and conditions; however, in circumstances where the business rescue plan includes a compromise as envisaged in section 154(1), the debt owed by the company to dissenting creditors will not be discharged by way of a compromise, and the dissenting creditors may arguably be entitled to proceed against the company *after* business rescue proceedings have concluded.[956]

In *Merchant West Working Capital Solutions (Pty) Limited and Advanced Technologies and Engineering Company (Pty) Limited and Another*, Kgomo J considered the effect of section 152(4) where a business rescue plan had already been adopted by 98 per cent of the creditors. The applicant in the matter had applied to court (urgently) to perfect its security over assets under the control of the company in business rescue. The business rescue plan had dealt with the applicant's security and had recognised the applicant's claim. The issue of whether lawful security attached to the applicant's claim remained in issue. The applicant nevertheless launched proceedings to perfect its security. Kgomo J stated:

> The applicant admits that it is bound by the adopted business rescue plan. It has not disputed the applicability of section 152(4) of the Act. That being the case, I find that the applicant has no legal right or standing (*locus standi*) to request this Court to order a relief that is in conflict with the business rescue plan. To do so would in my considered view be rendering nugatory section 152(4) of the Act and thus the business rescue proceedings would also be rendered pointless.[957]

Kgomo J struck the application from the roll, with a punitive costs order.

Insofar as suretyships are concerned, it appears that any suretyship given by a surety on behalf of a company that has been subject to a section 154 discharge, will result in the discharge of the suretyship obligation as well. The issue of the effect that the section 154

956. See Rushworth "A Critical Analysis of the Business Rescue Regime in the Companies Act 71 of 2008" (2010) *Acta Juridica* 408.
957. *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Limited* 2013 JDR 1019 (GSJ) 31 at para 74.

discharge has on a suretyship agreement is of course a very concerning aspect of the business rescue legislation. It could occur that directors who have signed suretyships to banks or other creditors (suppliers) could be motivated to place their companies into business rescue, have the principal obligation compromised in business rescue and then seek to have their suretyship obligations extinguished.

In terms of section 154 of the 2008 Companies Act, a business rescue plan, once implemented in accordance with its terms and conditions, would prohibit a creditor who has acceded to the discharge of the whole or part of the debt owing to that creditor, from proceeding to enforce the relevant debt or part of it against the company. The question then arises, if this is the case, what would the bank's right be to enforce a suretyship obligation against, for example, a director who had signed as surety for the company that was subject to the business rescue plan? It is submitted that due to the fact that there has been a legal discharge of the debt owed by the principal debtor, the bank would be prohibited from proceeding to enforce a suretyship (or guarantee against such surety, or guarantor).

It is to be noted that in terms of section 155(9) of the 2008 Companies Act, the section specifically provides that an arrangement or a compromise contemplated in the section does not affect the liability of any person who is a surety of the company. As the same provision is not contained in section 154, there can be no doubt that the acceptance of a plan will result in a full legal discharge of the debt owed by the principal debtor. Accordingly, the obligation of the surety would thereby be totally extinguished if a business rescue plan is approved.

In *Investec Bank Ltd v Bruyns*[958] Rogers AJ raised this issue crisply in his consideration of the effect that a compromise of a principal debt sanctioned in a business rescue plan would have on sureties and stated:

> A business rescue plan may provide for the company to be released in whole or in part from its debts (s 150(2)(b)(ii)). If the business rescue practitioner puts forward a plan with such a feature and if the plan is approved by the requisite 75% majority in terms of s 152 and if the plan is then implemented in accordance with its terms and conditions, an affected creditor may in terms of s 154(1) lose the right to enforce his claim (whether in whole or in part). I am prepared to assume in the defendant's favour (without so deciding) that if all of these events were to occur a surety for the

958. *Investec Bank Ltd v Bruyns* 2012 (5) SA 430 (WCC) 436 at para 20.

> company would not be liable to the creditor for more than so much of the claim as survives the implementation of the business rescue plan.

Thus, Rogers AJ definitely agrees that once a principal debt has been compromised in a business rescue plan, section 154(1) would result in a surety being discharged from his obligations.

In the matter of *African Banking Corporation of Botswana Limited and Kariba Furniture Manufacturers (Pty) Ltd and 5 others*,[959] the court dealt with a suretyship signed by a party for the obligations of the company to the bank. The suretyship specifically provided that the bank's claim against the surety would not in any way be affected by any compromise of the bank's claim against the principal debtor (the company) whether this is caused by an "insolvency, judicial management or liquidation" as the case may be.[960] The court confirmed that there is no provision in Chapter 6 of the Act which provides that the adoption of a business rescue plan will deprive creditors of the company of their rights as against sureties for the debt of the company in business rescue. Such an outcome would be drastic, as it would deprive a creditor of its rights against a third-party surety simply by virtue of the adoption of a business rescue plan for the debtor. The emphasis of the business rescue regime is on the company in financial distress and not on the surety. Whether or not a creditor is entitled to pursue a surety has no bearing on the prospects of rescuing the company.[961]

Further, the court held that section 133(2) specifically provided that during business rescue proceedings, a surety by a company in favour of any other person may not be enforced by any person against the company, except with the leave of the court. This was not applicable to a suretyship undertaken by a third person for the indebtedness of the company. Section 133 of the 2008 Companies Act did not have the effect of suspending the indebtedness of any surety under business rescue.[962] The court concluded as follows:

> Thus, the moratorium provided for in section 133 is directed exclusively at protecting the interests of the company in business rescue. By parity of reasoning, if the

959. *African Banking Corporation of Botswana Limited and Kariba Furniture Manufacturers (Pty) Ltd and Others* (228/2014) [2015] ZASCA 69 (20 May 2015).
960. Ibid 36 at paras 65 and 66,.
961. Ibid para 65.
962. Ibid 66. The Court referred to the judgment of Rogers AJ in *Investec Bank Ltd v Bruyns* 2012 (5) SA 430 (WCC) where it was held that the statutory moratorium in section 133(1) on claims against the company under business rescue was a defence purely personal to the principal debtor, namely the company, and could not be raised by the surety.

> legislation does not suspend the indebtedness of a surety pending the outcome of the business rescue proceedings, it is difficult to see how it could deprive entirely a creditor of its rights against a surety.[963]

In *DH Brothers Industries (Pty) Ltd v Gribnitz NO and Others*,[964] the court considered whether or not the plan deprives the creditors from proceeding against sureties:

> The common law provides that the cession of a guaranteed claim carries with it the right on the part of the cessionary to enforce the claim against both principal debtor and surety. The cedent loses that right because it has perforce ceded its claim against the principal debtor and suretyship is an accessory obligation. Unlike in s 155(9) of the Act, which provides that a scheme of arrangement or compromise under that section does not affect the liability of any person who is a surety of the company, there is no similar provision under business rescue. Under the 1973 Act it was held that a specific provision in an arrangement allowing for a loss of recourse against a surety as a result of a compulsory cession of a claim was not precluded. This approach was, with respect correctly, doubted in an obiter dictum of Botha JA where he said, "[I]t is a far cry from that to hold that a creditor who has voted against the acceptance of an offer of arrangement is bound to abide by a clause in it providing for the termination of his right to proceed against a surety, for, ex hypothesi, he has in fact not contracted out of the protection afforded to him in terms of s 311(3)".[965]

In the matter, claims of creditors had been ceded and no provision retaining the right of the cessionary to enforce the deeds of suretyship had been made. Thus creditors could not sue sureties if the plan was adopted. It was argued that because all creditors were bound by an adopted plan, whether they voted for it or not, the legislature would have included a similar provision to that set out in section 155(9), if it had envisaged that a compulsory cession of claims could form part of a plan.[966]

Further, the court held that the discharge provisions of section 154 were applicable in that a creditor who has acceded to the discharge of a whole or part of a debt owing to that creditor will lose the right to enforce the relevant debt or part of it. The court concluded as follows:

> It can be seen, therefore, that a plan may only provide that a creditor "who has acceded to the discharge of the whole or part of a debt" may be deprived of the right to enforce its claim. Since s 152(4) makes an adopted plan binding on non-consenting creditors and s 154(2) allows enforcement of pre-business rescue debts only to the

963. Ibid 37–38.
964. *DH Brothers Industries (Pty) Ltd v Gribnitz NO and Others* 2014 (1) SA 103 (KZP).
965. Ibid at para 65.
966. Section 155(a) of the 2008 Companies Act states that an arrangement or compromise contemplated in this section does not affect the liability of any person who is a surety.

> extent allowed for in a plan, any provision in a plan which goes beyond a voluntary discharge of a whole or part of a debt is not competent. The present plan goes well beyond that. It provides that all creditors are deprived of a part of their claim if the plan is approved, regardless of whether or not they voted in favour of it. Not only that, but they are deprived of even the right to attempt to recover that part of their debt from sureties. In this regard, I refer again to the presumption against any legislative deprivation of rights. It must follow as night follows day that a plan which deprives non-acceding creditors of the right to enforce a claim against a surety does not pass muster on the basis of this clause. The compulsory cession, and certainly one without the cedent retaining the right to proceed against sureties, can therefore not be a part of a plan.[967]

Dealing with the claims of sureties is an important element of business rescue procedure. It is submitted that most financial institutions, who hold sureties on security for the company's indebtedness to them, would be most concerned if such surety obligation fell away as a result of a plan being approved and claims compromised (at a far lesser amount that bargained for).

In *Absa Bank Limited v Theodor Gustav du Toit and 2 Others*,[968] Saldanha J dealt with a business rescue plan which contained the following clauses:

- the amounts made available for payment to creditors of the combined businesses in terms of the business rescue plan are paid in full and final settlement of any and all claims creditors may have against the combined businesses;
- such settlement is not intended to affect any rights that any creditor may have against any third party who had bound itself as surety.

The Judge referred to the *African Banking Corporation of Botswana* case and was of the view that section 154 did not extinguish a third-party's liability to a principal debtor as it could by separate agreement obtain a guarantee in the business rescue process for the continued liabilities of the principal debtor and by virtue of section 152(1) and (2) where provision could be made in the business rescue plan that the principal debt not be extinguished and which by implication would mean the retention of the principal creditors' right of recourse against a surety.[969]

967. Ibid 41–44 at paras 65–68. See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-117 at para 18.18.

968. *Absa Bank Limited v Du Toit and Others* (7311/13) [2013] ZAWCHC (13 December 2013). Also see Ford and Kleitman "Business Rescue and Suretyships" (3 December 2014) available at http://financialmarketsjournal.co.za/oldsite/19thedition/printedarticles/businessrescue.html.

969. *Absa Bank Limited v Du Toit and Others* (7311/13) [2013] ZAWCHC (13 December 2013), para 18, p. 12. Also see article by Ford and Kleitman "Business Rescue Threat to Creditors' Suretyships can Exploit Rescue Plan Loophole if Principles of Debt Provisions are Changed by Agreement" (March 2014) *Business Day*.

In *Tuning Fork (Pty) Ltd t/a Balanced Audio v Greef and Another*,[970] the court again considered whether a creditor loses its claim against surety if a duly adopted and implemented business rescue plan provides for the creditor's claim against the principal debtor to be compromised in full and final settlement of such claim. In this instance, the suretyship did not stipulate that the claim against the surety would survive a compromise with the principal debtor. The court disagreed with the finding in the *African Bank Corporation of Botswana* case (*supra*). The judge was of the view that the effect of a statutory provision depriving creditors of their claims would be "drastic". No express provision is made for such a consequence in Chapter 6. Accepting that a business rescue plan will often provide for the principle debtor's release, the question whether the effect of discharging the surety is drastic depends upon from whose perspective one looks at the question and how one balances competing interests. The surety might regard it as drastic to preserve a creditor's claim against him without preserving his right of recourse against the company. At least the creditors hold their fate in their own hands, whereas the surety has no say in the matter. The judge respectfully disagreed with the learned judge's conclusion to the extent that she held that the release of a distressed company from its liabilities to creditors under an approved business rescue plan left the position of sureties unaffected.[971]

In a further recent decision, the SCA delivered what should be the "final word" on how courts will treat sureties who had provided security for the debts of a company that subsequently went into a business rescue process and adopted the business rescue plan. In *New Port Finance Company (Pty) Ltd v Nedbank Limited*,[972] Wallace JA was not convinced that the judgment of Rogers J in the *Tuning Fork* case was indeed correct. Wallace JA held that the deeds of suretyship contained standard clauses which deal with the eventuality of the principal debtor compromising or otherwise rearranging its debts generally with its creditors. In a far more "creditor-friendly" approach, the SCA held that these clauses[973] undoubtedly bring business rescue within their ambit and cater for this

970. *Tuning Fork (Pty) Ltd t/a Balanced Audio v Greeff and Another* 2014 (4) SA 521 (WCC). See Morgan "Release the Surety" (August/September 2014) *Business Brief* available at www.bbrief.co.za 40; Van Vuuren "Guarantees the Way to Go" (August 2011) *Without Prejudice* 46–47. Also see comments by Assheton-Smith "Case shines spotlight on suretyship" (30 October 2014) *Business* Day; Musesengwa "Obligations of a surety" (February 2015) *Without Prejudice* 20–21.

971. See *Tuning Fork (Pty) Ltd t/a Balanced Audio v Greeff and Another* 2014 (4) SA 521 (WCC); *Taboo Trading (Pty) Limited v Pro Wreck Scrap Metal CC and Others* 2013 (6) SA 141 (KZP) 33–34 at paras 84–86. See comments by Lombard and Swart "Business Rescue: The uncertainty about sureties – *Tuning Fork (Pty) Ltd t/a Balanced Audio v Jonker* (2015) 78 (3) *THRHR* 521.

972. *New Port Finance Company (Pty) Ltd v Nedbank Limited* 2014 JDR 2547 (SCA).

973. These clauses entitled the bank to pursue the sureties notwithstanding their dealings with the principal debtor and the grant of any extension of time, or any compromise in relation to the extent and scope of the principal debtor's indebtedness. Any default on the part of

eventuality, such that the adoption of a business rescue plan would not prejudice the lender's claims against the sureties on a joint and several basis. In an *obiter* ruling, the SCA went further to state that even in the absence of specific wording, the creditor's rights against sureties are not necessarily affected by the adoption of the business rescue plan.

Thus, creditors (particularly financial institutions) should feel pleased with the outcome in the *New Port Finance* matter and where such creditors (mainly banks) have such standard wording appearing in their suretyship documentation.[974]

However, it is still open to debate (in the author's view) that where a plan does not preserve a right to proceed against a surety and where the suretyship itself does not remain of force if there is a compromise of the principal debt, the ruling in the *Tuning Fork* case would still be applicable.[975]

Thus the court held that if the principal debt is discharged by a compromise with or release of the principal debtor, the surety is released unless the deed of suretyship dictates otherwise.

The further effect that section 154 has on claims of creditors is that once there is a discharge of a creditor's claim, there is no further opportunity for such creditor to sue a director for loss or damage to such creditor and which would be made up by the balance of the now compromised claim. The business rescue procedure is thus seen by certain directors as an opportunity to escape personal liability (under section 22 of the 2008 Companies Act or under section 424 of the 1973 Companies Act) for claims against them brought by creditors. Business rescue thus "sanitises" claims of creditors against directors. Of course, if a creditor can show that it has a claim against a director over and above the extent of such creditor's compromised claim, it is submitted that such creditor would be entitled to proceed against such director(s).[976]

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the principal debtor entitled the bank to sue the sureties. These clauses were perceived to be "standard clauses to be found in most commercial deeds of suretyship". See p. 7 of the judgment.

974. See Levenstein and Heinzelmann "A 'New Port' of call?" (May 2015) *Without Prejudice* 10–11.

975. It should be noted that one can cure the issue of a suretyship obligation being "compromised" in a business rescue situation by a creditor taking a guarantee instead of a suretyship. A guarantee is not, like a surety, accessing in nature to the principal obligation but is rather "principal" in nature. Where an independent guarantee has been provided, a creditor will be entitled to proceed against the guarantor on the loans that such guarantee has provided on independent principal obligation which is not in any way affected by a compromise in terms of a business rescue.

976. Meskin et al. *Henochsberg on the Companies Act 71 of 2008* (2011+) 536(2):

In *Blignaut v Stalear (Pty) Ltd*,[977] it was resolved by the majority of creditors with voting interests that they would each forfeit 75 per cent of their claims against the company under business rescue and that the remaining 25 per cent of their claims would be paid back to them on a monthly basis. With reference to the discharge provisions contained in section 154, the court held that the moratorium created by the business rescue plan is purely there to protect the company. It is exactly for this reason that the creditors insist, *inter alia*, on personal suretyships to protect themselves in the event of a corporate entity going into either liquidation or business rescue. The purpose of business rescue is to get the company back on its "financial feet" as it were. It is thus a temporary measure which can be achieved if it is afforded to the company and the company alone. It could accordingly not have been the intention of the legislature with the enactment of section 154 to include sureties and co-principal debtors as beneficiaries within the scheme of business rescue provided by Chapter 6.

Thus the *Blignaut* case provides a contrary view to that enunciated in *Tuning Fork*.

The cases on discharge of sureties are very important. It appears that our courts are of the view that those individuals (or directors) that have signed suretyships for the principal obligations due to creditors, cannot use the discharge provision of section 154 to escape liability.

As set out above, the majority of business rescue plans which are implemented result in a compromise with creditors. Plans deal extensively with the manner and extent to which the company may be released from its debt. Clearly, the effect of the adopted plan (as dealt with in section 154 of the 2008 Companies Act) is that the majority of creditors will lose the right to enforce the relevant debt or part thereof to the extent that the creditor has acceded to the discharge of such debt. The problem caused for the company is a serious Value Added Tax (VAT) implication for debtor companies that are VAT vendors. The net effect from such debt relief for debtors is that the debtor will suffer some form of tax

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The purpose of s 154 is to clarify the position regarding the discharge of debts and claims against the company once a business rescue plan has been approved and implemented. The approval of the business rescue plan, and the implementation of its terms and provisions thereafter, results in the relevant creditor losing the right to later enforce a debt or part of it if the creditor has acceded to the discharge of the whole or part of that debt as part of the approved plan. Similarly, no creditor is entitled to enforce pre-business rescue debts against the company in circumstances where a business rescue plan has been approved and implemented, unless the enforcement stems from the provisions of the business rescue plan itself.

977. *Blignaut v Stalcor (Pty) Ltd* 2014 (6) SA 398 (FB).

consequence as a result. This appears to be counterintuitive, especially when Chapter 6 relief was specifically designed to assist businesses in financial distress.[978]

While many tax consequences raised are often absorbed by any assessed loss the debtor may have, it must be borne in mind that preserving an assessed loss in itself is important in assisting a distressed debtor, as the assessed loss will shelter the debtor from paying tax should the trading activities of the debtor again start to generate profit.[979]

When considering the tax implications of business rescue, it is important to apply the relevant provisions of the Tax Administration Act 28 of 2011. In brief, currently Part C of Chapter 14 of the Tax Administration Act incorporates the 2008 Companies Act's business rescue provisions and clearly provides that a tax debt will be irrecoverable at law if a business rescue plan has been implemented, and one of the terms of the plan is that, if so implemented, SARS (as a creditor) will lose the right to enforce the tax debt or part of it against the company in question (as envisaged in section 154 of the 2008 Companies Act).

Part C of Chapter 14 of the Tax Administration Act places SARS on par with the other creditors subject to the business rescue plan and this ensures that all parties are treated in a fair and similar manner. Section 152(2) of the 2008 Companies Act is clear that an adopted business rescue plan is binding on all creditors of the company involved. In *Commissioner of South African Revenue Services v Beginsel NO and Others*,[980] it was held that SARS be treated the same as any other concurrent creditor in business rescue proceedings.

The following tax implications could occur, which would then be subjected to the business rescue plan (and the write-off, in part, based on the plan):

- VAT claw-back on input tax claimed but never settled (especially given the business rescue plan);

978. Terblanche "Rescue has Tax Consequences" Business Law and Tax Review (12 May 2014) *Business Day*.

979. Ibid. Terblanche submits that it is very important to endeavour to bring the financial year end returns, PAYE and VAT returns up to date, as it will be necessary to review the company's financial position as at the effective date. The company and practitioner should establish whether there are any assessed tax losses before the business rescue plan can be drafted, especially where the core of the business plan is based on a compromise of debt with creditors.

980. *Commissioner of South African Revenue Services v Beginsel NO and Others* 2013 (1) SA 307 (WCC). On tax implications in a business rescue see Du Toit *Tax implications for business rescues in South Africa* (LLM Dissertation, University of Pretoria 2012) available at http://repository.up.ac.za/bitstream/handle/2263/43876/Boraine.

- Section 19 income tax recoupments where debts are compromised/waived and part of that debt funded trading stock or deductions;

- Paragraph 12A Capital Gains Tax implications – either a reduction of assets' base cost and/or reduction of assessed loss.

In the 2013 draft amendments to the Tax Administration Act, a tax debt tied up in business rescue proceedings cannot easily meet the test of "uneconomical to pursue" as laid out in section 196 of that Act, and it has been proposed that the tax debt may be temporarily written off by SARS for the duration of the period that the debtor is subject to the business rescue proceedings. This contrasts the permanent write-off referred to above and contained in the 2008 Companies Act. This seems to go against the intent of business rescue proceedings.[981]

It is submitted that the principle of discharge of creditors' claims once a plan has been approved is a fundamental element to the rescue regime and serves to effectively "rescue the company".

As referred to above,[982] the conclusion of restructuring proceedings must effectively culminate in a discharge of creditors' claims. This springboards the company into its position of a "fresh start"; the ability to continue to trade on a solvent basis.

It is submitted that the debt discharge provides commercial certainty to the rescue process, notably for the debtor company. The modern view of the "debt haircut" and the compromise of debt supports a clear indication that at the end of a restructuring process, creditors must accept a position where they receive less than their full claim. The old

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981. Formal comment on this issue on SARS' website is as follows:

Clause 51: Section 195 TAA – Temporary write off of tax debt

Comment: It is unclear what the purpose of the proposed amendments is because a debt that is compromised in terms of the business rescue proceedings by the acceptance of the compromise by the majority of creditors per section 155(7) of the Companies Act, 2008, will result in the debt becoming permanently irrecoverable by SARS as concurrent creditor and SARS cannot therefore reinstitute the claim after the business rescue proceedings have been concluded. This is also quite evident in section 198(1)(c) of TAA which already lists compromised debt in terms of business rescue proceedings as being irrecoverable in law.

Response: Misplaced. Where a taxpayer is engaged in business rescue proceedings SARS' recovery efforts are suspended under the Companies Act, 2008, until the business rescue proceedings are over or when the business rescue plan has failed, and the tax debt becomes recoverable again. All that the amendment does is to allow SARS to temporarily write off the tax debt during business rescue to recognise this suspension.

See http://www.treasury.gov.za/legislation/bills/2014/TLAB-TALAB/2014%20October%2016%20-%20Response%20document%20TLAB%20and%20TALAB.pdf 42. Also see Dachs "South Africa: Tax Consequences Arising from the Writing Off of Loans" ENS Africa (4 September 2014) available at http://www.mondaq.com/southafrica/x/338286/tax+authorities/Tax+Consequences+Arising+From+The+Writing+Off+Of+Loans.

982. See Chapter 7, para 7.9.

principle contained in the judicial management procedure of creditors being paid in full has now been accepted as archaic and outdated.

SYNOPSIS OF PART 3

The 2008 Companies Act and the rescue provisions contained in Chapter 6 have established a standard for the restructuring of companies in financial distress and which is both operative and effective and which contains the essential elements and characteristics of a modern and effective corporate rescue mechanism.

It is submitted that the provisions of the business rescue regime applies many of the common themes found in international jurisdictions, which themes support the requirements for a speedy analysis of the cause of the financial distress; an effective engagement between the supervisor/practitioner and creditors; a process which is inclusive of all employees and shareholders (to an extent) and which culminates in the approval of a detailed business rescue plan. If the business rescue plan does not meet the approval of creditors (and shareholders), then the company falls to be liquidated. Liquidation is a negative outcome for all stakeholders, including creditors (negligible dividend) and for employees (loss of jobs). Thus, business rescue provides a viable alternative to the restructure of a financially distressed company which avoids the disastrous consequences of liquidation.

Provision is made for affected persons to either formally object to the voluntary commencement resolution or intervene in a liquidation application to convert proceedings to a business rescue. The provisions make it easy for all stakeholders to participate in the process should it be required. In particular trade unions are given the opportunity to call for the financial statements of the company in an effort to ascertain whether or not their constituent members would be better served if the company was placed into liquidation. Employees are specifically consulted at the section 151 meeting to ascertain whether they support the terms of the plan.

Although the practitioner does not take instructions from the creditors, he is able to "consult" with them and take note of their views relevant to the proposed plan. Additionally, those creditors that hold securities over the assets of the company also have an opportunity to participate in the process.

Thus, the South African regime, it is submitted, is very inclusive and attempts to ensure that all stakeholders participate in the rescue process.

The ease of commencement of the process (by resolution) further makes the rescue regime user friendly in that a board of directors requiring intervention can quite easily appoint a practitioner and ensure that the company obtains the benefits of the moratorium (stay) from the outset. The moratorium provides the much needed breathing space to allow the practitioner to assess the “reasonable prospects” of the company being rescue and to engage with all stakeholders in the development of the plan. The key feature, which was missing in judicial management, was the automatic imposition of a moratorium once the rescue process commences. This provides the essential breathing space necessary to allow the debtor to have its affairs and business restructured. This is provided for in section 133 of the 2008 Companies Act together with the necessary exceptions for actions against the company during the moratorium.

Property interests are protected and especially the rights of creditors over secured assets. The process envisages a full engagement with secured creditors to ensure that their rights remain unaffected if their secured property is required to be sold. Similar protection would apply to creditors who hold cession over the book debts of the company. In summary, secured creditors must give their consent to the practitioner in the event that their secured property is affected by the provisions of the plan.

Cleary, an essential is the provision of post-commencement finance. Access to such post-commencement finance is necessary to allow the company to continue to pay its expenses and in order to keep the company afloat whilst it is being restructured. The ranking of post-commencement finance in the business rescue and thereafter in a liquidation is of critical importance and superpriority ranking in the waterfall of payment can only result in attracting post-commencement finance into the rescue process. The recognition of the need for ongoing supply of goods and services by suppliers and other contracted parties results in such parties also being recognised as post-commencement financiers. This again assists the company in being able to continue to trade whilst it is in the rescue process.

The ranking of post-commencement employees and their services as a superpriority category of creditor (also as post-commencement financiers) supports the legislature’s intention of looking after the interests of labour in the rescue process. The opportunity for employees to continue to work for the company in business rescue is a unique and imperative feature of the rescue mechanism. Employees and trade unions are becoming more involved in the rescue process and detailed engagement with the practitioner enables employees to understand the challenges facing the practitioner and what is required by such practitioner in attending to the restructuring of the company. Employees are generally becoming more comfortable with the fact that the company has gone into its restructuring phase and that job retention might (not always) be a likely outcome. Employees and trade unions understand that business rescue provides a better outcome than liquidation where generally the loss of jobs is an expected outcome.

The ability of the practitioner to amend, vary or cancel (by way of court application) prejudicial contracts is a welcome provision to the rescue process. This enables the practitioner to alleviate financial pressure and further to terminate those prejudicial contracts that inhibit his ability to rescue the company. Although a harsh outcome for the counter-party if a contract is cancelled, the ability to claim damages from the company does assist to an extent. The ability to suspend a contract provides a practitioner with a very effective negotiation tool. It allows the practitioner to place burdensome obligations on hold while the company is going through its restructuring process. The fact that a contract has been suspended provides the practitioner with the real opportunity to renegotiate prejudicial contracts and to do so on a basis more favourable to the company. The further ability to cancel the contract (which is not a good outcome for the counterparty) serves to focus the minds of such counterparty, often allowing the practitioner to emerge with an agreement/contract on far more favourable terms than previously concluded.

The three week time frame required for the rescue process to be completed is there for a reason. The objective is for the practitioner to get involved immediately and report to stakeholders immediately if the company is capable of being rescued. If not, the company should be placed into liquidation. The lead time is short, but it certainly assists in ensuring that those companies that are not candidates for rescue end up in liquidation.

Chapter 6 of the 2008 Companies Act is very workable in the sense that it is not bogged down in protracted court procedures, which would ultimately delay the effectiveness of the process. Courts generally become involved when clarification is required of certain sections contained in Chapter 6 or where there is a clash of interests between creditors, the business rescue practitioner, supplies of goods and services to the company, employees and the trade unions.

The content required for the formulation of the plan is well thought out and contains, it is submitted, sufficient detail to enable creditors to make an informed decision as to whether to approve the plan or to reject it. The problem of hold-out creditors appeared to be well catered for by the binding offer provisions (such as being bought out at liquidation value) and alternatively setting aside a dissenting vote on the basis that the vote was inappropriate. Some clarity is however required as to the practical implementation of the binding offer provisions (as recently dealt with by the SCA). Generally the mechanisms to ensure that a good plan and one supported by the majority of creditors is approved, is very much part of the process.

Shareholders appear to be excluded from the rescue process to a large degree. Unless their rights are being affected, shareholders do not participate in the restructuring of the company. It is submitted that this is probably a fair proposition, as shareholders generally take the "risk of investment" from the outset and can only really sit back and rely on the effectiveness of the company's board of directors and management. Many rescues do ultimately have shareholders participating in the process, particularly when the company (or its shares) is sold in terms of a business rescue plan.

The core principle of the discharge of debt is catered for and ensures that a company can have its debt exposure compromised to ensure that it can continue to trade on a solvent basis.

A key challenge in the rescue process offered by Chapter 6 is to secure an efficient and effective supervisor or business rescue practitioner. Identification of the right candidate is essential to the successful outcome of the rescue process. The practitioner must have some experience in turnaround management or in the rescue of companies. It is submitted that practitioners should have a strong accounting expertise and should not take on too many rescue assignments at any one time. Industry expertise will be a very important factor and one which will largely contribute to a successful outcome.

In summary, it is submitted, Chapter 6 of the 2008 Companies Act is robust, effective and provides the necessary alternative to that of liquidation. The mechanism has its shortfalls and there is a need for further reform and amendments. However, generally all of the rescue mechanisms are prevalent and available to the practitioner and to all stakeholders where they believe that a company should be given a second chance and that its position of financial distress be resolved in terms of the provisions of the legislation.

PART 4 – APPRAISAL, RECOMMENDATIONS AND CONCLUSION

CHAPTER 8 : AN APPRAISAL OF THE NEW BUSINESS RESCUE REGIME, RECOMMENDATIONS FOR FURTHER REFORM AND CONCLUSION

8.1 COMPARISON WITH INTERNATIONAL RESCUE PRINCIPLES, BEST PRACTICE AND COMMON RESCUE THEMES

It is submitted that the South African government has made a concerted effort to bring South Africa's new rescue dispensation in line with those existing in modern foreign jurisdictions.

As in many other countries around the world, governments have attempted to create and promote more vibrant market-based economies, in part by introducing new insolvency and reorganisation systems. With the provision and availability of credit becoming more prevalent, governments have attempted to reduce the pain and suffering that could result from such new credit economies and have enacted lenient discharge and reorganisation laws to address the financial failure that will inevitably occur. This is the global trend.[1]

Likewise, in South Africa, it is submitted that the legislature, wary of the availability of credit adding fuel to the "insolvency" fire, have sought to introduce a viable and effective rescue and restructuring methodology through the introduction of Chapter 6 of the 2008 Companies Act. The workable international best practice standards and core principles have been used as the foundation to creating the "fresh start" principle for financially distressed companies in South Africa.

It is submitted that the legislature did not merely take the US Chapter 11 system or the Canadian/UK/Australian systems of administration and "dump" them on the doorstep of the South African insolvency industry. Careful thought was given to creating a bespoke and unique system in tune with the challenges faced when dealing with a South African financially distressed company. In the main, shifting focus from the interests of creditors to that of the debtor company and employees (preservation of jobs) was the major shift in the mindset for South Africans.

1. Martin "The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation" *Boston College International & Comparative Law Review* (2005) 28(1) Article 2 75–76

It is important to assess the "learnings" that we have garnered from considering the various international systems and regimes referred to above. The continued expansion of restructuring and development of regimes (over many years) by international jurisdictions (and their governments) serve to support the proposition that a developed and functioning system of debt compromise must have a positive effect on the sustainability and development of the economies in those jurisdictions. More particularly, the confidence levels of investors and shareholders must be enhanced if they are satisfied that their corporate investments will (to an extent) be protected and that returns will be forthcoming, despite the fact that the company has entered into a period of financial distress. It is submitted that the more developed, efficient and robust the insolvency and restructuring regime, the greater the likelihood of continued investment and increased trading levels within the market of that jurisdiction.

Once one considers the impact of international best practice standards and those common core rescue themes being applied in other jurisdictions and compares such standards and themes to the provisions and impact of the Chapter 6 legislation, one certainly gets a sense that the South African regime has fallen into line ("stacks up") with what must be perceived as a modern business rescue system of international best practice standard.[2]

It is my view that as a result, Chapter 6 continues to gain traction and is becoming recognised as a truly modern and effective restructuring mechanism and as a real alternative to liquidation. The international tools/instruments referred to above,[3] the current existing restructuring mechanisms available in modern regimes of the US, UK, Canada and Australia,[4] are all met by the carefully thought out sections of Chapter 6.[5]

As is set out above,[6] the UNCITRAL Legislative Guide,[7] provides best practice standards in an effort to guide those foreign jurisdictions looking to establish rescue and restructuring regimes. UNCITRAL set the bar high enough to ensure that if such an exercise was to be

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2. Meskin *Insolvency Law and its Operation in Winding Up* (1990+), para 18.1. See synopsis of Part 3 for confirmation of the fact that the rescue regime contains all of the essential core rescue themes required.
3. Chapter 4.3.
4. Chapter 5.2.
5. See analysis set out in Chapter 7 above of the provisions of the South African legislation compared to that existing in these international jurisdictions.
6. See Chapter 4, para 4.2.
7. UNCITRAL *Legislative Guide on Insolvency Law* Part 1 and Part 2 (2005).

undertaken, then it would be proper to take their best standards of rescue practice into account.

The South African business rescue legislation was drafted in a clear attempt to incorporate international best practice standards and in order to bring South Africa into line with a modern rescue regime capable of assisting companies in financial distress.

It is submitted that Chapter 6 achieves a balance between the need to address the debtor's financial difficulty as quickly and as efficiently as possible, and the interests of creditors and other stakeholders impacted by such financial difficulty. The marked shift away from an insolvency regime that historically looked after the creditor, to one which began to look after the interests of the debtor (with all of its relevant stakeholders) is a strong feature of the legislation.

As is set out in the UNCITRAL Legislative Guide, the establishment of key objectives for restructuring must be achieved in a balanced manner. These key objectives must reflect and, to an extent, mirror the legal and social values applicable in South African society which would allow industry to accept what was set out to be achieved: that is, to rescue financially distressed companies and allow them to continue to trade on a solvent basis, or alternatively provide creditors with a better dividend than they would have received had the company been placed into liquidation.

It is submitted that the eight key objectives set by UNCITRAL in its Legislative Guide[8] are met head-on by Chapter 6 which brings South Africa into line with international best practice standards of rescue.

The eight key objectives set out by UNCITRAL are briefly discussed:

1 The provision of certainty in the market to promote economic stability and growth

Prior to the introduction of Chapter 6, South African financially distressed companies were faced with three alternative outcomes: an attempt at an informal compromise; a judicial management order or a liquidation (with a possible section 311 compromise out of a provisional winding-up order). As we have seen above, all three options were

8. See Chapter 4, para 4.2.

unpopular and unworkable. What was required was the provision of a formal procedure, with an automatic stay, which allowed the company some breathing space to undergo a restructuring of its debt and business. Business rescue has indeed provided that certainty which, in most cases, allows a company to avert liquidation and be rescued. The knock-on effect of jobs being retained and the company (together with its customers and suppliers) remaining part of the economy, is a feature which has and will continue to sustain growth in the South African economy.[9]

2 *The maximisation of value of assets*

Once a liquidator is appointed, it is well known that assets are realised at "fire-sale" values on auction. The sustainability of value in a piecemeal (break-up) sale of assets out of a liquidation is unlikely to create value for creditors. Again, most liquidations do not result in a sale of the business of a company as a going concern. For a liquidator to maintain the business in liquidation, requires funding which is not readily forthcoming from shareholders or creditors, once the company has gone into final liquidation. The stigma of insolvency does not offer much opportunity to keep the assets alive once liquidation has intervened.

However, in the rescue context, quite the opposite occurs. The business rescue practitioner should be able to maintain the value of the business and its assets by the protective net that is placed around the company once it is placed under business rescue. The very purpose of the moratorium is to allow the company and its businesses to be "propped up" or "sustained" by the provision of post-commencement finance, the ongoing engagement with creditors on negotiated debt restructuring and the approval of a business rescue plan, which would allow the company to be rescued. Keeping the company intact and not allowing it to go to a "break-up" value will probably result in a maximisation for all stakeholders, and particularly the creditors, who would usually receive more than would be paid out in a liquidation.[10]

9. See Chapter 3, para 3.2. The future of judicial management opened up the door for a new modern form of rescue in line with international jurisdictions.

10. The benefits of the moratorium in retaining the value of the enterprise are dealt with in Chapter 7, para 7.4.

3 *Striking a balance between liquidation and reorganisation*

It is clear, from the South African experience, that not all companies are candidates for business rescue. If the company has an unsustainable business, a workforce and management that are disillusioned and demotivated, no opportunity to raise post-commencement finance and no workable plan that will be considered and approved by creditors, then liquidation can be the only fall-back position. The key for the business rescue practitioner is to remain independent and not to "flog a dead horse". If it is time for the company's life to come to an end, then the practitioner must be brave enough to place the company into liquidation. There is absolutely no point in prolonging the life of a company that is already in its "death throes". If it is time to put the company out of its misery, then so be it. The consequent losses sustained by creditors will have to be ascribed to the risk of doing business. The practice of entrepreneurship is always linked to risky outcomes, which might result in losses.[11]

4 *Ensuring equitable treatment of similarly situated creditors*

In South Africa, secured creditors and preferent creditors (mainly SARS) always shared in the dividends flowing from liquidation. The liquidator would get his fee (or tariff) and concurrent creditors would generally end up with negligible or zero dividends. Sometimes, concurrent creditors might have to contribute towards the costs of the administration, that is "pay in" rather than be paid a dividend (pay a contribution). This left liquidation outcomes very poorly viewed by the general body of creditors.[12]

In business rescue however, careful consideration has been given to the waterfall (ranking) of creditors. There is certainly a levelling of the playing field when it comes to the ranking of creditors in a business rescue. Secured creditors and post-commencement providers remain perplexed (uncertain) as to their ranking in a rescue. Employees who provide services during business rescue are placed in a superpriority category of creditors in line with the legislature's view to look after employees in a situation where a company is financially distressed. Unlike in a liquidation, SARS is

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11. See discussion in Chapter 7, para 7.1 and Chapter 8, para 8.1.
12. The maximisation of returns for creditors can objectively be increased if practitioners and creditors comply with the INSOL *Global Principles for Multi-Creditor Workouts* available at http://www.insol.org/global-principles. It is submitted that Chapter 6 of the 2008 Companies Act complies with the eight principles set out by INSOL.

not preferent but shares in the spoils like all other creditors. There is an equalisation of creditors, with a very small contingent being treated better than others. Of course, a practitioner is free to treat critical creditors differently in his or her plan, but such treatment must always be with the approval of creditors voting in favour of the rescue plan. Secured creditors' property over which they hold security cannot be interfered with without their consent.

All in all, rescue does provide a fair and equitable process in the treatment of creditors which, over the last three years, creditors in South Africa have come to accept. After all, the alternative is liquidation with negligible returns for all.[13]

5 Provision for timely, efficient and impartial resolution of rescue procedures

The business rescue procedure must be completed within three months from the date of the appointment of the practitioner. Additionally there are important time lines which must be met, such as notifying all affected persons of the commencement of the business rescue process, the time within which to convene the first meeting of creditors, the publication of the business rescue plan and the convening of the meeting to vote in the plan.

If the rescue time lines are followed, the process should result in a successful outcome. In many instances, due to the number of creditors and the complexities in administering the rescue process, these time lines are not met; however, as long as the creditors approve extensions (within reason), then the rescue process can continue.

What is key is the efficiency of the process. Creditors will not have an issue with extending the time lines as long as they can see that the practitioner is being proactive in the running of the rescue process and is not attempting to run up fees (through delay) to benefit him- or herself to the detriment of the company and its creditors. Thus the practitioner must display impartiality and independence. If the rescue process is clearly going to fail, then he or she has an obligation to place the company into liquidation.[14]

13. See discussion on the ranking of claims in Chapter 7, para 7.7.
14. The importance of time lines and the duration of the business rescue process is dealt with in Chapter 7, para 7.3.

6 *The preservation of the estate to allow equitable distribution to creditors*

The legislature provides various opportunities for the practitioner to preserve the value of the estate. Early intervention by the practitioner is key. Once he or she has ascertained the level of debt, how much of such debt has to be compromised to enable the company to survive, the level of post-commencement finance required to keep the company afloat while it is being restructured, then the practitioner is in a position to either restructure the company or sell it to a third party, but at all times provide a better dividend to creditors than would be achieved in a liquidation. The legislation allows the practitioner to ring-fence and preserve such value from his or her appointment to the date he or she exits from the process.[15]

A very important feature assisting in the preservation of the value of the estate, is the ability of the practitioner to suspend, vary or cancel prejudicial contracts. Ensuring that the company is not dragged down by obligations which cannot be met and which can be suspended, varied or terminated, goes a long way in assisting the practitioner in preserving value in that company while it is going through its restructuring.[16]

As a result of such preservation, a fair and equitable dividend can be distributed to the creditors where maximum value has been maintained during the rescue process.

7 *Ensuring a transparent and predictable law that contains incentives for the gathering and dispensing of pertinent information*

The South African legislature has designed a very transparent rescue regime. The practitioner is obligated to engage with all stakeholders from the outset. The practitioner's reporting obligations commence with ensuring that all affected persons are notified of the commencement of business rescue. If the practitioner fails in this duty, then the rescue is a nullity. Thereafter, the practitioner must convene the first meeting of creditors and employees at which he or she must inform the creditors as to whether or not he or she believes that there is a reasonable prospect of rescuing the company. This obligation cannot be taken lightly. If this is not a true and honest belief and creditors are strung along for an inordinate period, resulting in a diminishment of

15. The importance of post-commencement finance in preserving the value of the business is dealt with in Chapter 7, para 7.7.
16. See discussion in Chapter 7, para 7.6.

the value of the company which results in liquidation, such a practitioner could be sued by the creditors for the losses caused by such inaction.[17]

Although the practitioner does not have interrogation powers, the practitioner is obligated to engage with directors and management in obtaining as much pertinent financial and other information as possible to enable him or her to report to creditors in regard to his or her continued view that there is a reasonable prospect of rescuing the company. If this view changes, the practitioner is obligated to apply to court to discontinue the business rescue proceedings and place the company into liquidation.[18]The task of the practitioner in gathering such pertinent information is not an easy one. Directors who are feeling threatened by the introduction of a third-party supervisor might not be that willing to assist. Threats of being sued for reckless trading will not leave the directors with huge amounts of enthusiasm to assist the practitioner in the conduct of the rescue.[19]

Nevertheless, the practitioner is obligated to dispense whatever pertinent information he or she might have which is relevant to the conduct of the rescue, to all affected persons and stakeholders. By doing so, the practitioner protects him- or herself. As long as creditors are being kept informed, the practitioner will have a much easier task in either persuading creditors and stakeholders to support the plan, or alternatively support the decision to place the company into liquidation. Once this occurs and the rescue process is approved, creditors and stakeholders will expect deliverables from the process, which will allow the rescue process and its outcome to be predictable, with no surprises along the way.

8 The recognition of existing creditor rights and the establishment of clear rules for the ranking of priority claims

The legislature certainly recognises the different classes of creditors and establishes the ranking of claims in the relevant sections. There is no interference in the rights of secured creditors to continue to exercise their rights over secured assets.

17. For the extent and level of interaction with creditors in the business rescue process see Chapter 7, para 7.6.1.
18. The investigative powers of the business rescue practitioner are set out in Chapter 7, para 7.5.4.
19. The director's role in the business rescue process is set out in Chapter 7, para 7.5.5.

The ranking of different classes of creditors and the tension between secured creditors and post-commencement financiers is dealt with above.[20]

It is submitted that the South African rescue regime has certainly "ticked all the boxes" of the key objectives set by UNCITRAL in its Legislative Guide. The high-level objectives of best practice set out by UNCITRAL have "stacked up" in Chapter 6, which can safely be said to be a regime which is effective, modern, robust and predictable.

It is further submitted that a further appraisal needs to be done as to whether the Chapter 6 mechanism meets the various core common rescue themes of best practice principles as dealt with above.

Many of the features that we have seen applied in the US's Chapter 11 proceedings, administration proceedings in the UK and those restructuring procedures in other jurisdictions have found their way into Chapter 6. Many of these themes have found their way into specific sections of the legislation.[21] In addition (as referred to above), the key objectives set out by UNCITRAL have also been met in the new legislation.

The important core common rescue themes such as, *inter alia*, ease of entry into the rescue process, the duration of the process, the moratorium on claims, the cram-down on dissenting creditors[22] and the need for creditors to take some form of debt forgiveness all appear in the new business rescue procedure.[23] However, South Africa's business rescue process is by no means perfect. There is certainly room for improvement and the identification of shortfalls and recommendations for further reform will be dealt with below.

A brief synopsis and appraisal of the international core rescue themes as compared to that existing in Chapter 6 is dealt with below.

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20. See Chapter 5, paras 5.5.4 and 5.5.5.
21. The seven core rescue themes (see Chapter 5, para 5.5) are all mirrored and are dealt with in the provisions of Chapter 6.
22. However note that the effect of the cram-down (binding offer) procedure has been diminished by the findings in *African Banking Corporation of Botswana Limited and Kariba Furniture Manufacturers (Pty) Ltd and Others* (228/2014) [2015] ZASCA 69 (20 May 2015). See the comments on the distinguishing features of the US cram-down procedure as compared to the South African binding offer principles dealt with in Chapter 7, para 7.8.2.
23. For an excellent comparison between Chapter 11 and Chapter 6 see Mindlin *Comparative Analysis of Chapter 6 of the South African Companies Act No. 71 of 2008* (Presentation to the Company Law Symposium organised by the South African Department of Trade and Industry and the Specialist Committee on Company Law, Johannesburg, 1 March 2013) available at http://www.thedti.gov.za/business_regulation/presentations/symposium1of6.pdf. Also see Mongalo "Two Steps Forward and One Step Back is better than One Step Forward and Two Steps Back: A Limited Comparative Analysis of Business Rescue in South Africa" Opening address for *Business Rescue – First three years* University of Pretoria (7 October 2014).

8.1.1 GATEWAY INTO RESCUE

The gateway into a restructuring/rescue regime is of fundamental importance. For a financially distressed company to enter into a "protective regime" where it will have the opportunity to be rescued, must be easy and accessible. Like in international jurisdictions, Chapter 6 also provides a dual gateway into the rescue process,[24] either by way of a board resolution or by way of a formal application to court.[25]

The type of entity that is eligible for rescue or restructuring will differ from jurisdiction to jurisdiction. Generally, corporate trading entities, where trade includes the incurrence of credit (from suppliers or financial institutions) will be the party eligible for some sort of rescue protection, once such entity becomes financially distressed.[26] In the US and Australia, there is no need to specifically show imminent insolvency. In the UK, the test remains a position where the company's ultimate inability to meet its financial obligations would result in either liquidation or some form of administration. In Canada, the CCAA provides statutory eligibility requirements for the commencement of the restructuring process.[27]

The South African process has allowed for an easy entry into the business rescue process by providing the option of a voluntary commencement. Boards of directors, after having considered the financial position of the company, can pass a resolution for business rescue and appoint a practitioner to take control of the company in a fairly short period of time. This can be effected without court intervention and with a fairly simple engagement with the CIPC.[28] As set out above, and in accordance with UNCITRAL best practice principles, intervention by a practitioner should happen as early as possible and before the company is in fact insolvent. The six-month window period provided for the assessment of the company's financial distress, allows the board the opportunity to appoint a practitioner to restructure the company while there is still value.[29]

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24. See Chapter 5, para 5.5.1.
25. See Chapter 7, para 7.3.1.
26. For the international tests for eligibility/burden of proof, see discussion in Chapter 5, para 5.5.1. Except for the US, the tests are all almost identical to those applicable in South Africa.
27. Ibid.
28. See Chapter 7, para 7.3.
29. For the benefits of a pre-assessment, see Chapter 7, para 7.3.1 and para 7.8.2.

Of course, abuse of the process exists. Certain boards will take the opportunity to take advantage of the moratorium and have creditor claims stayed. If there is no sustainable business rescue plan available, the practitioner (if he or she is acting independently) should resolve at the first meeting to place the company into liquidation. Intervention by way of court application (normally brought by a creditor) to set aside the resolution would put an end to such abuse of process, on the basis that the resolution was nothing more than an attempt to stave off an inevitable liquidation.[30]

The South African voluntary commencement procedure into rescue is effective. In accordance with international best practice, the speedy introduction of a practitioner who is able to deliver a suitable and acceptable business rescue plan should achieve the objectives of a rescue, and avert a liquidation.

In line with international tests/eligibility for entry into the rescue process, Chapter 6 provides that the company by way of resolution and statement of affairs, or the applicant (affected person) in its application to court, must show, at the very least, commercial insolvency i.e. an inability to pay its creditors in the ordinary course of business. Factual insolvency (liabilities exceeding assets) is the other entry point for the financially distressed company.

The Chapter 6 burden of proof, both in the voluntary (resolution) commencement procedure and in a compulsory commencement (by way of court application), has a basic premise. The CIPC and/or a court must be persuaded that the company is financially distressed and that there is a reasonable prospect of rescuing the company. These two fundamentals would allow a company to gain entry into the rescue process. In line with international "burden of proof" standards, the objective must be to keep the business of the company intact and capable of being rescued successfully. In line with UNCITRAL principles, as long as the process either delivers a company that can continue successfully after it exits from the rescue process, or allows a partial recovery, where the overall result is one which is of greater benefit to the various stakeholders than would be the case in a liquidation, then the objective has been met. Rescue is about allowing the debtor company to survive a temporary cash flow predicament and continue (after debt has been

30. See Chapter 7, para 7.3.2.

restructured) to trade on a solvent basis. If the authorities can be persuaded that this is a likely outcome, then the company should be allowed the option of a rescue process.[31]

8.1.2 MORATORIUM/STAY

The international principle of a "stay" or "moratorium" on claims is a fundamental principle of rescue. "Premature dismemberment of the debtor's assets" should be avoided at all costs.[32] In order to preserve the assets of the company and to allow the company to have breathing space while it is being restructured, such moratorium is an essential element of a rescue.[33]

The Chapter 6 moratorium is automatic and applies from the date of the commencement of the rescue process. Without the moratorium the rescue process is a nonstarter. The shortcomings of an informal compromise is clearly the lack of a moratorium on claims. Any aggressive creditor can apply to liquidate the debtor company to the prejudice of the balance of the creditors.[34] The moratorium (although subject to certain exceptions) places all litigation and the prosecution of creditor claims on hold, pending the conclusion of the rescue process. In line with the guidelines set out in the UNCITRAL Legislative Guide, the South African moratorium prevents any creditor from "stealing a march" on other creditors who are willing to await the outcome of the rescue process. The moratorium preserves the value, the assets and the business of the company. The company is ring-fenced and isolated from an attack from creditors that would inevitably destroy value.[35]

No practitioner would, once appointed, be in a position to effectively administer the company whilst being distracted by ongoing protracted and expensive litigation, while at the same time be in a position to devote meaningful time to the restructuring of the company. Like in the US, the stay is automatic and commences from the outset of the rescue process. The necessary breathing room that is provided by the automatic moratorium, serves the key best practice (and essential) requirement of rescue methodology applicable in international jurisdictions.

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31. Discussion on the burden of proof in a compulsory commencement of business rescue is dealt with in Chapter 7, para 7.3.3.
32. See UNCITRAL *Legislative Guide on Insolvency Law* Part 1 (2005) 12. Also see analysis in Chapter 5, para 5.5.2.
33. See discussion on the need for an automatic moratorium in Chapter 3, para 3.1 (judicial management).
34. See Chapter 3, para 3.3.
35. See Chapter 7, para 7.4.

The practitioner is given the necessary time to engage with creditors, employees, directors, shareholders and other affected parties so that he or she can properly formulate a business rescue plan. The moratorium is designed to preserve the assets and business, thus allowing the practitioner to deliver a maximum dividend to creditors, well beyond what would be available in liquidation.

8.1.3 SUPERVISION/MANAGEMENT

Effective management of the company in the rescue process is critical. In the US, a supervisor may be appointed or alternatively the debtor company and its management may remain in possession.[36] In the UK and Australia, an administrator is appointed on a "fast track" basis and plays a very similar role to that of the business rescue practitioner (but bound to follow the specific terms of his/her legislative engagement). Challenges in having to administer the financially distressed entity remain similar in all jurisdictions, with the main focus on appeasing creditors, while still continuing to administer the company (normally with the assistance of management). Proponents of the "debtor in possession" model are met with severe criticism in the US while many are adamant that it is the least disruptive process and leads to successful outcomes.[37] In the UK, the parallel system of the administrator and the supervisor appointed in a CVA (applicable to less contentious debtor restructuring) allows the administrator to make proposals and the supervisor in the CVA to "supervise" rather than act as chief executive. This is similarly applied in South Africa. In Australia, the lack of debtor involvement is criticised. The Canadian Monitor provides an effective method for supervision.[38]

Clearly, the supervisor or practitioner is an essential role player in any successful rescue. The South African version of the supervisor, namely the business rescue practitioner, is placed into a position where, like his or her international counterpart, he or she has access to all of the tools, mechanisms and legislative machinery to deliver an effective rescue of a financially distressed company. In accordance with UNCITRAL best practice standards, he or she must be independent, impartial and have the interests of the company at the forefront of the rescue process. The practitioner is the driver of the rescue objectives and,

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36. See discussion in Chapter 5, para 5.5.3.1.
37. See analysis in Chapter 5, para 5.5.3.2.
38. Ibid.

depending on his or her skill set, should be in a position to take the company through its restructuring. Although South Africa has not yet provided accreditation standards, the practitioner, once appointed, certainly has a support structure to enable the rescue of the company. He or she can investigate the financial affairs of the company, suspend, vary or cancel prejudicial contracts, engage with all stakeholders and publish a plan for approval which sets out the detail of the restructuring. Further, his or her ability to cram down the plan on dissenting creditors (by way of the inappropriate vote procedure and/or allowing binding offers) ensures that a viable plan, supported by a majority of creditors, can be approved.[39]

The South African business rescue practitioner has the ability to operate from a supervisory as well as an executive position. The practitioner joins the directors in operating the company (subject to his or her supervision). It is a hybrid form of a debtor-in-possession approach coupled with the degree of supervision that most creditors would expect in a rescue scenario. Removal of an inefficient practitioner can occur. Likewise, ineffective management who contribute to the destruction of the business rescue process can also be removed, if necessary, by the practitioner. It is submitted that South Africa is just not ready for a rescue mechanism that allows existing management to continue to operate the company without some kind of independent supervision. The legacy of liquidations in South Africa, where directors and management helped themselves to the assets of the company, does not allow this as a possibility.[40]

8.1.4 COURTS

Internationally, the role of the courts varies from jurisdiction to jurisdiction. Delays and costs occasioned by extensive court procedures and intervention will make the rescue process cumbersome.[41] Of course, many jurisdictions (like in South Africa) allow the court to make orders for formal supervision as part of the dual gateway into a rescue regime. However, beyond that point, court intervention can effectively cause the rescue to fail. In the US, there is a high degree of court participation which causes costs to increase and delays to ensue, where lenders, suppliers and investors become frustrated. In the UK, the

39. For the practitioner's role in the business rescue process see Chapter 7, para 7.5.
40. Ibid.
41. See discussion in Chapter 5, para 5.5.3.3.

lack of court process assist in an effective method for restructuring. In Australia and Canada, similarly, there is very little court involvement. Time, costs and frustration are thus reduced and the lack of formality assists the process. Clearly, there is international support for as little court regulation as possible in the restructuring process.[42]

South African courts have certainly played a role in assisting in the development and precedent required in the evolution of the Chapter 6 South African rescue process.[43]

Our courts have certainly contributed towards weeding out those applications for the business rescue of companies where the reasonable prospects of successful rescue appear to be unrealistic. Although our courts have stated on several occasions[44] that the 2008 Companies Act favours business rescue over liquidation, orders for business rescue are not there for the asking. Judges require a proper analysis of whether or not the proposed rescue plan addresses "the cause of the demise or failure of the company's business and offers a remedy therefor that has a reasonable prospect of being sustainable".[45] Wassman emphasised that the South African courts are not allowing frivolous applications to succeed. As a result our courts are setting a standard (benchmark) for successful business rescue applications to succeed where the facts set out are material, factual and objective.[46] Business rescue should not be seen as "a quick fix to avoid debt". The key for applicants is to identify and provide objectively reasonable prospects accompanied by factual support to ensure the success of the application.[47]

Our judges have been brave in dealing with difficult interpretations of the legislation and have gone out of their way to balance the interests of the creditor against that of the debtor. Other judges have placed those companies that clearly were never candidates for rescue into liquidation, and conversely have provided those companies facing a liquidation

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42. See discussion in Chapter 5, para 5.5.3.3.
43. See Chapter 7 of the thesis and the development of jurisprudence on the Chapter 6 rescue process. In international jurisdictions, courts have influenced the development of restructuring legislation. The same applies in South Africa.
44. See *New City Group (Pty) Ltd v Pellow NO and Others, China Construction Bank Corporation Johannesburg Branch v Crystal Lagoon Investments 53 (Pty) Ltd and Others* (12/45437, 16566/12) [2013] ZAGPJHC 54 (28 March 2013).
45. *Southern Palace Investments 256 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd* 2012 (2) SA 423 (WCC).
46. Wassman "Business Rescue: Getting it Right" (January/February 2014) *De Rebus* 36.
47. Ibid.

application, with a "second chance", by placing some of these companies into a rescue process. The test of a "reasonable prospect" has played an important role in this process.[48]

South Africa, through the introduction of the business rescue process and further by way of court rulings, has carefully considered the old-school approach of favouring the creditor (advantage to creditors) against punishing the financially distressed debtor.[49] A balanced approach has begun to emerge where creditors cannot just ignore the rescue option and rush off to court to place the debtor company into liquidation. Dismemberment by way of liquidation is not always a desired outcome for creditors. The assistance of our courts and the robust mechanism provided by the legislation allow the debtor company to be elevated above destruction and to be provided with the option of a restructuring. Balancing the competing interests of disgruntled creditors against that of the debtor who wants a fresh start, has moved South Africa into a different rescue mind-set which is in line with international principles of rescue.

8.1.5 CREDITORS

South Africa has reached a point where there is now a levelling of the playing field between the interests of the debtor and those of the creditor.[50] The equitable treatment of creditors is necessary to ensure support for the restructuring of financially distressed companies.[51] There is an acceptance in international jurisdictions that creditors with aligned legal rights should be treated fairly, and distributions should take place in terms of an equitable ranking. Different classes of creditors (secured, preferred, concurrent and subordinated) should be recognised in the restructuring regime and in terms of specific legislature rankings. UNCITRAL makes mention of the importance of establishing clear rules for the ranking of priority claims and a balancing of the rights of the different classes of creditors must be achieved.[52] In the US, the rights of secured creditors are recognised as a separate class, and in the UK, charge holders have specific rights which must be

48. See judicial precedent set out in Chapter 7, para 7.3.3.
49. See *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others* 2013 (4) SA 539 (SCA) as an example and the cases that follow, as discussed in Chapter 7, para 7.3.3.
50. See discussion in Chapter 2, paras 2.3 and 2.4. Also see discussion in Chapter 8, para 8.2.
51. Dealt with from an international perspective in Chapter 5, para 5.5.3.3 and 5.5.4.1. Also see discussion on creditors and the compromise of debt in Chapter 5, para 5.4.
52. UNCITRAL *Legislative Guide on Insolvency Law* Part 1 (2005) 13. Also see discussion above (Chapter 8, para 8.1) in respect of the establishment of the UNCITRAL key objectives.

enforced. In Canada and Australia, the restructuring plans must recognise recoveries for secured creditors and their security and property interests.[53]

In South Africa, Chapter 6 deals with creditors in a unique and specific manner. Firstly, creditors participate at a high level in the business rescue proceedings. The voting mechanisms set out in section 152(2), the role of creditors at the first meeting of creditors (section 147), and their level and extent of participation in the rescue process is dealt with specifically in section 145. This all supports the proposition that creditors were given a significant and meaningful role in the business rescue process.[54] The legislation grants to creditors the right to form a creditors' committee (section 145(3)) and entitles creditors to "consult" with the practitioner in the development of the plan.[55] Further rights are given to creditors (as affected persons) to dispute the liquidation valuation of their claims (section 145(5)(b)) and to set aside the votes of dissenting creditors as being inappropriate (section 153(1)(a)(ii)). The binding offer principle allows creditors to make a "binding offer" to purchase the voting interests of persons who opposed the adoption of the plan.[56]

In practice, creditors generally support the proposed plan, particularly when the distribution offered in the plan is compared to the liquidation values of such claim. Most importantly, unlike in jurisdictions such as the US and the UK, South African creditors all get to vote on the plan in one "class" with no differentiation between secured creditors and other creditors. This is a significant deviation from that which exists elsewhere.[57]

In South Africa, secured creditors do not have any special or controlling vote on the plan. They participate in the process on the same basis as any other creditor. The rights of secured creditors are however protected insofar as their "security" is concerned, and cannot be interfered with or security disposed of without the consent of the security holder, unless the proceeds of the disposal would be sufficient to fully discharge the indebtedness protected by such security holder's security or little interest.[58]

53. See Chapter 5, para 5.5.4.1.
54. See discussion in Chapter 7, para 7.6.1. It is submitted that despite provision being made for creditor involvement in the business rescue process, the real focus of the rescue legislation is on the interests of the financially distressed debtor company.
55. See section 149 of the 2008 Companies Act for the functions and duties of the creditors' committee.
56. Section 153(1)(b)(ii) of the 2008 Companies Act. See discussion in Chapter 7, para 7.8.2.
57. See discussion in Chapter 7, para 7.8.1.
58. See section 134(3) of the 2008 Companies Act and discussion in Chapter 7, para 7.8.1.

In summary, South African creditors have been distinguished from their international counterparts at the level of secured creditors' rights and interests. Historically, it is submitted, the rights of secured creditors in a liquidation were generally secured. Secured creditors would walk away in a liquidation, being paid out the value of their security (often in full). Chapter 6 intentionally departs from this premise (at the voting threshold level), and seeks to level the playing fields by ensuring that all creditors participate on an equal footing, especially when it comes to voting for the approval of the plan.[59]

8.1.6 CONTRACTS (EMPLOYEES)

In international jurisdictions, there is an acceptance that ongoing and existing contracts that are in place must be preserved once the company enters into a restructuring regime.[60] The sustainability of these contracts will in turn determine the company's viability going forward and after it exits from the rescue regime.[61]

The supervisor however is obligated to identify prejudicial contracts and, if possible, terminate them.[62] If not, these burdensome contracts will result detrimentally in respect of the ability of the debtor company to continue trading. The UNCITRAL guidelines refer to the dangers of interfering in the sanctity of contract, but at the same time recognises the fact that certain essential contracts might affect the company's prospect of survival.[63]

In the US, the US Bankruptcy Code supports property rights, but discharges contractual claims against the debtor.[64] The legislation attempts to preserve value for the debtor company and provides options to the trustee or DIP in dealing with certain types of contracts.[65] The Canadian and Australian legislation have provisions dealing with the disclaimer of contracts (so-called *ipso facto* clauses) and in the UK, the administrator will consider all contracts (good and bad) in the determination of the rescue process. Clearly,

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59. Section 152(2) of the 2008 Companies Act. See discussion in Chapter 7, para 7.8.1 in respect of voting for the approval of the plan. However, it should be noted that although secured creditors vote in the same pool as all other creditors, in most cases the plan differentiates those secured creditors in that they would often receive a distribution aligned with the value of their security. Such secured creditors, who in most cases carry the vote in terms of the threshold set out in section 152(2), would need to be satisfied that the value of their security be met in the plan's proposed distribution of dividends.
60. See Chapter 5, para 5.5.4.2.
61. Ibid.
62. See discussion in Chapter 5, para 5.5.4.2.
63. UNCITRAL *Legislative Guide on Insolvency Law* Part 2 (2005) 121.
64. Section 365 of the US Bankruptcy Code.
65. See discussion in Chapter 5, para 5.5.4.2.

the ability to deal with prejudicial contracts (and to terminate them), if necessary, is a fundamental feature of international rescue legislation.

The ability of the business rescue practitioner in Chapter 6 to preserve essential contracts and suspend, vary or cancel prejudicial contracts is in line with international best practice. Suppliers of goods and services must come along for the ride and accept that in the short term, other contractual terms might be suspended or varied for the benefit of the debtor company. There is also the possibility of a termination of the supplier contract with the alternative of a claim for damages. However, the international philosophy of the opportunity to continue to do business with a rescued company must outweigh any alternative outcome. The practitioner is obligated to consider the cost benefit of continuing with the contract in its original format or "restructuring" the business of the company by altering its contractual matrix for the benefit of the company.[66]

Section 136(2)(a) and (b) provides the practitioner with the specific option to suspend or cancel contracts (the latter by way of an application to court).[67] The counterparty is entitled to assert a claim for damages as a result of such suspension or cancellation (section 136(3)). The South African legislature has thus carefully thought through the consequences to the counterparty if a reciprocal agreement is suspended or cancelled by the practitioner and provides such counterparty with some redress as a result of such action. The focus is clearly on the debtor company and the promotion of its prospects of survival. Counterparties will have to accept that their claims for damages might or might not provide them with sufficient compensation in the circumstances.[68]

The unique contract which plays an important role in any international restructuring is the employment contract.[69] The ongoing ability of the company to trade, is its ability to secure the continued participation of existing employee relationships. Careful consideration must be given to whether or not onerous labour contracts should be terminated to provide cost saving measures in the restructuring process. In the US, employment contracts are treated the same as all executory contracts. Employment contracts can be terminated, with the

66. See Chapter 7, para 7.6.3.
67. See discussion in Chapter 7, para 7.6.3.
68. Ibid.
69. See discussion in Chapter 5, para 5.5.4.2.

employee having the right to have a pre-petition claim for damages.[70] In Canada, both the CCAA and BIA have provisions which recognise the need to preserve employee contracts; if to the detriment of the debtor company.[71] In Australia, the administrator is bound to give effect to the Corporations Amendment (Insolvency) Act, 2007, where the DOCA must reflect priority afforded to unsecured debts payable to employees. In the UK, an administrator bears no responsibility under adopted employment contracts, but will take cognisance of the size and extent of the workforce as part of the strategy used to rescue the company.[72]

Thus there is a clear recognition that the employment contract and the rights of employees must be catered for in the restructuring of the company and in the formulation of the rescue plan.

In South Africa, employees are recognised as the lifeblood of any business and an employee contract is seen to be an essential contract that must be carefully considered in any restructuring. In Chapter 6, the practitioner, in line with international standards, has the ability to consider which employees (key personnel) should be retained and which should be retrenched. This exercise is conducted within the controlled confines of the business rescue process. As mentioned, the legislature has gone a long way in looking after the interests of employees in a rescue process. The elevation of employees to a superpriority status is unique to the South African process and serves to add a layer of protecting employees not found elsewhere.[73]

The need to consider job preservation is a driver and an essential feature of the South African legislation. Employees participate in the process through an employee committee.[74] Section 136 provides employees the right to continue to be employed on the same terms and conditions but subject to changes in the ordinary course of attrition. Any retrenchment must take place subject to the provisions of the Labour Relations Act, 1995.

70. Section 502(b)7 of the US Bankruptcy Code.
71. See Wood *Bankruptcy and Insolvency Law* (2009) 367–368.
72. See discussion in Chapter 5, para 5.5.4.2.
73. See Chapter 7, para 7.6.2.
74. Section 144 of the 2008 Companies Act.

Thus, South Africa has designed a specific regime for the protection of creditors, entrenching their rights where they (as a class) must be considered carefully within the confines and drafting of the rescue plan.[75] Like in international jurisdictions, there is a recognition that key employees are an essential cog in the development of a successful rescue plan.

8.1.7 RESCUE FINANCE

International requirements for a successful rescue recognise the need and availability of "rescue finance", once the company is placed into a restructuring process.[76] Without post-commencement finance or DIP finance, the prospects of a company being successfully rescued diminish. Liquidity requirements to pay ongoing expenses provides the supervisor with the ability to preserve value, whilst the company goes through its restructuring process. DIP financing in the US allows funders first priority claims on repayment. The rules of DIP finance repayment (section 364(d) of the US Bankruptcy Code) provides superpriority status on pre-petition assets to new lenders. In the UK, there is no equivalent regime to that available to US superpriority lenders. Any additional liquidity requirements must be met by funding from existing creditors. The administrator is allowed to borrow money and grant security on the company's behalf. These loan obligations are catered for as a superpriority in the repayments set out in the administration process. In Canada, the CCAA and BIA have been bolstered by court orders allowing for interim financing. Lenders might be independent third parties or an existing creditor. The Canadian legislation also recognises the superpriority charge in favour of such lenders. Careful cognisance is taken of the effect that such lending might have on the position of secured lenders and if their security positions are prejudiced. In Australia, additional lending requirements are met by funding provided by existing lenders and creditors. Often, banks provide such finance and generally are prepared to assist the corporate rescue process.[77]

75. See discussion in Chapter 7, para 7.6.2.
76. See discussion in Chapter 7, para 7.6.2.
77. See discussion in Chapter 5, para 5.5.5.

Generally post-commencement finance in international markets have become sophisticated and involve "loan to own principles", "vulture funding" and "distressed debt investments".[78]

Clearly, without financial support to ensure continued operations of the distressed corporate debtor, the prospects of a rescue become remote.

In South Africa, the manner in which post-commencement finance is made available to the company under rescue stacks up well with international best practice standards (debtor-in-possession finance). The provisions of section 135(2) sets out the manner in which post-commencement finance can be provided to the company and the superpriority status provided to such lenders.[79] Without the ability of the financially distressed company to have access to funds to pay creditors, its ability to conduct a business rescue will be a nonstarter. Liquidity requirements must therefore be well considered prior to looking at the viability of a business rescue. In order to preserve ongoing value and to preserve the assets of the company, post-commencement finance must be made available. The current ranking of post-commencement finance before that of secured creditors remains a controversial feature of the legislation but one which, it is submitted, is necessary in order to attract post-commencement finance to the company.[80] The statutory provision of ranking provided by section 135 is critical to the ongoing ability of practitioners to conclude successful rescue plans. Sources of funding range from existing banks, financial third party institutions and providers of post-commencement finance and the prospective offeror that is considering, through the rescue plan, to acquire the company.

The categorisation of post-commencement suppliers of services and products to the company as post-commencement finance also allows for the ongoing support necessary to allow the rescue to be successful. Clearly the provision of post-commencement finance allows the company to be propped up (thus preserving the assets and business of the company) while the company is in the process of being rescued. It is a necessary feature and one well recognised in international rescue practice.[81]

78. Ibid.
79. See discussion in Chapter 5, para 5.5.5.
80. See Chapter 7, para 7.7.
81. See discussion in Chapter 5, para 5.5.5.

8.1.8 THE RESCUE PLAN

The component features of the business rescue plan and its content is determined by the existing legislation available in each international jurisdiction. Local laws would generally provide for guidelines, nature and content (minimum) for the plan, how it is to be approved by stakeholders, the identification of classes of creditors and the voting mechanisms applicable for approval.[82]

The rescue/reorganisation plan would have to deal with distributions to creditors on a compromised basis and the mechanics applicable for the reorganisation of the company. The objective being to ensure that creditors approve a plan which offers a better distribution than that which would be available upon the liquidation of the company.[83]

In the US, the plan of reorganisation in a Chapter 11 process is a key feature in the process. The US system provides that the requisite majority approves the plan, and as a result, all creditors are bound. In limited circumstances the plan may be "crammed down" and would be confirmed despite the objection of a class of creditors. Section 1123(a) of the US Bankruptcy Code identifies a number of mandatory provisions that must be addressed in the plan.[84] In the UK, the administrator attends to the formulation of the proposals. The statement of proposals are sent to the creditors for consideration and approval. In Canada, the administrator must formulate a commercial restructuring plan (which includes a compromise of creditors claims) and if approved by creditors, would bind all creditors. Bothe CCAA and the BIA set out certain mandatory features that must be included in the plan. In Australia, once an administrator is appointed, various meetings of creditors will take place in order to finalise the terms of the DOCA. There is no particular legislative format for the DOCA and it can make various proposals as to the manner in which the company is to be restructured. The creditors would vote to implement the DOCA.[85]

In South Africa, there is no strict requirement as to the exact content of what must appear in the plan. Section 150(2) does list the minimum requirements and it must contain

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82. See Chapter 5, para 5.5.6.
83. Ibid.
84. See provisions in discussion under Chapter 5, para 5.5.6.
85. Ibid.

sufficient information to enable creditors and other affected persons to decide whether to adopt or reject such plan.

The legislation specifically deals with the make-up of the business rescue plan by setting out only the minimum or basic requirements of what should be incorporated into the plan. In accordance with international principles, there is no attempt to prescribe exactly what should be included into the plan. It is submitted that it does not work to be too prescriptive. There must be elements of flexibility to enable the practitioner to cater for the peculiar nature of the restructuring. It is submitted that the Chapter 6 approach of the provision of guidelines for publication of the content required for a plan is the better option.[86]

8.1.9 CRAM-DOWN

The ability of the business rescue process to allow for a cram-down on dissenting creditors alleviates an international problem; that of the "hold-out" creditor. The ability in Chapter 6 to set aside a dissenting vote as inappropriate and the ability to buy out a dissenting creditor by way of the "binding offer" process at liquidation value, is a crucial element in pushing a plan that is generally accepted by the majority of creditors through.[87]

International best practice supports the notion that a rescue system must enable a "cram-down" to prevent the obstruction of a feasible plan and keeping it from being approved. The forced acceptance of a plan imposed on dissenting creditors is a common rescue theme applicable in international jurisdictions. Flowing from the US principle of "best interests of creditor's" test, the cram-down provisions in the legislation support the contention of the promotion of debtor-creditor agreement. The hold-out creditor cannot be allowed to hold the rescue process to ransom with the inevitable fallout flowing from a liquidation.

In the UK, approval of the administrator's proposals must be made by a simple majority. Either the administrator's proposals are approved without modification or with modification. If there is a refusal of the proposals, the administrator would approach the court for directions. The court's role here is flexible. The court might suggest alternatives, allowing further modification in order to ensure that the proposals are in fact accepted by creditors. If not, a voluntary or compulsory winding up might ensue. Thus, there is no

86. See Chapter 7, para 7.8.
87. See Chapter 7, para 7.8.2.

formal "cram-down" procedure in the UK. Ultimately approval is left to the court, and to an extent the administrator.[88]

In Canada, the need for creditor approval is required and is not binding on creditors unless approved by creditors. In Australia, a simple majority is required to approve the DOCA.[89]

Clearly, the fundamental premise for the "cram-down" is to ensure that "hold out" creditors, who wish to be obstructive, must be forced to accept a compromise on their claims and ensure that the company is rescued and not placed into liquidation.

The consideration and voting for the approval of the plan is set out in section 152(1) and (2). Various mechanisms are set out for establishing the threshold levels required for approval. In addition, remedies are available to affected persons to set aside the voting down of a plan (rejection) on the basis that the plan was inappropriate.[90]

The voting requirement in South Africa is clear. The required 75 per cent majority with the 50 per cent independent creditor vote, aligns the legislation with what is a reasonable level required for approval. The relevant cram-down procedures (provided by the binding offer procedure – although to an extent now watered down) and ability to prevent unreasonable hold-outs by creditors allows the South African legislature to obtain approval of the plan on an acceptable and fair basis. Of course, if the plan is not accepted, liquidation can be the only outcome.[91]

It is submitted that the "binding offer" principle ensures that viable plans are ultimately "pushed through" by the provisions of section 153(1)(b)(ii). The requirement that dissenting creditors (even if in the majority) should be forced to sell their voting interests at liquidation value is aligned to the principles of rescue and as is set out in section 7(k) of the 2008 Companies Act.[92] If as a result of the rejection of the plan, the company is facing liquidation, the section supports the notion that the company should survive, jobs retained and the company continue to contribute to the South African economy.

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88. See discussion under Chapter 5, para 5.5.6.
89. In Canada, section 445D of the Corporations Act, 2001 can make an order declaring that secured creditors and owners or lessors of property are bound by the plan.
90. Section 153(1)(a)(ii) of the 2008 Companies Act.
91. See Chapter 7, para 7.8.1.
92. Section 7(k) states that one of the purposes of the 2008 Companies 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.

Fitting in with foreign principles of “cram-down” (although as a process distinguishable), dissenting creditors who voted against the plan must be placed into a position to sell at liquidation value to those creditors who wish to vote in favour of the proposed plan.

8.1.10 DISCHARGE

The conclusion of the restructuring process in every modern jurisdiction must be the discharge (exit) of the company from its rescue process and further that there is a discharge of creditors’ claims.[93] The necessity of allowing the debtor to have a “fresh start” is aligned closely to the principle of discharge. The company must be allowed to exit from its rescue regime and continue to trade into the future on a solvent basis. In the US, discharge occurs upon confirmation of its Chapter 11 plan. In the UK, once a proposal is approved by its creditors, a discharge would occur. In Canada, discharge occurs once the approved plan is recognised by a court order, and in Australia, the conclusion of an approved DOCA will discharge the company from administration.

In all of these jurisdictions, the concept of a discharge of creditors’ claims would follow.[94] The discharge of creditors’ claims by way of a debt compromise is a fundamental element of restructuring practice.[95] International rescue legislation provides for a discharge or alteration of debts and claims. Debt forgiveness gives rise to the fresh start and the ability of a company to continue to trade on a solvent basis.[96]

In South Africa, section 154 brings about a full discharge of all debts and claims once the business rescue plan is implemented.[97] Subsequent to such discharge, no creditor can enforce any debt against the company that existed prior to the commencement of business rescue. The company then has the opportunity to exit from the business rescue process and continue to trade on a solvent basis or in terms of a position where it has been purchased by a new acquiror.[98]

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93. See discussion in Chapter 5, para 5.5.4.
94. Ibid.
95. See discussion of this international principle of rescue in Chapter 5, para 5.4
96. Ibid.
97. See discussion in Chapter 7, para 7.9.
98. The company exits from the business rescue process when the practitioner files a notice of substantial implementation in terms of section 152(8) of the 2008 Companies Act.

Discharge thus concludes the restructuring or rescue process and allows the company to proceed with its "fresh start". This objective and result is completely in line with international principles of rescue, as set out in international benchmark standards of practice across the world.

The fundamental international principle of the discharge of creditors' claims, albeit on a compromised basis, aligns with probably the most essential international requirement of rescue practice. The ability of a plan to force a compromise on creditors' claims is a necessary component of international restructuring proceedings. The voting in of the plan, coupled with the exit of the company from the rescue process, aligns the South African process with the key international objectives and principles of successful restructuring.[99]

In summary, it is submitted that best practice thresholds and common rescue themes set out in international jurisdictions have certainly been taken aboard in the South African rescue legislation. The "stacking up" of the common rescue themes found in the provisions of Chapter 6 match (and it is submitted even to an extent improve on) aspects of international benchmark standards of best practice.

Clearly we, as South Africans, and particularly the legislature, have taken cognisance of the key features and principles from international mechanisms of rescue and have imposed certain of these into the South African rescue environment. This, in the author's view, does not detract from the uniqueness and "best fit" that we now have in the provisions and process set out in Chapter 6. We have learnt from the generic international essentials required for a successful rescue regime. These core themes, tools and mechanisms have ultimately found their way into the South African legislation, no doubt for the better for all stakeholders and for the economy as a whole.

The South African government recognised that to battle on with the archaic provisions of judicial management, with very few alternatives other than liquidation, was damaging to the economy and to investor confidence. The introduction of a workable business rescue model, with effective mechanisms for debt discharge, was welcomed in May 2011 by all parties interested in the field of financial distress and restructuring. Four years later, we are still trying to get fully acquainted with the provisions of the legislation. With the assistance

99. See Chapter 7, para 7.9.

of quality judgments on aspects of the legislation and with further research being done on this topic, South Africa is in a position to safely say that we have a rescue system in touch with levels of international best practice.[100]

All in all, it is about "buying into" the process. The real task of the practitioner is to ensure that all parties are included in the process and that proper and correct information is disseminated to all stakeholders. The practitioner is the "supervisor" and he or she must supervise! Allaying concerns of disgruntled creditors through effective pre-assessment meetings, allaying the panic and fears of critically minded staff and employees, are all critical in the process. The company is on "life support" during the business rescue process and the patient must be kept alive!

The general perception of the business rescue industry is positive. Pretorius states as follows:

> Business rescue appears to be valuable to society and stakeholders in general. Respondents, subjects and interviewees *do not think* that BR will follow the route of judicial management that is perceived as a failed regime.[101]

Business rescue worldwide is about compromise, about give and take. All stakeholders ultimately will exit the process, unhappy or happy, but hopefully with a company that has been resuscitated and is on the road to healthy financial and managerial recovery.

Corporate restructuring is no longer a rare or episodic event that happens to someone else. It has become a common and significant event in the professional lives of many managers. The reach of corporate restructuring is far greater than this, when one also considers the web of relationships between restructured companies and their customers, suppliers, lenders, investors, employees, and competitors.[102]

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100. Reference is made to the report submitted by the Business Enterprises division at the University of Pretoria on 30 March 2015 http://www.cipc.co.za/files/4714/2866/7900/Report Number 3. At p. 77, the report confirms that the 9,4 per cent success rate is comparatively good. Job protection is perceived to be a major benefit provided by business rescue in South Africa. In a quarterly report compiled by the CIPC in June 2015, the CIPC stated that 13 per cent of business rescues had terminated successfully; see www.cipc.co.za. The statistics on successful terminations, it is submitted, appear to be erratic and unreliable.
101. The report was prepared by Professor Marius Pretorius, Business Enterprises at the University of Pretoria (the UP Report) 84. See http://www.cipc.co.za/files/4714/2866/7900/Report_Number_3_amended_30032015.pdf
102. Gilson *Creating Value through Corporate Restructuring: Case Studies in Bankruptcies, Buyouts and Breakups* (2001) 3.

8.2 SHIFT FROM A PRO-CREDITOR TO A PRO-DEBTOR RESCUE CULTURE?

In 2012/2013, discussion had already begun as to whether or not the new business rescue mechanism had resulted in South Africa shifting from a pro-creditor liquidation culture to one now focused on the rescue of companies (pro-debtor).[103]

The 2004 policy document[104] published by the Department of Trade and Industry set the quest for a successful corporate rescue procedure in motion. The abandonment of judicial management as a "rescue procedure" and the eventual introduction in May 2011 of Chapter 6 of the 2008 Companies Act resulted in the South African legislature placing South Africa into a mind-set shift – now focused on rescuing the financially distressed corporate debtor and placing (or so it was perceived) the creditor at the "back of the queue" when it comes to recoveries.[105]

All in all, the South African business rescue system echoes the principles and themes of those international jurisdictions dealt with above. Burdette summarises as follows:

> On the face of it, South Africa's new business rescue procedure appears to contain the most important elements of a modern and effective corporate rescue regime. The procedure provides for a dual gateway to access the procedure, a moratorium that can prevent creditors from undermining a genuine attempt at saving the company, post-commencement financing to keep the company afloat during the rescue procedure, and a cram-down provision that can bind dissenting creditors. All these elements are indicative of a successful corporate rescue procedure and provide for a proper legislative framework within which corporate rescues and reorganisations can take place. Despite possible shortcomings in the procedure there is no doubt that it represents a huge improvement on the current judicial management procedure which has proved to be a spectacular failure since its inception in 1926.[106]

Earlier in the thesis, the pro-creditor/pro-debtor debate was dealt with in some detail. Clearly, the new business rescue system, although very much controlled by creditors (when it came to voting in a plan), had created a new mindset in South African restructuring practice. Creditors now had to sensitively consider their position in the outcome. Would

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103. See discussion in Chapter 2, para 2.3.
104. Government Gazette No. 26493 Notice 1183 *South African Company Law for the 21st Century – Guidelines for Corporate Law Reform* (23 June 2004).
105. As set out above, the fascination with the US Chapter 11 reorganisational model, even prior to the introduction of Chapter 6, had already sown the seeds of a shift in mind-set – see Loubser "Tilting at Windmills? The Quest for an Effective Corporate Rescue Procedure in South African Law" (2013) *SA Merc LJ* 438–446).
106. Burdette "Legislative Framework for the Facilitation of Turnarounds" in Harvey (ed) *Turnaround Management and Corporate Renewal – a South African Perspective* (2011) 140.

they be the "party" that would "push" the debtor company into liquidation, with the negative job losses and destruction of value? Alternatively, would it be up to the creditor to carefully consider the business rescue plan and the possible acceptance of the compromise of their debt. Politically, as time has gone on since 2011, creditors have little choice (in my submission) but to support the business rescue plan and rather allow the debtor company to have the opportunity of a "fresh start" (with the prospect of job retention), as has been the case in international jurisdictions for many years.

In 2015, it is submitted, we have now seen a marked shift in mind-set, from a realisation in the liquidation scenario (at best with negligible dividends) to one of realising for creditors a better return on their claims that they would receive in an immediate liquidation.

The benefits of attempting to deliver a better return for creditors in a business rescue as opposed to liquidation is open to debate. However, it is submitted that when one considers the low returns for creditors received (historically) in South Africa from the liquidation process, it has now become generally accepted that returns in business rescue are higher.[107]

If this is indeed the case, then it is submitted that rescuing the company through its business rescue process achieves a better outcome for creditors as a result of the legislation placing a mechanism focused on preserving the value of a company first, and only thereafter concerning itself with the interests of creditors and the maximisation of returns. Of course, achieving a "true rescue" (first part of the definition of business rescue) by developing a plan which enables the company to have its affairs, business, property, debt and other liabilities and equity restructured in a manner that maximises the likelihood of the company continuing in existence on a solvent basis,[108] would always be the preferable outcome. This is the true "end point" for a proper and effective shift from a pro-creditor to a pro-debtor culture. If this occurs, jobs will be saved, the company (and its stakeholders) remain part of the South African economy and the conduct of its business will continue to contribute to the GDP of the South African economy.

107. See the definition of business rescue in section 128(1)(b)(iii) of the 2008 Companies Act – the "second part of the definition". See Loubser "Tilting at Windmills? The Quest for an Effective Corporate Rescue Procedure in South African Law" (2013) *SA Merc LJ*. Loubser argues that this might not always be the case.

108. Section 128(1)(b)(iii) of the 2008 Companies Act: "the first part of the definition".

The fall-back position (second part of the definition of business rescue) supports the pro-creditor philosophy; that is to obtain a better dividend than that which would be achieved in a liquidation.

Clearly, the historical "advantage to creditors"[109] culture (emanating from the insolvency of individuals) brought us to the pro-creditor culture of liquidation and the judicial management culture of all creditors having to be paid in full. The shift, since 2011, to preservation of the debtor in the rescue context supports a pro-debtor culture. Thus, there remains a certain tension in a system where the debtor company needs to be rescued, and at the same time there remains a focus on maximising pay-outs to creditors.[110]

It is submitted that South Africa has reached an optimum point where both the interests of the debtor company and the interests of creditors are balanced within the pendulum of Chapter 6. Both sets of stakeholders now get a "seat at the rescue table" with both sets of interests remaining paramount.[111]

While the provisions of Chapter 6 clearly support the preservation of the debtor company, the same provisions support and recognise the interests of creditors. The immediate notification requirements of the company and its appointed practitioner having to notify creditors of the commencement of business rescue proceedings,[112] the ability of creditors to fully participate in the rescue proceedings,[113] the right of creditors to form a creditors' committee,[114] the protection of creditors' secured property interests[115] and, most importantly, having the right to vote on the business rescue plan,[116] all support the submission that business rescue supports a proactive role for creditors. The further opportunity available to creditors to "buy out" dissenting creditors[117] and to set aside

109. Although the concept of an "advantage to creditors" remains part of our law in respect of the sequestration of individuals, it does not appear to have influenced the South African government from legislating in a refreshing change of philosophy i.e. to protect the debtor with claims of creditors being compromised.

110. See Boraine, Evans, Roestoff and Steyn "The Pro-Creditor Approach in South African Insolvency Law and the Possible Impact of the Constitution" (2015) *Nottingham Insolvency and Business Law E-Journal 5* 59–92.

111. See discussion in Chapter 2, paras 2.3 and 2.4.

112. Section 129(3) and (5) of the 2008 Companies Act; section 130(3).

113. Section 130(4) of the 2008 Companies Act: an affected person (creditor) has a right to participate in the application for business rescue and section 145.

114. Section 147 of the 2008 Companies Act.

115. Section 134 and section 146 of the 2008 Companies Act.

116. Sections 151 and 152 of the 2008 Companies Act.

117. Section 153(1)(b)(ii) of the 2008 Companies Act.

inappropriate votes,[118] all support the contention that creditors' interests are a strong feature of the new rescue dispensation.

Of course, the plan inevitably results in a compromise of creditors' claims as part of the financial restructuring of the company.[119] As is set out above, international thinking on corporate restructuring requires creditors of companies that are truly financially distressed from having to (often unhappily) agree to a "debt haircut" or "compromise'. Clearly, in South Africa, the judicial management outcome of having to pay creditors in full was unworkable and led to judicial management's demise as part of our law.

In a judgment handed down by Katz AJ on 13 January 2015,[120] the court stated that the law of insolvency is concerned with protecting the rights and interests of creditors. However, insolvency, necessarily and appropriately, is shifting from being a creditor-driven regime to focusing on the interests of other stakeholders involved in and affected by insolvency proceedings.[121] With the implementation of the 2008 Companies Act and the business rescue provisions, "the rights of creditors no longer have pride of place and have been levelled with those of shareholders, employees and with the public interest too".[122] The court was of the view that "insolvency proceedings effect much wider interests than just that of creditors; society as a whole is engaged".[123]

It is submitted that the hybrid approach of looking after the needs of the creditors and, at the same time, that of the debtor company in its urgent need for restructuring, marks the high point of a dramatic shift of South African rescue legislation from days gone by.

8.3 APPRAISAL OF CHAPTER 6 OF THE 2008 COMPANIES ACT

8.3.1 WEAKNESSES AND CRITICISMS

The shortfalls in the business rescue process are many and should be analysed. There remains a strong perception that business recue does not work, is an attempt to buy time

118. Section 153(1)(b)(i)(bb) of the 2008 Companies Act.

119. See section 150(2)(b) of the 2008 Companies Act on the need to have a release from the payment of debt and section 154 which creates the discharge mechanism for creditors' claims once a plan has been approved.

120. *The South African Restructuring and Insolvency Practitioners Association v The Minister of Justice and Constitutional Development and Others, and Another Application* 2015 (2) SA 430 (WCC).

121. Ibid at para 24.

122. Ibid at para 27.

123. Ibid at para 28.

with the establishment of the moratorium on claims and provides an opportunity for errant directors to "hide their misdemeanours" and extinguish the possibility of being held personally liable for the debts of the company.[124]

On 30 March 2015, the CIPC released a report prepared by the Business Enterprises Department at the University of Pretoria on the status of business rescue in South Africa. The report is titled "Business Rescue: Status Quo report (Final Report)" (the UP Report).[125]

The UP Report is significant in the context of business rescue in South Africa. It highlights the many challenges, pitfalls, shortfalls and questions that we all face in the rescue and restructuring industry in South Africa.[126]

What follows is an analysis of what are currently perceived to be weaknesses and criticisms of the business rescue process.[127]

8.3.1.1 DIRECTORS ROLE

A weakness in the Chapter 6 procedure is certainly the reliance on the board of directors to place the company into business rescue without having to go through a formal court process.[128] Often, it is submitted, directors have no real and definitive position or understanding of the level of the company's financial distress, nor do they have a sustainable plan to rescue the company. The filing of the section 129 resolution could easily become a futile exercise and place the company one step away from the inevitable

124. For some early recommendations for changes to the legislation, see Bezuidenhout *A Review of Business Rescue in South Africa Since Implementation of the Companies Act (71/2008)* (MBA dissertation, North-West University 2012) 49–51.

125. See the UP Report http://www.cipc.co.za/files/4714/2866/7900/Report_Number_3_amended_30032015.pdf; CIPC *Status of Business Rescue Proceedings in South Africa* (September 2015) http://www.cipc.co.za/files/5914/4488/9277/Status_of_Business_Rescue_in_South Africa_September_2015_version1_0.pdf. Also see Visser "Provisions for Business Rescue under the Spotlight" (25 August 2014) *Business Day* available at http://www.bdlive.co.za/business/2014/08/25/provisions-for-business-rescue-under-spotlight; Ensor "Business Rescue under Scrutiny as Remedies Fail to Save Stricken Firms" (6 August 2014) *Business Day* available at http://www.bdlive.co.za/ business/2014/08/06/business- rescue-under-scrutiny-as-remedies-fail-to-save-stricken-firms.

126. In Chapter 7 of the UP Report, Pretorius proposes certain recommendations and directives for consideration. Many of the recommendations are highly useful and informative and fall to be considered by the CIPC and other relevant bodies (p. 84). It should also be pointed out that the report recognises the prospective contribution to be made once this LLD thesis has been submitted. It is proposed that a commission/committee be formed by the CIPC to address the discrepancies and shortcomings in the 2008 Companies Act with reference to this thesis (p. 92).

127. Recommendations for changes and reform follow in Chapter 8, para 8.4.1. Also see Ndweni "The business of business rescue" (20 August 2015) *Finweek* 16.

128. Terblanche "Business Rescue Processes need serious rethinking" (14 November 2013) *Business Report* available at http://www.iol.co.za/ business/opinion/business-rescue-processes-need-serious-rethinking-1.1606810#.VkHCg9IrLIU. In the UP Report reference is made to the fact that directors have a very low level of awareness or knowledge of the business rescue process). This appears to increase during the course of the process itself (p. 28).

liquidation. In the UP Report, the issue of a pre-assessment was highlighted.[129] When the company has reached a stage of financial distress and is trading through the "zone of insolvency" (a stage of illiquidity and digressing towards insolvency), some practitioners insist on completing a pre-assessment. This includes an analysis of the levels of financial distress and a consideration of the "reasonable prospect" test. If the company's position remains unfeasible, certain (competent) practitioners will decline the instruction. Other practitioners push on regardless, desperate to obtain a track record as a business rescue practitioner or alternatively with the intention of earning fees.

8.3.1.2 IMPACT OF THE BANKS/FINANCIAL INSTITUTIONS ON BUSINESS RESCUE

Negative perceptions of the banks/financial institutions towards the business rescue process is of concern and practitioners have generally been critical of this approach by the banks. The issue of the ranking of secured claims, as opposed to that of PCF providers, remains a stumbling block to the banks and financial institutions in providing their full support for the rescue process. Recently, in practice, it is submitted that banks are increasingly becoming more supportive of companies going into business rescue and of supporting such companies through the restructuring process.[130] This must be promoted and encouraged. Certain banks have "business rescue" departments geared towards identifying those customers that are potential candidates for business rescue. Many of these companies are placed on a "corporate watch list" or go under the scrutiny of an "intensive care" department, preparing for the inevitable filing for rescue. During the process itself, many banks insist on being placed on the creditors' committee,[131] where they can engage with and possibly "guide" the practitioner and/or other creditors or stakeholders involved in the restructuring.

Banks are often accused of preferring liquidation over business rescue. After all, banks can always rely on their security in a liquidation. As is identified in the UP Report, the "Bank–business rescue practitioner ("BRP")" conflict remains a challenge in business rescue. The general perception is that banks consider the option of the concept of a "better return than

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129. The UP Report 57.
130. See the UP Report: secured creditors' (banks') knowledge of the business rescue process is medium to high, with banks now "being very knowledgeable" (p. 28).
131. Section 145(3) of the 2008 Companies Act.

in liquidation" as very negative. The banks are of the view that the distributions would most of the time equate to an equivalent liquidation pay-out in any event.[132]

8.3.1.3 SHAREHOLDERS ROLE

The role of shareholders in a business rescue process is limited and as a result is perceived by many as being a weakness in the rescue process. Generally, shareholders perceive rescue as being a competent alternative to liquidation. Although shareholders are not always the beneficiaries in a rescue scenario, often rescue plans end up with shareholders receiving some benefit by their shares being purchased by the relevant offeror for the company. Sometimes shares are purchased at negligible value, with creditors receiving a sufficient dividend to enable them to vote in the plan at the required thresholds. As is evident, shareholders will only get a vote on a plan when their rights are being affected.[133]

Generally, shareholders' expectations upon a rescue filing are that the practitioner will reorganise the business and therefore save it. Shareholders appear to recognise that the principle of a better return than in a liquidation is acceptable and preferable to liquidation.[134]

8.3.1.4 SET-OFF OF CLAIMS

The issue of the set-off claims in terms of section 133(1)(c) requires clarity. The provision which allows pre- business rescue claims to be set off against claims incurred post-commencement of business rescue, appears to conflict with section 154(2) of the 2008 Companies Act.[135]

8.3.1.5 CONTENT OF THE BUSINESS RESCUE PLAN

Furthermore, there has been criticism around the content and structure of business rescue plans. Some feel that the plans currently being published do not adhere to the developed

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132. The UP Report 39. As part of the "Bank-BRP" conflict debate, often the "better return than in liquidation" principle is associated with the "abusive practices of BRPs and shareholders". The complaint is that certain practitioners are well aware that there is no reasonable prospect of rescuing the company but stretch out the process as long as possible to "milk" their fees as much as possible, leaving a distribution almost on a par with that distributed in a liquidation (p. 40). Also see Ensor "Banks are cautious, not reluctant over rescues, says lawyer" (7 August 2014) *Business Day* available at http://www.bdlive.co.za/business/financial/2014/08/07/banks-are-cautious-not-reluctant-over-rescues-says-lawyer.
133. See section 152(3)(c) of the 2008 Companies Act.
134. The UP Report 41.
135. See discussion in Chapter 7, para 7.4.

expectations of international regimes where sets of principles have been set in respect of structure and content of the plan.[136]

8.3.1.6 EMPLOYEES' ROLE

Employees' rights remain prevalent in business rescue. Despite this, there has been some criticism of the level of retrenchments effected in the business rescue process and sanctioned by the plan. Successful business rescues have seen many jobs remaining intact, although in many instances retrenchments have been inevitable and incorporated in the business rescue plan. Notwithstanding this, we have not seen trade unions participate in business rescues as affected persons to the level that would have been expected.[137]

Professor Tshepo Mongalo, who is a member of the Corporate Law Reform Committee, had the following to say in regard to the interface between employees' rights and those of creditors:

> Some concluding remarks that deserve to be mentioned are that the policy imperatives in existence at the time of the Corporate Law Reform clearly made it clear that employee interests were to be roughshod in a bid to elevate creditors' interests at all cost. Whether this was a self-defeatist move remains to be seen in the years to come as the success of the business rescue proceedings is put under the spotlight. Whatever that could be set, the policy-makers hands were tied at the time of the Corporate Law Reform Process as the NEDLAC Act required (as it still does) that the principles of the new corporate law needed to be subjected to consensus between business, labour and government constituencies within NEDLAC prior to their implementation and the Companies Act, including the Chapter 6, is the result of that process.[138]

8.3.1.7 SECURED CREDITORS

Whether secured creditors will continue to "ride roughshod" over the interests of unsecured creditors remains to be seen. Unsecured creditors believe that the larger secured creditors (with substantial claims) often carry the day on the vote for the plan. Notwithstanding this, secured creditors and unsecured creditors vote in one "pool".

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136. Pretorius and Rosslyn-Smith "Expectations of a Business Rescue Plan: International Directives for Chapter 6 Implementation" (2014) 2 *SABR* 133. The authors are of the view that there is a need to evaluate business rescue plans based on the principles and guidelines set out in Chapter 6 of the 2008 Companies Act. Also see discussion in Chapter 7, para 7.8.

137. See the UP Report, p. 28. The level of awareness by employees of the business rescue process is "non-existing". See discussion in Chapter 7, para 7.6.2.

138. Mongalo "Two Steps Forward and One Step Back is better than One Step Forward and Two Steps Back: A Limited Comparative Analysis of Business Rescue in South Africa" Opening address for *Business Rescue – First three years* University of Pretoria (7 October 2014) 7.

Unsecured creditors generally "go with the flow" when business rescue intervenes, although we are certainly seeing more interest from unsecured creditors in a business rescue process than we would see in a liquidation scenario. In a liquidation, unsecured creditors would receive negligible, if not a zero, distribution or dividend. The possibility of a pay-out or distribution of "some substance" in a business rescue is higher, thus unsecured creditors take more of an interest in the rescue process. There has been some willingness for unsecured creditors sitting on creditors' committees and participating in creditors' meetings.[139] Additionally, unsecured (concurrent) creditors generally prefer a business rescue restructuring over liquidation. If the result is going to generate a better return than in liquidation, this would clearly be a preference. During a reorganisation, unsecured (concurrent) creditors can benefit from cash generated from continuing trade. There are rarely benefits for concurrent creditors in the liquidation scenario as secured creditors generally take proceeds for themselves.[140]

8.3.1.8 SPECIALISED COURTS

There has been criticism (and a perceived weakness) of the fact that to date there have been no specialised courts set up to hear business rescue matters. Although the 2008 Companies Act refers to the possibility of designated judges being allocated to hear business rescue matters, these designations have not yet taken place.[141] Currently all business rescue matters are being heard, in the author's view extremely competently, by our senior commercial judges across the country. To date we have at least 100 judgments handed down by our courts. These judgments (some of which have been dealt with in this thesis) have canvassed a cross-section of issues relevant to the interpretation of sections in Chapter 6. There is thus, it is submitted, no need to set up either specialised courts or to designate particular judges to hear business rescue matters.

Courts have also contributed to reducing the abuse of the provisions of Chapter 6. As set out, many companies have filed resolutions for business rescue merely to obtain the benefit of the moratorium on claims from creditors. Many of these companies do not have access

139. See the UP Report 28. The level of awareness and knowledge of business rescue processes appears to be fairly low. Also see Le Roux and Duncan "The Naked Truth: Creditor Understanding of Business Rescue: A Small Business Perspective" (2013) *SAJESBM* 57–74. For a discussion of participation of creditors in a business rescue, see Chapter 7, para 7.6.1.

140. The UP Report 40.

141. Section 128(1)(e) of the 2008 Companies Act.

to post-commencement finance and do not have any rescue plan to put before creditors. These companies end up in liquidation. Our courts, as is seen in many of the cases referred to above, have dealt with the abuse of process, and have placed many of these companies into liquidation. However, our courts are not able to prevent those companies that are not suitable candidates for business rescue from passing a section 129 resolution and thereby commencing business proceedings at the whim of directors.

It is submitted that our judges have clearly set the tone for future deliberations on Chapter 6 and the intention behind the business rescue process. What is clear is that our courts have provided meaning to the provisions of Chapter 6 which will of course be of great assistance to other courts, judges, practitioners and the entire legal profession. This instils confidence in those who wish to make use of the new business rescue regime. The more legal precedent that is set by the South African judiciary, the greater the chances are of successful business rescue proceedings taking place in financially distressed companies in the future.[142]

8.3.1.9 ACCREDITATION OF BUSINESS RESCUE PRACTITIONERS

A further criticism is that to date, no business rescue practitioners have been accredited as envisaged by section 138 as read with regulation 126.[143] Although no professions have yet been accredited, it is submitted that most appointments will be from the accounting profession, with a few from the legal profession.[144] There is as yet no recognised "business management" profession in South Africa. It appears that, for now, *ad hoc* appointments, together with the provision of certain conditional licenses by the CIPC will continue. The system is working, with practitioners being appointed on application to the CIPC, duly appointed by directors in the section 129 resolution or by the affected person in the relevant court application.[145]

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142. See discussion in Chapter 7, with particular reference to case law dealt with in para 7.3.3.

143. Regulations relevant to Chapter 6 appear from regulations 126–128 to the 2008 Companies Act.

144. Recent suggestions made by the CIPC support the notion that certain "professional bodies" will become "accredited" in due course and as contemplated by Regulation 126(1)(a) to the 2008 Companies Act. In time, business rescue practitioners will receive "accreditation" through this process.

145. See Van der Walt "A Turnaround Practitioner's View of New Business Rescue Legislation" in Harvey (ed) *Turnaround Management and Corporate Renewal: A South African Perspective* (2011) 166. Note this has recently changed (since May 2015), where conditional licenses are being granted to practitioners – see http://www.cipc.co.za.

An analysis of both competency and performance levels of business rescue practitioners is a strong feature of the UP Report.[146] Reference is made to a "competent group" of practitioners, the "opportunist groups" and those that take "once-off" appointments. The competent group conducts a robust pre-assessment of the company and is selective in which rescues they take on and progress. Such competent practitioners identify their own "specialty" within a particular sector or industry and only take appointments in such area of competency. The competent group complies with the time lines prescribed by the legislation, have some business, financial and legal background and have strong connections with legal and financial advisors.

The "opportunist" category focuses on the "profit opportunity" and uncertainty that emanates from the business rescue environment. There is a lack of genuine basic business education and their competency levels are limited. These opportunists focus on the "better return than in liquidation" principle and attempt to achieve a "controlled winding-up". There is no realistic attempt to reorganise the business at all, but rather to pursue the rescue process to benefit from the process on a financial level, and to do so for as long as possible.[147]

The category of "once-off opportunities" do not benefit the rescue industry at all. Many of these practitioners were appointed in the first three years (since May 2011) but as the industry developed and the complexity of the process became clear, many such practitioners did not make themselves available for new appointments.[148]

The importance of a competent business rescue practitioner is summed up by Bradstreet as follows:

> In conclusion, the new business rescue provisions promote economic development in South Africa by nurturing the growth of emerging commercial endeavours and protecting companies in general from being effectively axed by liquidation, but the importance of adequate regulation of the practitioner ought not to be underestimated. The appointment of any "loose-cannon" practitioners, particularly in the initial business rescues effected under the Companies Act 2008, would create the risk of fostering an impression of volatility in the Chapter 6 procedure and lead to creditors being unwilling to contribute finance needed to expand the company. The irony

146. The UP Report 58–59.

147. Ibid 59. Often these processes are seen to be "glorified liquidations". Such a business rescue process is seen to frustrate the banks immensely.

148. The UP Report 59.

> would be that overprotecting debtors would lead to harming them instead – their demise resulting from being "starved" of credit rather than "executed" by insolvency proceedings. Legislation that is debtor protectionist should be welcomed to the extent that it does not undermine the value of creditors in the equilibrium of a properly functioning marketplace in the totality of its social and financial context.[149]

In November 2013, it was reported that the CIPC were considering a number of possible plans to address serious competency and skills challenges including[150] –

- implementation of an accreditation and/or competency framework;
- pairing of practitioners (shadow programme to transfer skills);
- disciplinary review committee;
- limiting the number of ventures that practitioners are allowed to accept;
- firm action against culprits found to abuse the rescue process that could include litigation to claim bank fees and damages; and
- blacklisting of all those who are found guilty.[151]

Business rescue in South Africa is currently highly underskilled and backed by little experience in formal rehabilitation mechanisms. Though Chapter 6 is modelled on a modern rescue system, it still requires local uptake of knowledge, experience and culture to become effectively established. Pretorius and Rosslyn-Smith are of the view that business rescue remains a "young profession" and where the business rescue practitioner must be seen as a "new phenomenon".[152] Assignments taken on by these practitioners are complex. What is urgently required are competency requirements for practitioners. Educators need to have competency guidelines dealing with the required level of skills for practitioners. The

149. Bradstreet "The Leak in the Chapter 6 Lifeboat: Inadequate Regulation of Business Rescue Practitioners may Adversely Affect Lenders' Willingness and the Growth of the Economy" (2010) *SA Merc LJ* 212–213.

150. Terblanche "Business Rescue Processes need serious rethinking" (14 November 2013) *Business Report* available at http://www.iol.co.za/business/opinion/business-rescue-processes-need-serious-rethinking-1.1606810#.VkHCg9IrLIU. For an excellent analysis of the practical approach that should be adopted by business rescue practitioners, see Pretorius "Tasks and activities of the business rescue practitioner: A strategy as practice approach" (2013) 17 (3) 1 *South African Business Review*. This paper investigates the specific set of practices for practitioners to execute their jobs successfully. The guide could ultimately be used to direct a qualifications framework required to assess practitioners once appointed.

151. To date, other than the consideration of the accreditation of professional bodies by the CIPC, none of these suggestions has occurred.

152. Pretorius and Rosslyn-Smith "Expectations of a Business Rescue Plan: International Directives for Chapter 6 Implementation" (2014) (2) *SABR* 134–135. Also see Crotty "Expertise Central to Business Rescue" (12 January 2010) *Business Report* available at http://www.busrep.co.za/general/print_article.php?FArticleID=5277398&FSectionID=5; Crotty "Business Rescues Will Need Special Skills" (28 March 2010) *Business Report* available at www.busrep.co.za.

CIPC also needs to set a framework for measuring competence levels so as to promote the profession in what is a relatively new industry.[153]

Clearly, the need for the professional accreditation of business rescue practitioners remains an extremely urgent requirement for the business rescue process to be elevated into a mechanism of stature within the South African economy.[154]

8.3.1.10 TIME LINES

One of the major considerations (and challenges) for all stakeholders (mainly the practitioner) is the extent and practicality of the time lines prescribed in the 2008 Companies Act for business rescue. Generally, the industry perceives the prescribed time lines as not workable or sensible. Many are of the opinion that the target dates set are not "attainable".[155]

In practice, the time lines for the submission of a business rescue plan have become blurred and uncertain. The Act prescribed time periods within which to hold the first creditors' meeting,[156] publish a plan after having been appointed[157] and specifically when a plan must be voted upon after publication.[158]

The problem is that in almost every instance, the practitioner is forced to extend these time lines beyond those that are prescribed. The 25-day time period set out in section 150(5) is just too short and to expect a practitioner to have had enough time to have considered the company's financial position, the reasonable prospect of being rescued and to have consulted with creditors, employees and shareholders is unreasonable and often impossible.

153. Ibid.

154. See comments by Pretorius "A Competency Framework for the Business Rescue Practitioner Profession" (2014) 14 (2) *Acta Comercii* available at http://www.actacommercii.co.za/index.php/acta/article/view/227. For an excellent analysis on suggestions for the accreditation of business rescue practitioners in South Africa, see this article.

155. Pretorius "Tasks and activities of the business rescue practitioner: A strategy as practice approach" (2013) 17 (3) 1 *South African Business Review*. The various time lines pervade Chapter 6 and are set out fairly uniformly across the various applicable mechanisms. See discussion in Chapter 7, para 7.3.

156. Section 147 of the 2008 Companies Act.

157. Section 150(5) of the 2008 Companies Act: a plan must be published by the company within 25 business days after the date on which the practitioner was appointed.

158. Section 151 of the 2008 Companies Act prescribes that within ten business days after publishing a business rescue plan, the practitioner must convene and preside over a meeting of creditors and other holders of a voting interest, called for the purpose of considering the plan.

In practice, practitioners always appear to find mechanisms to "stretch out" these time lines and often blame "court proceedings" as reason for delay. Additionally, the bulk of the tasks and activities that are time consuming occur immediately after the practitioner has been appointed.[159]

Furthermore, where there is a need for raising post-commencement finance, the negotiation process takes some time to complete.[160] As set out above, without post-commencement being made available to the company, the practitioners will have no option but to convert the process into a liquidation. At the same time, the practitioner might be canvassing and soliciting offers for the company (either its shares, business or assets). This process takes a considerable amount of time. Once an offeror is identified, extensive negotiations would ensue, eventually culminating in a formal offer for the company which would be accepted by the practitioner. A formal agreement would be concluded which would be conditional, *inter alia*, upon a business rescue plan (incorporating such offer) being approved by the company at a section 151 meeting of creditors and other holders of voting interests. For a practitioner to be able to deal with all of these aspects within a period of 25 days from appointment would be a very difficult task.

8.3.1.11 NUMBER OF BUSINESS RESCUE APPOINTMENTS

Business rescue practitioners must not fall into the trap of taking on too many appointments. This has a destructive effect on the success of business rescue. The process is hugely time consuming and stressful, and many practitioners will need to have access to limited resources. Many practitioners end up spending much of their time in meetings with lawyers, advisers, management, creditors, employees and the potential offeror if the asset/business is being sold. The practitioner in some instances has little alternative but to spend hours or days at the premises supervising and managing the business and day-to-day operations of the company, while a plan is being put in place. Practitioners taking on too many appointments of companies in business rescue can only result in disaster and possibly liquidations of companies where practitioners simply could not give due and

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159. Pretorius "Tasks and activities of the business rescue practitioner: A strategy as practice approach" (2013) 17 (3) 1 *South African Business Review*.

160. See section 135 of the 2008 Companies Act. Often post-commencement finance will require a post-commencement finance agreement to be negotiated and concluded with the post-commencement financier. This can take time and often occupies the practitioner in addition to his or her other obligations set out in the 2008 Companies Act.

proper consideration to the myriad of tasks required to ensure that the company continues to trade and stay afloat.

Practitioners (particularly in the larger matters) often have little choice but to engage additional services of experts and advisors. These include specialist advisors (industry consultants), forensic investigators, valuators, liquidators (independent) to determine liquidation value, debtor clerks to monitor claims, insurance advisors, a second-appointed practitioner to assist in the work load, legal or litigation support and, for those without a financial background, accountant expertise.[161] The legislation is not clear as to the role that a practitioner will play as opposed to that of the company's board of directors in a business rescue process. Although section 127(2)(a) states that directors continue to exercise the functions of directors subject to the authority of the practitioner, during business rescue proceedings, the practitioner will have "full management control of the company in substitution for its board and pre-existing management". Which takes precedence, the board or the practitioner?

Thus, it is submitted, costs of the business rescue process has become an inhibiting factor for stakeholders wanting to engage in the business rescue process. Just like in liquidations, the greater the costs incurred by the practitioner in the rescue process, the smaller the dividend available to creditors.[162] The banking fraternity have been (to an extent) critical of excessive costs being incurred by practitioners, particularly where these relate to the incurrence of excessive advisor fees.[163]

The actual drawing up of the business rescue plan can be complex and time-consuming. If one has regard to the extent and high level of detail required to be included in the plan, one then begins to understand why many business rescue processes go beyond the time lines set out in the 2008 Companies Act. The calculation of creditors' claims, working out which creditors' claims should be excluded, the calculation of liquidation values and the calculation of voting interests take time to consider and capture in the plan itself. The

161. The UP Report 36–37. See Bradstreet "Business Rescue Practitioners: What Role for the Legal Profession?" (July 2012) *De Rebus* 22.

162. See Braatvedt "Costs of Business Rescue" (October 2014) *Without Prejudice* 23–24.

163. The UP Report 37–38. There is no huge enthusiasm to consenting to success/performance fees as is allowed by section 143(2) to (4) as read with Regulation 128(2) to the 2008 Companies Act. Also see the UP Report 38–39 for views of shareholders, public and practitioners regarding costs and fees incurred in a business rescue. The issue of "conflict in the industry" is highlighted in the UP Report 79–80. Practitioners are blamed for their perceived inability to identify "reasonable prospect of rescue" and to exhibit too strong a focus on achieving a better return than in liquidation. Banks are blamed for a perception that they generally prefer liquidation. See Pretorius "Tasks and activities of the business rescue practitioner: A strategy as practice approach" (2013) 17 (3) 1 *South African Business Review*, where he identifies a key issue in that "banks hold disproportionate powers within the BR relationship".

various service requirements prescribed by the 2008 Companies Act must be adhered to, and if extensions are to be granted, such extensions must be supported on valid grounds and without legally tainting the process. The finalisation of the plan is usually done in collaboration with the practitioner's legal team and often with direct input from major creditors and, if required, the offeror's legal team. The manner in which creditors vote at the section 151 meeting of creditors, including requests for adjournments, and the voting of different classes of creditors can be complex and can become adversarial at times. A weakness is clearly the time delays being experienced in the preparation of the plan and the complexity of its development. Unfortunately, such delays are often caused by inexperienced practitioners taking on highly complex and challenging appointments with an inability to effectively deliver a workable rescue plan as envisaged by Chapter 6.

8.3.1.12 INVESTIGATIVE POWERS

The investigative powers of the practitioner remain severely limited. Although the 2008 Companies Act allows the practitioner to investigate the affairs of the company,[164] he or she has no real ability to interrogate the directors and management as to the exact cause of the company's demise and position of the financial distress. Unlike in a liquidation,[165] a practitioner must rely on the interaction and consultation with the directors and management of the company. There is no ability to interrogate directors and management under oath so that the true (and detailed) financial position of the company can be ascertained with certainty. The other challenge is that directors, while being expected to cooperate and assist the practitioner in his or her investigations, might be reluctant to provide a frank, honest and candid explanation as to the reason for the company's financial predicament.[166]

A major shortfall in Chapter 6 is thus the inability of the practitioner to "investigate" the affairs of the company (and in particular the actions of the directors and management) prior

164. Section 141 of the 2008 Companies Act.

165. In Chapter 14 of the 1973 Companies Act, the liquidator can in terms of section 417 and 418 interrogate directors, management and any person who has knowledge of the trade, dealings and affairs of the company prior to its winding-up

166. In terms of section 137(4) of the 2008 Companies Act, a practitioner is entitled to apply to court to remove a director from office on the grounds that the director has failed to comply with Chapter 6 or by act or omission has impeded or is impeding the practitioner in the performance of his or her powers and functions, the management of the company by the practitioner or the development or implementation of the plan. In order to establish factual evidence of such behaviour, a practitioner would find it extremely useful to be in a position to formally interrogate directors to support an application to court for a director's removal. Additionally, in terms of section 140(1)(c)(i) of the 2008 Companies Act, the practitioner can remove from office any person who forms part of the board or pre-existing management. Similar conditions would apply. Also see Van der Walt "A Turnaround Practitioner's View of New Business Rescue Legislation" in Harvey (ed) *Turnaround Management and Corporate Renewal: A South African Perspective* (2011) 168–169.

to the company filing for rescue. This, to an extent, allows directors (and management) to prefer the rescue process (due to the lack of a formal investigative process), as compared to liquidation, where the investigative provisions of sections 417 and 418 of the 1973 Companies Act (formal insolvency enquiries) would be applicable. The inability to take such evidence (under oath) in Chapter 6, supports the perception that the rescue process serves to sterilise creditors from properly investigating the conduct of directors and management in support of claims for reckless conduct (section 22), and civil claims (section 218) provided for by the 2008 Companies Act.[167]

On a positive note, it is submitted that generally practitioners appointed consider that more often than not, the principle of a better return than in liquidation provides a much more acceptable option for creditors (despite the lack of investigative powers) than would ever be the case in a liquidation. In addition to saving jobs, creditors are "winners" when a successful rescue is completed.[168]

8.3.1.13 SUPERVISION OF WINDING UP PROCESS

The lacuna in the legislation remains where a winding-up application is brought by a creditor and such winding-up process is suspended by the launch of a business rescue application.[169] The company is placed in a most invidious position. It has the prospect of being placed in liquidation but the liquidation process is suspended pending the outcome of a business rescue application. It is submitted that the legislature must deal on some basis with this hiatus period.

8.3.1.14 RANKING OF POST-COMMENCEMENT FINANCE CLAIMS

The need for post-commencement finance and the current uncertainty on the ranking of post-commencement finance remains a concern. Without available capital in a business rescue to pay ongoing expenses in the operation of the company, the effect to reorganise the enterprise is stillborn. As set out, the need for certainty in the ranking of post-commencement finance and the waterfall of payments is critical as this will encourage

167. Also see *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others* 2013 (4) SA 539 (SCA) at 56. Judge Rogers is similarly of the view that the lack of procedures within Chapter 6 of the Act is a weakness. This hampers the ability of the practitioner (compared to the liquidator) to properly investigate the affairs of the company.

168. The UP Report 40.

169. Section 131(6) of the 2008 Companies Act. See discussion of debate in Chapter 7, para 7.3.4.

more lenders to provide much-needed finance to the company in the proceedings. A key reason for the failure of rescue processes is the difficulty in obtaining PCF funding. Generally, PCF funders are reluctant "to put in any new money" into a company which is already financially distressed. The perceived "low preference" that a PCF investor will hold in the event of liquidation (if rescue fails) contributes to the lack of available PCF funding. Often, PCF funders perceive the risk to be too high when one considers the level of allocated preference provided by Chapter 6. Coupled with remaining uncertainty in regard to ranking of claims within a business rescue, PCF funding will, for the present, remain scarce.[170]

8.3.1.15 CIPC ROLE

The level of implementation by the CIPC in respect of business rescue is a strong feature of the UP Report and provides an excellent and in-depth analysis of the inner-operations of the CIPC when it comes to rescue procedures.[171] Certain highlighted issues and weaknesses were as follows:

- while a sworn affidavit is mandatory,[172] there is no real evaluation on whether the company truly meets the criteria of business rescue;[173]
- the process of the certification by the CIPC appears to be seamless (but without real and effective evaluation of the candidate), particularly for previously appointed practitioners;[174]
- there is a limited analysis of the stipulated documentation submitted by a "first time" practitioner;[175]
- there are no defined criteria in the form of an accreditation process for appointment of practitioners;[176]

170. See the UP Report 46 and 81–82. PCF is identified as a key requirement for rescue success.
171. Ibid 61–64 and 82.
172. Section 129(3)(a) of the 2008 Companies Act.
173. The UP Report 62.
174. Ibid. This is of concern, as some previously appointed practitioners have been found unfit to operate as practitioners, yet continue to receive appointments without any intervention by the CIPC.
175. Ibid.
176. Ibid. This despite the efforts of the CIPC (in July 2011) to evaluate accreditation models "locally and internationally".

- there is no real "policing" of the failure by practitioners to submit their status reports;[177]
- there is a lack of timeous response and absence of availability to address queries;[178]
- inaccuracy and inconsistency of appointment procedures is prevalent;[179]
- there is a general lack of capacity (resources);[180]
- there is a failure by practitioners to submit substantial implementation or termination reports;[181]
- there is a lack of enforcement by the CIPC at all levels.[182]

It is submitted that it is of concern that the CIPC generally does not fulfil its perceived role in the business rescue process to the expected and required levels. The sustainability of the CIPC going forward remains open to question and the legislature is required to intervene.

The UP Report has suggested that an "Expert Advisory Committee to the CIPC" ("CIPC Expert Committee") be established by government as soon as possible.[183] The CIPC Expert Committee would serve as an effective "watchdog" over the CIPC and deal with the shortfalls and weaknesses identified above and in the UP Report. Business rescue is a highly specialised field and thus the CIPC Expert Committee could support the Regulator and "build internal capacity".[184] It is submitted that the establishment of such a CIPC Expert Committee would contribute greatly to improving confidence levels at the CIPC

177. See obligation in section 132(3)(a) and (b) of the 2008 Companies Act. Those status reports that are submitted are not critically analysed or mitigated; see the UP Report 62.
178. On 31 March 2015, the CIPC had no alternative but to release a notice to companies and close corporations to inform all stakeholders that there would be continued delays in the business rescue process due to "lack of processing capacity". See CIPC website http://www.cipc.co.za. Also see the UP Report 62.
179. The UP Report 82.
180. Ibid 64.
181. Ibid 62.
182. Ibid 62–63. Continuing to neglect this division (enforcement) may cause a continuous corrosion of the legitimacy of the CIPC and as a consequence have a serious impact on the industry. For an in-depth analysis of the inner workings (or lack thereof) at the CIPC, see pp. 63–64. These shortfalls have been identified as system breakdowns, lack of response rates, resource constraints (staff), lack of knowledge requirements and general lack of effectiveness.
183. The UP Report 87.
184. Ibid.

and thereby result in better service to the practitioners and all stakeholders involved in the rescue indirectly.[185]

8.3.1.16 REASONABLE PROSPECT

A critical issue which will serve to create a better understanding for assessment of entry levels into a rescue process, will be the clarification of the test for what constitutes a "reasonable prospect" as set out in section 129(2)(b) and in section 131(4) of the 2008 Companies Act.[186] Although the legislation does not assist with a clear and precise definition of such term, certain judgments have served to clarify the meaning of a "reasonable prospect".[187] Unfortunately, as set out above, conflicting decisions have not assisted in providing clarity. Certain decisions have set a high level of proof for the grant of a business rescue order, while others have taken a more flexible approach.[188]

Professor David Burdette encapsulates the position when he states:

> While there have clearly been many attempts to abuse the business rescue process the business rescue process should of course be aimed at saving viable companies, and it would have been useful if the court could have at least tried to develop a test or threshold as to when a company is still viable.[189]

8.3.1.17 INAPPROPRIATE VOTE

The vagueness of the term "inappropriate vote", as set out in section 153(1)(a)(ii), remains unsatisfactory.[190] Although section 153(7) attempts to provide some guideline on the manner in which a vote can be set aside, the section is cast in very wide terms, providing very little certainty for the basis to set aside an "inappropriate vote".

Perhaps, the legislature could introduce a definition of "inappropriate" in section 128 which would provide the practitioner and affected persons with an indication as to when

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185. See Ensor "Business registration looks set to take half the time" (15 April 2015) *Business Day* available at http://www.bdlive.co.za/business/2015/04/15/business-registration-looks-set-to-take-half-the-time, where it was reported that "the long delay in registering a business with the CIPC could be halved once it introduces biometric verification in collaboration with the Department of Home Affairs". It is submitted that this upgrade in IT systems could possibly be used in streamlining business rescue processes and the filing of formal documentation in due course.
186. The UP Report 79.
187. See *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others* 2013 (4) SA 539 (SCA).
188. See Meskin *Insolvency Law and its Operation in Winding Up* (1990+) 18-34 at para 18.1. Also see discussion in Chapter 7, paras 7.3.1 to 7.3.3.
189. See the UP Report 56.
190. See discussion in Chapter 7, para 7.8.2.

they could apply to court to set aside a vote as being "inappropriate". The cases which have deliberated on the issue have indicated that the term remains vague and open to differing interpretations.[191] Clearly an amendment is needed.

8.3.1.18 LIQUIDATION PROCEEDINGS

The further complication set out in section 131(6) and (7) in reference to the term "liquidation proceedings" needs to be clarified. In this regard, reference is made to the debate over the meaning of these sections set out above. Is the term "liquidation proceedings" confined to the actual process of winding-up consequent upon an order of winding-up having been issued by a court, or does it only refer to the "liquidation application" brought for such company's winding-up?[192]

8.3.1.19 BINDING OFFER

Another very important issue which is a major weakness in the legislation and which requires clarification, is that of the "binding offer" principle set out in section 153(1)(b)(ii). If the recent SCA decision in *African Banking Corporation* is correct, then the concept of a cram-down on dissenting creditors has been watered down. The cases set out the divergent views in respect of section 153(1)(b)(ii). If the decision in the *DH Brothers* case is indeed correct, then secured creditor's rights are protected and remain unaffected by a binding offer. Whether or not the legislature intended to divest a dissenting creditor of its future rights to participate in the vote on a business rescue plan, and the effect of the binding offer, requires clarification. The legislature, when granting parties such powerful rights, i.e. to buy out a dissenting creditor at liquidation value, should have been more definitive as to the nature of such right, the mechanism to be used and the effect that such "binding offer" would have on the recipient (offeree).[193]

8.3.1.20 COMMENCEMENT OF BUSINESS RESCUE

There further remains some uncertainty as to when business rescue proceedings commence. It appears clear that business rescue in the voluntary commencement procedure would commence from the date of the filing with the CIPC of the section 129 resolution.

191. See *KJ Foods (supra)* and *Ex Parte Target Shelf (supra)* – Chapter 7, para 7.8.2.
192. See discussion in Chapter 7, para 7.3.4.
193. See Chapter 7, para 7.8.2.

Uncertainty remains (despite deliberation in the cases) as to when business rescue commences in the compulsory commencement (section 130–131, by court order) procedure. Debate continues as to whether compulsory initiation of the business rescue process occurs at the time the application is made to court in terms of section 131(1), or on the date of the court order for business rescue itself. The discrepancy and time delay from the date when the application is brought to the date of the final order for business rescue, creates a host of practical problems as is identified above.[194] Clarity is thus required as to exactly when compulsory business rescue commences.[195]

8.3.1.21 GENERAL ISSUES

The UP Report further makes some useful recommendations[196] to be considered by the CIPC and by the legislature.[197] These include the following:

- Regulation of the industry. This would ensure a "predictable and equal playing field".[198] Effective regulation at the CIPC should include fast-tracking procedures, keeping proper statistics, developing the processes in support of required legal action, a robust complaints procedure, a tribunal option, an ombudsman, a specialised "Business Rescue Court", the establishment of the Expert Advisory Committee to the CIPC, and rules for the accreditation, appointment and licensing of practitioners.[199]

- A proposal that creditors ratify the appointment of business rescue practitioner on appointment, rather than at the first meeting of creditors.[200]

- A procedure to enable the practitioner to "resign" from a rescue after an appointment.[201]

- A differentiation in the licensing process for existing and new appointments.[202]

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194. See Chapter 7, paras 7.3.1, 7.3.2 and 7.3.4.
195. See discussion in Chapter 7, para 7.3.4.
196. See the UP Report 84.
197. In respect of the author's own recommendations for reform, see Chapter 8, para 8.4.
198. See the UP Report 85, para 7.2.
199. Ibid 85–88.
200. See section 147 of the 2008 Companies Act. The reason for this novel suggestion is that the banks have a history with the filing company (going into rescue) and would have an ability to properly evaluate the company's history and make-up with the nominated practitioner; see the UP Report 88. This would require an amendment to the 2008 Companies Act.
201. The UP Report 88.

- A requirement for previously licensed business rescue practitioners to be evaluated by peers, and the establishment of a post-mortem assessment and investigation procedure by a respectable professional body. Once "approved", such practitioners duly evaluated could become part of the business rescue practitioner "pool" and obtain membership to a professional body as potential practitioners for appointments.[203]

- Prospective practitioners should be allowed to apply to the CIPC for prior vetting. Such applications could be continuously vetted (on a monthly or quarterly basis) by a panel of peer reviewers. Detailed background checks (criminal and credit records, and good standing with relevant professional bodies) could be part of the vetting procedure.[204]

- A process needs to be set up to investigate complaints against business rescue practitioners.[205]

- A formal accreditation process is urgently required. It would be preferable if such accreditation body (a subcommittee of the proposed expert advisory committee) could oversee the selection and training of business rescue practitioners.[206]

As appears from the aforegoing, legislative amendment to the 2008 Companies Act will be required. The UP Report suggests that a formal process be commenced in respect of such proposed amendments.[207]

Shortfalls in the legislation were recognised by Loubser from an early stage. Loubser pointed out that the challenge in South Africa will be creating a successful and acceptable business rescue procedure in what is a creditor-friendly system. Due to the failure of judicial management as a "rescue procedure", no rescue culture had developed in South

202. Ibid 88–89.
203. Ibid 89.
204. Ibid.
205. Ibid.
206. Ibid 90–92. This should include examination and formal entry requirements for practitioners.
207. Ibid 95. It is uncertain as to when the 2008 Companies Act is to be amended, although it is likely that these amendments will occur in the near future.

Africa. Historical negative attitudes towards judicial management invariably would affect acceptance levels of the new rescue procedure.[208]

In addition, Loubser was concerned of the impact that external factors might have on elements of business rescue in South Africa. Cultural and political factors should not be underestimated. A general pervasive culture of negativity, with business rescue seen as "the last refuge of the terminally insolvent" would not assist in the acceptance of the new procedure. Hopeless rescue plans, which delay the inevitable liquidation process, fees for practitioners being created at stakeholder expense, and a general lack of care in assessing whether business rescue was in fact a viable option, all add to the sense of negative perceptions. As Loubser points out, the real issue will be bridging the "credibility gap" when it comes to stakeholders supporting the business rescue process.[209]

It is submitted that all in all, save for the above considerations and weaknesses, Chapter 6 is working. As time goes by, the various stakeholders and especially creditors are becoming more and more confident in the workings and outcomes of the new legislation. The steady evolution of reported cases indicates a definite trend that business rescue is proving to be a real alternative to liquidation. The procedure is being used, and is arguably being used more effectively, as companies and their advisers get comfortable with the procedure.[210]

This is supported by the fact that many creditors, once on board in a business rescue, do not hastily rush off to court to set aside the resolution (section 129) or the order granted by the judge in placing the company into business rescue. Rather, creditors remain involved and generally work with the practitioner and other affected persons in an effort to achieve the best possible outcome that can be achieved in the circumstances of each distressed company. This bodes well for the future of business rescue in South Africa and certainly brings South Africa into line with the international principles of corporate rescue referred to above.

208. Loubser "The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions" Part 2 (2010) 4 *TSAR* 700–701.

209. Ibid. Also see Marcus "South Africa Reforms Business Rescue Laws: New Objectives, New Opportunities" (30 September 2013) available at https://www.dlapiper.com/en/global/insights/publications/ 2013/09/south-africa-reforms-business-rescue-laws--new-o_/.

210. Kleitman "Evolving Business Rescue" (July 2014) *Without Prejudice* 28–29.

The critical issue is the change in mind-set from a liquidation culture to a rescue culture. As Bradstreet emphasises, the crucial element for the success of the new procedure is a change in mindset in corporate reorganisation in South Africa. Business rescue should not be seen as "a halfway house to liquidation". If creditors approach business rescue with levels of confidence, and actively participate in the rescue process, it is more likely that rescues will be successful.[211]

The impact that the provisions of Chapter 6 have had on the South African restructuring and formal business rescue processes were recognised in the *World Bank Report on the Observance of Standards and Codes – Insolvency and Creditor Rights* of 2012:

> The insolvency regime in South Africa is extraordinarily complex, as the provisions applicable to the insolvency proceedings are dispersed across five different statutes. The system is geared towards liquidation, and the perception is that the insolvency process is costly, not very effective, and does not yield significant returns for creditors. There are several issues that would deserve attention in the assessment of the liquidation process, such as the criteria for access to the processes, the treatment of executory contracts, and the classification of creditors.
>
> The Companies Act 2008, in force since May 2011, has introduced a reformed compromise procedure and a new business rescue procedure, in an attempt at creating an effective reorganization mechanism and resolution framework. The business rescue procedure holds considerable promise: it is important, however, to observe how some key provisions in this new procedure are implemented in practice and applied by the courts. In any case, the enactment of a general insolvency law would ensure a coherent policy vision, and an easier coordination with other areas of the law, such as secured transactions and individual enforcement procedures.[212]

There is no question that business rescue is fast becoming the option of choice when it comes to dealing with companies that are in financial distress. As a result, liquidations of companies have been dropping steadily since the introduction of business rescue in May 2011.[213] It is submitted that the decline in company liquidations since the introduction of business rescue in May 2011 can, at least, partially be ascribed to the alternative offered in business rescue proceedings.

211. Bradstreet "The New Business Rescue: Will Creditors Sink or Swim?" (2011) *SALJ* 380.

212. The World Bank *Reports On the Observance of Standards and Codes – Insolvency and Creditor Rights* (June 2012) available at http://www.worldbank.org/ifa/rosc.html 3. Also see comment on the World Bank Report in Boraine and Roestoff "Revisiting the State of Consumer Insolvency in South Africa After Twenty Years: The Court's Approach, International Guidelines and an Appeal for Urgent Law Reform" (2014) 77 *THRHR* 351–374 (Part 1) and 1–20 (Part 2).

213. Statistics SA show that company liquidations have been steadily dropping. Figures for November 2015 show that the total number of liquidations decreased by 18,3 per cent year on year for November 2015 compared with the same period in 2014. Whether this is directly related to the introduction of business rescue is difficult to tell, but there is no doubt that directors of companies are beginning to use business rescue as an alternative to liquidation. See http://www.statssa.gov.za/?s=Statistics+of+Liquidations+and+insolvencies&sitem=publications.

Business rescue provides companies with an opportunity for a fresh start and a healthy "breathing space" in which to restructure. Business rescue is a far more cost-effective process than the costly intervention of opposed winding-up applications, which sometimes take weeks to resolve. The company can adopt its section 129 resolution, appoint a practitioner, develop a plan, have it adopted and exit business rescue (in theory) in a period of three months.

8.3.2 SUCCESS OF BUSINESS RESCUE IN SOUTH AFRICA

Prior to the introduction of Chapter 6 in South Africa, the benefits of an effective business rescue regime were recognised. Rajak and Henning state:

> A radically reformed business rescue regime in South Africa would minimize the risk to the lender by carefully tailored monitory provisions, taking account of the interests of borrowers who want the freedom and financial resources to help build the fresh infrastructure of the new South Africa and of the interests of lenders who want some security to set against the risk of lending.[214]

After a period of almost four years, it is clear that business rescue is a success and a saviour for companies in financial distress, but only where there has been a reasonable plan implemented which has resulted in the company being allowed to continue trading on a solvent basis. The latter outcome occurs either where the company continues to trade in the same entity albeit on a restructured basis, or where the entity has been sold off to new owners and where such company continues to trade under the helm of such new owners.

Most creditors go along with the process. After all, their only alternative is to resist, thereby pushing the company into a liquidation scenario with low realisations at liquidation values. Once the practitioner has taken control and the time lines offered by the 2008 Companies Act are being met (even on an extended basis), creditors are generally happy to wait it out in order to secure their preferable business rescue dividend, even though on a compromised basis. Bradstreet commented that academics are of the view that a business rescue regime is far more likely to succeed if it operates within a debtor-friendly system of insolvency. Chapter 6 is debtor-friendly, but at the same time does not act necessarily to the detriment of creditors. The concept of rescue of financially distressed companies

214. Rajak and Henning "Business Rescue for South Africa" (1999) *SALJ* 275.

clearly promotes free enterprise and which supports the interests of national economic development.[215]

The change in mind-set from a liquidation culture to one of rescue is slowly becoming apparent. Loubser highlighted the need for a change in attitude and was of the view that a change in mind-set was required. Only a very small number of distressed companies are capable of being rescued in the true sense, in other words, "returned to a solvent state". The vast majority of companies that enter business rescue proceedings by being financially distressed should be placed into liquidation. If liquidation is the correct alternative, and if the case is appropriate, liquidation can achieve the same or even better results, than a formal business rescue procedure.[216]

Further, the attitude adopted by our courts appears to be shifting strongly in favour of supporting the business rescue process:

> I am a proponent of supervision and business rescue proceedings and am a firm believer that if the spirit and purpose of the Act is given effect to, success will be achieved and the proceedings will not become redundant as was the case with judicial management under the 1973 Companies Act. If a purposive approach to interpretation of the Act is undertaken as one should do, there can be little doubt that companies, being vehicles to obtain economic and social well-being, should rather be rescued if at all possible, then "killed" in a winding-up process. However, all stakeholders will have to participate bona fide all the time and within the prescripts of the law.[217]

It is submitted that business rescue is working and we are seeing more and more stakeholders supportive of the process. Very few creditors see fit to attempt to interfere with or overturn (vote down) plans, and are generally in favour of receiving a better pay-out than in liquidation. Success of business rescue is in the mind-set of the particular stakeholders and is measured by the extent that the business rescue provides such stakeholders with a favourable and lucrative outcome.

In the period subsequent to May 2011, business rescue proceedings were met by intense scepticism and many stakeholders were dismissive of the process. The banks and financial

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215. Bradstreet "The Leak in the Chapter 6 Lifeboat: Inadequate Regulation of Business Rescue Practitioners may Adversely Affect Lenders' Willingness and the Growth of the Economy" (2010) *SA Merc LJ* 210–211.
216. Loubser "Tilting at Windmills? The Quest for an Effective Corporate Rescue Procedure in South African Law" (2013) *SA Merc LJ* 456–457.
217. Judge Daffue in *Absa Bank Limited and John Frederick Kneale Cain NO, CRIR Properties CC* (FB) Case No. 3813/2013 (2 April 2014) (unreported) 40 at para 47.

institutions saw business rescue as an opportunity for distressed companies to get the benefit of a moratorium period from creditor claims in cases where there was really no viable business rescue plan envisaged on any basis. Many of these companies were driven into the business rescue process by practitioners who promised successful outcomes but where the only driving factor was the ability to ratchet up fees for such a practitioner while the company was being "restructured". Wassman highlighted the contentious nature of business rescue precedent and was of the view that our courts are no longer faced with simplistic applications whereby any affected person can, on application to the High Court, apply to have a company placed under business rescue. Matters are made more complex where competing applications for liquidation and business rescue are being considered simultaneously by our courts. Notwithstanding, our courts have dealt with these cases admirably and have set important business rescue benchmarks in certain of these cases.[218]

As set out above, many companies have exited from the business rescue process successfully with business rescue dividends being paid well in excess of what creditors would have received in a liquidation. This outcome is contemplated by the second part of the definition of business rescue,[219] and is echoed in international jurisdictions as being a successful outcome from a restructuring process.[220]

Dividends that have been paid include 4 cents in the rand in the case of Meltz Success,[221] 10 cents in the rand in the case of ATE[222] and 10 cents in the rand in the case of ODM.[223]

The Moyo Group (African-themed restaurant chain) of restaurants was brought out of business rescue by the Fournews Developments Group. Some five restaurants were bought

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218. Wassman "Business Rescue: Getting it Right" (January/February 2014) *De Rebus* 36.
219. Section 128(1)(b)(ii) of the 2008 Companies Act.
220. For a synopsis of the current state of business rescue in South Africa, see Deloitte & Touche *South Africa Restructuring Outlook Survey Results 2015 – The Industry Speaks* (15 April 2015) available at http://www2.deloitte.com/content/dam/Deloitte/za/Documents/finance/ZA_RestructuringOutlookSurveyResults_2015.pdf. Also see Timme and Henderson "South Africa: increasing adoption of a rescue culture" in Fessey (ed) *Business Restructuring and Insolvency Report* (2015) 89–93.
221. See Planting "Fashion Chain Meltz in Business Rescue" (6 March 2013) *Moneyweb* available at http://www.moneyweb.co.za/archive/fashion-chain-meltz-in-business-rescue/.
222. See Helfrich "ATE set to become part of Paramount Group" (22 April 2013) *defenceWeb* http://www.defenceweb.co.za/index.php?option=com_content&view=article&id=30222:ate-set-become-part-of-paramount-group&catid=7:Industry&Itemid=116.
223. See Laher "New Business Rescue Law gives Strategy by TopTV a lifeline" (3 May 2013) *GoLegal* available at http://www.golegal.co.za/business/new-business-rescue-law-gives-struggling-toptv....3/5/13.

out, with over 500 employees keeping their jobs. Creditors received approximately (average) 10 cents in the rand as part of the compromise offered on claims.[224]

Other successes include the property estates Pearl Valley, Romansbaai Beach, Fynbos Estate and Wedgewood in the Western Cape.[225] Property syndication groups such as the Louis Group were also placed into business rescue and creditors have voted in favour of a plan which has allowed the group to continue to trade its vast and diversified group of property portfolios, such as the Louis Pasteur Hospital in Pretoria.[226]

The Southgold acquisition of Witsgold is probably the biggest business rescue to date. Witsgold paid approximately USD 7,25 million towards Southgold's creditors in late 2013. The acquisition placed Witsgold in possession of the Burnstone Gold Mine, enabling it to be placed back into production after operations had been suspended for over a year. More recently, Sibanye Gold Exploration has bought out Witsgold, a key driver of which was the acquisition of the Burnstone mine.[227]

In most cases, employees have continued in the main to provide services to the company after the practitioner had exited and subsequent to the implementation of the plan. In those cases where the company had been bought out of business rescue, new management has assisted in the implementation of the plan with those managers and directors remaining in place after the business rescue process had terminated.[228]

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224. See Peacock "Moyo Restaurant Buyer Found after Business Rescue" (2 February 2014) *Business Day* available at http://www.bdlive.co.za/businesstimes/2014/02/02/moyo-restaurant-buyer-found-after-business-rescue. Also see Muller "Business rescue can work" (27 March 2014) *Financial Mail* available at http://www.financialmail.co.za/features/2014/03/27/business-rescue-can-work accessed for a report on the success of various business rescue processes including the business rescue of the Shelley Beach Hotel, KwaZulu-Natal.

225. See Peacock "Luxury Estates Rise from an Unplayable Position" (26 January 2014) *Business Day* available at http://www.bdlive.co.za/business/property/2014/01/26/luxury-estates-rise-from-an-unplayable-position.

226. See Du Preez "Louis Group Investors Take Big Income Cut" (28 April 2013) *Independent Online* available at http://www.iol.co.za/business/personal-finance/louis-group-investors-take-big-income-cut-1.1507181#.VlAyZXYzdD8.

227. See Odendaal "Witsgold Issues Cautionary as Southgold Buy-out Agreement Still under Negotiation" *Engineering News* (17 February 2014) available at http://www.engineeringnews.co.za/article/wits-gold-issues-cautionary-as-southgold-buy-out-agreement-still-under-negotiation-2014-02-17.

228. ATE is a good example. Subsequent to the purchase of ATE, the Itzikowitz Group placed a significant number of employees, managers and technicians with the aeronautical company to ensure its continued success. The same applied in the StarTimes (StarSat) acquisition of ODM and in the Hubs acquisition of Meltz Success. See McLeod "StarSat will be a 'serious competitor'" (10 February 2014) *TechCentral* http://www.techcentral.co.za/starsat-will-be-a-serious-competitor/46334/ on the successful acquisition by StarTimes (StarSat) of ODM and the fact that such company has now emerged as a "serious competitor" to Multichoice in the provision of satellite television services in South Africa Other companies that commenced with business rescue processes which failed (and ended up in liquidation), are companies such as Pinnacle Point Gold Estate, Blyvooruitzicht Mine, 1Time Airlines and Velvet Sky Airlines. The South African media and press have been highly supportive of the business rescue process. The effect that business rescue has had on job retention has been a strong feature of their interest in the topic. The fact that employment contracts are suspended in a liquidation, pending a final decision by a liquidator after a period of 45 days, is of concern. In business rescue, employment contracts are preserved, on the same terms and conditions, with labour legislation remaining applicable. See Pickworth "Business Rescue Slow to Catch on in SA" (17 February 2014) *Business Day* available at http://www.bdlive.co.za/business/2014/02/17/business-rescue-slow-to-catch-on-in-sa. Also see Salant "Business Rescue Operations and the New Companies Act" (January/February 2010) *De Rebus* 30, where he states:

In further comment provided by the Minister of Trade and Industry, Rob Davies, he appeared to be satisfied with the reported 15 per cent success rate for business rescue. The business rescue provisions were considered at a symposium organised by the Department of Trade and Industry in August 2014. Judge Dennis Davis was of the view that the new act was predicated on a radical break from exclusively protecting the interests of creditors and shareholders. It also now dealt with the interests of employees and trade unions. The preservation of jobs remained a vitally important consideration when assessing the success of business rescue in South Africa.[229]

Of course, not all business rescue matters have concluded successfully. Pinnacle Point, Velvet Sky, 1Time Airlines and Sharemax[230] have all ended up in liquidation. There are other examples of failure.[231]

The mega-filing for business rescue of the furniture retailer Ellerines (after the curatorship of its parent African Bank Investments Limited – ABIL) set in motion a complete shake-up of the microloan business throughout the furniture retail sector. A shortfall of R8,5 billion left these companies with no alternative but to file for formal processes, i.e. curatorship in the case of ABIL and business rescue in the case of Ellerines. The duly appointed business rescue practitioner formulated a plan which involved a formal restructuring of the company with certain leases being cancelled, divisions being sold to third parties and a further consideration of the sale of the book debt.[232]

It is evident from the provisions of the New Act that the survival of the company is of paramount importance and that all stakeholders are given formal recognition in participating in the court proceedings to the extent allowed by the Act in ensuring this objective. At a time when the providing and maintaining of jobs is vital, the business rescue plan goes a long way in affording employees and other affected persons the right to express their views on the rescue plan and provides a practical mechanism that has a more than even chance of succeeding and avoiding a liquidation.

If international trends are anything to go by, business rescue most certainly is the breath of fresh air the business community has been waiting for. Considering the current financial environment and that the whole world is suffering from a recession, statistics such as the estimated 47 per cent success rate achieved in the United Kingdom relating to business rescue might bring relief to the affected persons. Though still to be tried and tested in South Africa and at the risk of it sounding like the worst of all clichés … only time will tell.

229. Visser "Provisions for Business Rescue under the Spotlight" (25 August 2014) *Business Day* available at http://www.bdlive.co.za/business/2014/08/25/provisions-for-business-rescue-under-spotlight. Also see Khuzwayo "Business Rescue under the Spotlight" (12 August 2014) *Cape Times.*

230. See Pickworth "Receiver Pushes to Liquidate Sharemax" (19 September 2014) *Business Day* available at http://www.bdlive.co.za/business/financial/2014/09/19/receiver-pushes-to-liquidate-sharemax.

231. A high profile failure of a business rescue process was Blyvooruitzicht Gold Mine (which filed for liquidation after a failed business rescue in March 2014).

232. See Rees and Crotty "Ellerines Rescue No Free Ride for ABIL" (12 August 2014) *Business Times* available at http://www.bdlive.co.za/business/retail/2014/08/10/ellerines-rescue-no-free-ride-for-abil; Rees "Bitter Turnaround Medicine for Ellerines" (14 September 2014) *Business Day* available at http://www.bdlive.co.za/businesstimes/2014/09/14/bitter-turnaround-medicine-for-ellerines; Matuson "A Case Study: Turnaround Medicine for Ellerines" Presentation at GIBS *Corporate Renewal, Business Turnaround and Rescue – Challenges, Pitfalls and Remedies* (5 March 2015).

The successful exit of the Johannesburg Philharmonic Orchestra from its business rescue process in September 2015 (after being in rescue since 2012), certainly bodes well for the Chapter 6 process. A compromise plan to its R23 million body of creditors (including SARS) was approved and it is now back in business.[233]

The fact is that, but for the intervention of the new business rescue process in South Africa, many of these companies would have been liquidated with the resultant negative impact on the workforce and the South African economy as a whole. Bradstreet states:

> In conclusion, it is perhaps worth noting that South Africa's legislative approach to insolvency may be departing from the traditional view taken in the United Kingdom and Europe where insolvent companies are treated as cursed and delinquent. Business rescue appears to be underpinned by a more pragmatic philosophy that recognises the value of both debtor and creditor in the market place.[234]

In May 2013, the SCA handed down its first judgment on business rescue in the case of *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd and others*.[235] This was indeed a seminal case in the context of business rescue and confirmed an interpretation of "business rescue" that embraces the protection of creditors. In the light of the international experience referred to above, this case confirms the shift away from the more traditional creditor-oriented insolvency procedures that may be traced back to South Africa's English Law roots. The 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.[236]

Brand J confirmed that creditors' interests are aligned and are protected by the rehabilitation outcome offered by section 131 (4) of Chapter 6. The two goals, namely to return the company to solvency or provide a better deal for creditors and shareholders than

233. See Financial Mail (24 September – 30 September 2015) 61–62. Another very controversial business rescue is that of Optimum Coal Mine (part of the Glencore Group).

234. Bradstreet "Lending a Helping Hand – The Role of Creditors in Business Rescue?" (December 2013) *De Rebus* 23. For further discussion on the success of business rescue see Kleitman and Masters "Better Returns for Creditors – Business Rescue (August 2013) *Without Prejudice* 34–36; Wasserman "Business Rescue: Getting it right" (January/February 2014) *De Rebus*; Levenstein "Getting Clever with Business Rescue" (August 2012) *Without Prejudice* 30; Levenstein "Sink or Swim? Business Rescue the Art of Treading Water" (March 2012) *Without Prejudice* 12–13.

235. *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others* 2013 (4) SA 539 (SCA). Since such hearing, the SCA has deliberated on many other important elements of Chapter 6 – see references above. Further deliberations were considered in *New City Group (Pty) Ltd v Pellow NO and Others, China Construction Bank Corporation Johannesburg Branch v Crystal Lagoon Investments 53 (Pty) Ltd and Others* (12/45437, 16566/12) [2013] ZAGPJHC 54 (28 March 2013).

236. Bradstreet "Lending a Helping Hand – The Role of Creditors in Business Rescue?" (December 2013) *De Rebus* 22–23.

they would receive through a liquidation, are results which the legislature sought to achieve by the introduction of the business rescue process.[237]

In a very informative seminar held at the University of Pretoria on 7 October 2014, various speakers gave their views on the status of business rescue since its inception in 2011.[238] Certain business rescue practitioners expressed their frustration in respect of the overtly strict nature of the expectations set out in the 2008 Companies Act and which practitioners had to comply with, in order to ensure the success of a business rescue process. A business rescue practitioner presented practical examples of very successful business rescue processes culminating in the rescue of significant companies. Aspects of the self-regulation of business rescue practitioners and the possibility of the accreditation of professional bodies were also discussed.

The Deloitte South African Restructuring Outlook Survey 2015 provides an extremely useful snapshot of the current state of play of business rescue in South Africa.[239] The survey highlights the similarities and differences across different institutions and industries with regard to restructuring expectations, behaviours and insights. The Deloitte survey concludes as follows:

> Overall respondents commented that Business Rescue is a growing industry. Respondents have seen an increase in both the number of cases and success thereof. Evidently this will create awareness to stakeholders and lenders and allow them to tap into an untapped market in the near future.
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> Respondents have clearly noted that in order for the industry to grow it needs to correct the flaws in the legal environment. They also highlight the importance of the appointment of a regulatory body.[240]

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237. Ibid 23.

238. University of Pretoria *Business Rescue – First three years* (7 October 2014).

239. See Deloitte & Touche *South Africa Restructuring Outlook Survey Results 2015 – The Industry Speaks* (15 April 2015) available at http://www2.deloitte.com/content/dam/Deloitte/za/Documents/finance/ZA_RestructuringOutlookSurveyResults_2015.pdf. The Deloitte Restructuring Team, headed up by Wanya du Preez of Deloitte, interviewed more than 30 restructuring professionals across all disciplines in order to gain insight into their expectations for the restructuring landscape in 2015 (see foreword by Nisha Dharamlall, Head of Restructuring Services: South Africa on p. 3 of the survey). The survey and report were launched and debated at a seminar held at Deloitte on 15 April 2015 and is produced annually.

240. Deloitte & Touche *South Africa Restructuring Outlook Survey Results 2015 – The Industry Speaks* (15 April 2015) available at http://www2.deloitte.com/content/dam/Deloitte/za/Documents/finance/ZA_RestructuringOutlookSurveyResults_2015.pdf 45. For counter-views on the success of business rescue, see Van Zyl "As insolvencies drop, is business rescue working" (October 2015) *Business Day – Business Law and Tax Review*. Also see Visser "Business rescue in SA fails to deliver" (19 October 2015) *Moneyweb* available at http://www.moneyweb.co.za/moneybweb-opinion/soapbox/business_rescue_in_SA_fails. Also see Visser "SA's business rescue failing" (26 October 2015) *The Citizen*.

More recently, the UP Report indicated that business rescue had a success rate of 9,4 per cent up until March 2015.[241] The success rate was measured against the number of notices of substantial implementation filed by companies with the CIPC (Form CoR125.3).

It is submitted that the UP survey, together with the Deloitte survey, provides significant and important data to enable us to measure the success of business rescue. The extent and competency of these reports reflect an enthusiasm and interest by stakeholders to continue to develop thinking in the business rescue space.

The question of what constitutes a successful business rescue remains topical but unanswered. The UP Report provides useful data, as does the Deloitte survey. The evaluation criteria of what makes up a successful rescue regime has been considered in the international rescue arena. There is no doubt that findings of success internationally equally apply to measuring the South African rescue regime.[242]

Key indicators of success include the going concern status on existing business rescue and whether the return to creditors was maximised as opposed to liquidation.[243] A study conducted by Conradie and Lamprecht[244] indicated that given the unemployment rates in South Africa, the expectation from government and the general public for successful rescue in South Africa is high.[245] Conradie and Lamprecht conclude that "since our business rescue regime has similar goals to the main international regimes, we can draw from the criteria and indicators of success used to evaluate the success of the international regimes to formulate criteria and supporting indicators to evaluate the success of the local regime.[246]

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241. See the UP Report 33. The report states that there were 132 successes (out of 1398 filings) dependent upon a successful reorganisation and/or a better return for creditors than they would receive in a liquidation. In October 2012, the CIPC had reported that 15 per cent of business rescue filings had been successful, a figure much higher than that reflected in the UP Report of March 2015. In September 2015, the CIPC reported that the success rate for business rescue was at 12 per cent – see http://www.cipc.co.za/files/5914/4488/9277/Status_of_Business_Rescue_in_South_Africa_September_2015_version1_0.pdf. The report covered the period from 1 May 2011 to 30 September 2015 and confirmed that 238 proceedings were substantially implemented by the filing of a Notice of Substantial Implementation (CoR125.3). It is submitted that accurate statistics on successful business rescue available from the CIPC remain unreliable.

242. See Conradie and Lamprecht "Business rescue: How can its success be evaluated at company level?" 19(3) (2015) *SABR* 1.

243. Ibid. It was further found that an initial exit as a going concern may only be a short term success indicator. Success can ultimately only be established if further investigation reveals after some time period that no re-filing for business rescue is necessary.

244. Ibid. See the methodology employed and the empirical data sourced in this study. It is a very thorough examination of all of the factors and outcomes that result in a successful rescue. They include the number of companies having exited from the rescue process as a going concern, and those that have achieved a better return for their creditors and shareholders, either with or without the use of a going concern asset sale. Economic viability in the short and long term is another important indicator of prospective success. See 24.

245. Ibid 24.

246. Ibid 25. See comparisons and appraisal in Chapter 8, para 8.1.

Clearly, it is submitted, the similarities and parallels between the Chapter 6 legislation and those rescue dispensations existing internationally, make the comparisons easier to measure and determine the levels of success in all of such rescue regimes.

The success of business rescue in the next few decades will depend on continued debate, analysis and introspection into the process and its "perceived" or "actual" successes, with a view to improving the interpretation of the legislation and its development as part of the South African law of rescue.

8.3.3 STATISTICS

Despite initial scepticism, the South African business rescue procedure is starting to take hold and is being applied in companies where there are real prospects of rescue. The available statistics in the business rescue process emanate from the CIPC.[247] Although representatives of the CIPC have from time to time provided statistics to the rescue industry, these have been *ad hoc* and disparate at times. What follows is a brief summary of various statistics that have been made available by the CIPC from 2011 to date, which reflect the status of the rescue industry in South Africa.[248]

According to the CIPC, as at October 2014 there had been 64 successful business rescue proceedings and 45 companies ending up in liquidation as a result of the failure of business rescue proceedings. According to the CIPC, in October 2012, 55 per cent of all financially distressed businesses had successfully concluded their business rescue operations,[249] while 7 per cent were still in a business rescue process and 38 percent had gone into liquidation.

Despite the prescribed period of three months for business rescue proceedings to have ended, extensions have been granted beyond the three-month period.[250] The average time for a business rescue process to be consolidated is 5,6 months.[251]

247. Refer to the CIPC website www.cipc.co.za.
248. The most recent statistics published by the CIPC were in November 2015 – see http://www.cipc.co.za/enquiries. The UP Report (published in March 2015) also contains highly useful statistics applicable in business rescue in South Africa. Also see statistics published by the CIPC http://www.cipc.co.za/files/5914/4488/9277/Status_of_Business_Rescue_in_South_Africa_November_2015_version1_0.pdf.
249. CIPC Statistics as at 9 October 2012; presentation by the CIPC at a Bankers' Workshop.
250. Section 132 of the 2008 Companies Act.
251. CIPC Statistics given at a Bankers' Workshop on 9 October 2012.

The CIPC confirmed that 82 per cent of business rescues had commenced by way of resolutions in terms of section 129 of the 2008 Companies Act. In all other instances affected persons (the banks, shareholders, creditors and employees) had made application to court for an order for business rescue. Some 32 of the business rescue notices filed with the CIPC for business rescue had lapsed (a nullity) as the requirements of section 129(2) and (3) had not been met.

As at March 2013, 126 practitioners had been appointed and 840 companies placed into business rescue. The majority of appointees for business rescue practitioners were in Gauteng (60), with the remainder split up between the Western Cape (21), KwaZulu-Natal (12), Eastern Cape (4) and the balance in the rest of South Africa.[252]

In 2012, 80 business rescues ended up in resolutions lapsing and becoming a nullity, while 104 ended up in liquidation and 143 ended due to noncompliance with various provisions of Chapter 6.

As at May 2013, there were 143 business rescues that had terminated due to noncompliance with statutory procedures, and 9 terminating as a result of invalid procedures on filing of resolutions. As at May 2013, the CIPC had recorded 98 business rescues terminating on the basis set out above (since May 2011, exactly two years after date of implementation).[253]

In March 2014, out of the 653 businesses that have gone into business rescue, 264 have been rescued, while 52 have failed and have gone into liquidation. According to the CIPC, since May 2011, only 653 of the 1136 businesses that applied to the courts for the compulsory commencement of business rescue proceedings were granted an order to commence business rescue proceedings.[254] Pretorius states:

> It seems that the days of business rescue being perceived as a ruse for companies to run away from creditors are over, as it makes its mark in stemming the rate of liquidations in the country, especially among small businesses.[255]

252. CIPC Statistics: Lotheringen presentation at Leriba Lodge, Centurion, 6–7 March 2013.
253. CIPC Statistics: Lotheringen *CIPC Statistics – Advanced Course in Business Rescue* (PowerPoint LSSA, May 2013).
254. See Masote "Business rescue slows liquidations" (30 March 2014) *City Press Business* available at http://152.111.1.87/argief/berigte/citypress/2014/04/02/4/businessrescue_30_0_412751768.html.
255. Ibid.

According to statistics (March 2014) provided by the CIPC –

- in the first year of operation (after May 2011) and in the period 2011/2012, 8 per cent of the businesses that went into business rescue were saved;
- in its second year (2012/2013), 12 per cent of businesses that commenced with a business rescue process were saved.

With reference to the UP Report, more up-to-date statistics became available. The period of the UP Report covers the first three years and three months of business rescue – the period 1 May 2011 until 31 July 2014. Some of these statistics are as follows:[256]

- 1398 filings over 3,25 years;
- translates into 430,1/year average or a 35,8/month average;
- 400–500 filings per year;
- mainly private companies using the procedure;
- 135 out of 1398 filings have gone into rescue in terms of a section 129 filing;
- court applications mainly driven by "disgruntled creditors and shareholders" (50 per cent);[257]
- 8,57 per cent of applications to court have been refused;
- 132 out of 1398 (9,4 per cent) were successful;
- 31 per cent of companies reported that liquidation was the reason for termination of the business rescue process;
- time line for business rescue is 5,6 to 6,3 months on average.

According to the UP Report, reasons for the failure of rescue are varied. The general view is that rescue processes fail due to, *inter alia*, the unsustainability of the "reasonable

256. See the UP Report 29–35.

257. Most court applications are brought by major creditors (and not by other affected persons) because of the high costs of such applications. These applications are mainly brought by banks, high value creditors and shareholders to a lesser extent; see the UP Report 32.

prospect" principle; waiting too long before entering the process; shareholder disagreement; the integrity of available data, and a deliberate withholding of information.[258]

A key element (among others) for a failure of the business rescue process is the lack of PCF funding. In this respect, practitioners have only been able to obtain PCF in 29 per cent of cases. Sources vary, but in the main PCF is provided by shareholders and asset-based lenders (taking security over receivables and stock). Challenges in raising PCF funding include the lack of availability of assets available for security for the provision of PCF and an unwillingness on the part of existing banks (already exposed) to make further funding available in an already distressed situation.[259]

The reasons for business rescue plans not being approved are varied. Formal data confirms that 8 per cent of rescue plans were not accepted and therefore rescues were terminated. According to the UP Report –

- 70 per cent of rescue plans were published;
- 80 per cent of second creditors' meetings were held;
- 57 per cent of rescue plans were approved.[260]

Reasons for failure to approve plans varied from bad practitioner performance, failure of the legislative process, lack of competency and experience of practitioner, and the fact that some practitioners take on too many matters simultaneously and fail to give proper attention to the rescue process.[261]

As has been set out above, saving jobs was high on the list of priorities set by government when Chapter 6 became part of our law in May 2011. As appears from the UP Report, it

258. The UP Report 42. See factual data as to the reasons for failure on pp. 42– 436. In summary, the main reasons for failure were found to be as follows: 21 per cent due to insufficient creditor support, 15 per cent due to lack of PCF availability, 9 percent due to failing to substantially implement the rescue plan, and 45 per cent due to other elements/reasons – see p. 42. Also see Terblanche "Business Rescue Processes need serious rethinking" (14 November 2013) *Business Report* available at http://www.iol.co.za/ business/opinion/business-rescue-processes-need-serious-rethinking-1.1606810#.VkHCg9IrLIU; Levenstein "Job Losses and Business Rescue – A Lost Opportunity?" (19 February 2014) available at http://www.werksmans.com/virt_e_bulletins/job-losses-business-rescue-lost-opportunity/.

259. The UP Report 48. For further statistics relevant to the reasons for the lack of PCF, see pp. 49–50.

260. Ibid 50. Discrepancies exist in these statistics – see p. 51. For the reasons for low approval rates of plans see pp. 51–54.

261. The UP Report 54–55. See Gribnitz and Applebaum *Business Rescue and Compromise Offers: A Practical Analysis of the Obligations and Rights as set out in Chapter 6 of the Companies Act 71 of 2008, as Amended* (2015). There are over 800 obligations set out in Chapter 6. There are too many matters being taken on by practitioners which can only result in the failure of the business rescue process.

remains unclear as to whether or not this objective has been achieved. From a sample of 87 businesses –

- 16 per cent (14 of these businesses) reported not having any employees at the date of filing;
- 84 per cent (71 businesses) reported employment of 7 443 members of staff at the date of filing;
- From these, 4 479 out of 7 443 jobs were saved, suggesting that 60 per cent of jobs were saved.

All in all, in the first 3,25 years, 10 865 jobs were saved in total.[262]

The main reasons for filing for business rescue, considered from a statistical point of view, appear to be as a result of –

- pressure from creditors (36 per cent);
- lack of management capabilities (13 per cent);
- lack of corporate governance (7 per cent);
- loss of demand (need) for business (6 per cent);
- issues with capacity (4 per cent);
- profitability issues (20 per cent);
- unique circumstances eg. contracts becoming non-enforceable (10 per cent); and
- other reasons (4 per cent).[263]

The UP Report concludes[264] that there is a 9,4 per cent success rate for business rescues in South Africa. The issue, it is submitted, is the manner in which "success" is measured.[265]

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262. The UP Report 60. Considering that each person holding a job on average supports 4 to 16 people, business rescue affected at least 40 000 citizens in South Africa. Only 14 per cent of the close to 4 000 companies that had been placed into liquidation as at February 2014 had opted to be placed into business rescue; see Pickworth "Business Rescue Slow to Catch on in SA" (17 February 2014) *Business Day* available at http://www.bdlive.co.za/business/2014/02/17/business-rescue-slow-to-catch-on-in-sa. See also comments by Loubser "Tilting at Windmills? The Quest for an Effective Corporate Rescue Procedure in South African Law" (2013) *SA Merc LJ* 456–457.

263. See the UP Report 22.

In September 2015, the CIPC published its quarterly report on the status of business rescue proceedings in South Africa.[266] The report covered the period of 1 May 2011 (date of inception of Chapter 6 of the 2008 Companies Act) to 30 September 2015. The report is useful as it reflects the status of business rescue filings (commencement), invalid filings, the number of business rescue proceedings that have terminated and for what reason.

The report provides data up to date as at 30 June 2015. From the 1911 cases for which business rescue proceedings commenced –

- 175 proceedings were a nullity in law;
- 245 proceedings were terminated by the filing of a Notice of Termination (CoR125.2);
- 238 proceedings were substantially implemented by way of the filing of a Notice of Substantial Implementation (CoR125.3);[267]
- 165 proceedings ended up directly in liquidation without a Notice of Termination (CoR125.2) being filed;
- 15 proceedings were set aside by the court; and
- 1073 proceedings (as at 30 June 2015) were still in business rescue.[268]

The CIPC report goes on to provide, *inter alia*, statistics such as the different entities which commenced business rescue (close corporations, private companies, non-profit companies, public companies and incorporated companies); [269] the number of business rescue proceedings per province; [270] reasons for termination of business rescue

264. Ibid 77. The 9,4 percent success rate percentage attributed to the success of business rescue in South Africa is far below that stated by the CIPC (on 30 October 2012) as being 55 per cent.
265. See Chapter 8, para 8.3.2.
266. Most recent report published by CIPC as at 30 November 2015 was published in September 2015. See Status of Business Rescue Proceedings in South Africa – September 2015 at http://www.cipc.co.za/files/59/4/4488/9277/Status_of_Business_Rescue_in_South_Africa_September_2015_version1_o.pdf.
267. This equates effectively to a 13% success rate as is envisaged by section 152(8).
268. Status of Business Rescue Proceedings in South Africa – September 2015 at http://www.cipc.co.za/files/59/4/4488/9277/Status_of_Business_Rescue_in_South_Africa_September_2015_version1_o.pdf 1–2.
269. Ibid 3. Private companies were the highest at 62%.
270. Ibid 3. Gauteng was the highest at 710 rescues.

proceedings; [271] the number of liquidations filed; [272] the number of resolutions that were a nullity; [273] and the number of business rescues started per industry. [274]

The statistics are useful in that it reflects a gradual increase in the number of rescue filings, which although not all ended successfully (13% is a low number), reflects an industry hard at work in creating a rescue culture on the back of the provisions of Chapter 6.

Timme and Henderson are of the view that increased recognition and the adoption of a rescue culture could not have come at a more opportune time, given the fact that the South African economy had recently come under immense pressure. Incidences of corporate distress will increase in the short-term and lenders will come under increasing pressure to act against defaulting debtors. There is a need for multi-disciplined, experienced restructuring professionals. Clearly, a well-developed restructuring regime will make a positive contribution to economic development with South Africa. Challenges remain and there is much work to be done by all key stakeholders in capitalising and building on the successes of our recent rescue history.[275]

The pre-2011 mindset of liquidation and the realisation of assets for the benefit, in the main, of secured creditors has swung in favour of the debtor and its stakeholders within a developing business rescue culture.[276]

271. Ibid 5. There were a high number of terminations reported on an "unspecified basis", followed by liquidations.

272. Ibid 7. Total number of liquidations as at 30 September 2015 were 165.

273. Ibid 9. From the 1911 business rescue proceedings which commenced, 175 were declared a nullity i.e. 9,2% of all commenced proceedings ended in a nullity.

274. Ibid 10. The construction industry (at 16%) was followed by manufacturing (at 11%) and real estate (at 10%). For comments on these statistics see Ensor "Business rescue brings small results" (11 November 2015) *Business Day* available at http://www.bdlive.co.za/2015/11/business_rescue_brings_small_results. It is submitted that recently the mining sector has been hit hard and many mines have gone into business rescue. Examples are Optimum Coal Mine (part of the Glencore Group) and ASA Metals. See Beech "Is the South African mining industry in a crisis" (October 2015) *Without Prejudice* 68–69.

275. Timme and Henderson "South Africa: increasing adoption of a rescue culture" in Fessey (ed) *Business Restructuring and Insolvency Report* (2015) 93. Also see analysis by Bradstreet "Business Rescue proves to be Creditor Friendly – CJ Claassen's Analysis of New Business Rescue Procedure in *Oakdene Square Properties*" (2013) *SALJ* 44; Marcus "South Africa Reforms Business Rescue Laws: New Objectives, New Opportunities" (30 September 2013) available at https://www.dlapiper.com/en/global/insights/publications/2013/09/south-africa-reforms-business-rescue-laws--new-o_/.

276. For an excellent comparison on the benefits of liquidation versus business rescue, see Loubser "Tilting at Windmills? The Quest for an Effective Corporate Rescue Procedure in South African Law" (2013) *SA Merc LJ* 437.

8.4 RECOMMENDATIONS FOR FURTHER REFORM AND CONCLUSION

8.4.1 RECOMMENDATIONS FOR FURTHER REFORM

As seen above, there are numerous weaknesses and criticisms that can be levelled at the Chapter 6 procedure. Often, the practical implementation can be severely curtailed, which limits the prospects of the success of its implementation.

What follows are certain recommendations for change or reform which hopefully will be considered by the Department of Trade and Industry, the South African Law Commission (for business rescue) and the legislature going forward. Many of these recommendations are a direct consequence of the frustrations being experienced by lawyers and business rescue practitioners in the implementation of the business rescue process, and follow from the identified weaknesses and criticisms which have been set out above.[277] These recommendations are as follows –

8.4.1.1 It is recommended that a pre-assessment must be a prerequisite for the taking on of any appointment by a practitioner, and failure to conduct such pre-assessment should be regarded as reckless on the part of the practitioner. Clearly, a pre-assessment is of huge advantage to directors. Reliance on a properly detailed pre-assessment report alleviates the pressure placed on directors where they deliberate over a section 129 resolution without any guidance from a court. The input of an independent practitioner having conducted a pre-assessment in the company must serve to place the board of directors in a far better position to determine whether or not such board should pass a section 129 resolution and place the company into business rescue. The section 129 resolution should be scrutinised by a judicial officer of judicial standing and the decision to place a company into a formal business rescue should not just be left to the discretion of the CIPC.

8.4.1.2 The analysis of financial distress as is set out in section 128(1)(f) should not be left to the board of directors and management teams. The analysis of whether or not a company is financially distressed should be tested and

277. See Chapter 8, para 8.3.1.

examined by both a legal and accounting team prior to the board considering the issue. It is recommended that it be peremptory that a report should be prepared and submitted to the board for proper deliberation before a decision is made that the company is indeed financially distressed. This is particularly so when a board is faced with determining whether or not it is reasonably likely that the company will become insolvent within the immediately ensuing six months.[278] The first part of the definition is relatively straightforward in determining whether or not it is 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.

8.4.1.3 Just as important is the decision taken by the board as is required by section 129(1)(b) that there is a reasonable prospect of rescuing the company. The board of directors is obligated to deal with this analysis and decision in the sworn statement of facts dealing with both financial distress and the reasonable prospect analysis.[279] Often directors are not in a position to properly analyse the financial position of the company and the ultimate prospects of rescue. The Act requires directors to carefully determine that by entering into the business rescue process that either the company will be rescued, and if this is not possible that business rescue will provide a better dividend to creditors than would occur in a liquidation.[280] It is recommended that the CIPC should make compulsory the submission of a pre-assessment report to be filed by the practitioner, together with the section 129(1)(b) resolution and the sworn statement (section 129(1)(3)(a)). The completion of a pre-assessment conducted by the potential (nominee) business rescue practitioner will go a long way to assist directors' deliberations on the issue of a reasonable prospect of rescuing the company. Directors should be extensively involved in this process and place themselves in a position where they can rely on the pre-assessment report as confidentially completed by the practitioner to gather information and provide such findings to the board of

278. See the analysis dealt with in Chapter 7, paras 7.3.1 to 7.3.3 in respect of the second part of the definition of financial distress as set out in section 128(1)(f) of the 2008 Companies Act.

279. Section 129(3)(a) of the 2008 Companies Act.

280. Section 128(1)(b)(ii) of the 2008 Companies Act.

directors. Alternatively, the board should be able to consult independent professionals who would be able to make a similar determination and after a quasi- due diligence is conducted. Directors are, after all, heavily "joined at the hip" with the company and its history.[281] Reliance on their views and on their nominated practitioner might not result in an impartial decision being made to pass the necessary section 129 resolution.

Directors (particularly of privately held companies) might be overoptimistic with operational and financial projections which might overstate the forecasted cash flows and understate the funding requirements of the business. It is recommended that the financial director of the company be tasked to file a financial analysis (with future cash flows) to support the section 129 resolution for rescue.

Independent analysis is key to ensuring that the right candidates are placed into business rescue: those companies who have a real chance of being rescued rather than entering a process as a last and desperate attempt to buy time by the implementation of the moratorium on claims.

8.4.1.4 Another recommendation is to attend to the proper training and formal accreditation of practitioners. The Act makes specific provision for the accreditation of a profession under section 138(1).[282] It is recommended that licenses for business rescue practitioners should only be granted to those practitioners whose professions have been properly accredited by the CIPC. This will go a long way in improving the standard and quality of the practitioner who is appointed to a company in business rescue. To date, the CIPC have not yet accredited any profession.[283]

Currently, practitioners have licenses issued to them if the CIPC is satisfied that the applicant is of good character and integrity and the applicant's

281. Directors who have brought the company and all of its shareholders to the cusp of a potential liquidation of the company (financially distressed) might not be able to act independently and make such decisions on an impartial and unemotional basis. Directors might only be focused on protecting themselves against potential personal liability and may not necessarily be acting in the best interests of the company, its creditors and other stakeholders.

282. See Regulation 126(1)(a) to the 2008 Companies Act.

283. The CIPC has recently commenced with the consideration of certain "professions" to be accredited.

education and experience are sufficient to equip the applicant to perform the functions of a business rescue practitioner.[284]

As set out above, the legislation makes specific provision to enable the CIPC to appoint well-qualified and competent persons to act as practitioners.[285] While there are many competent practitioners being licensed to take appointments in companies, there remain those practitioners who do not have sufficient experience and who are incompetent. Unfortunately, many of the companies to whom these practitioners have been appointed have ended up in liquidation. The demise of the company from a business rescue process to liquidation is destructive of value. The business comes to an end, employees lose their jobs and shareholders end up with valueless shares. The knock-on effect on the South African economy is real and is of grave concern. It is submitted that had a competent duly accredited practitioner been appointed in many of these companies, they could have been rescued, or a better dividend than a liquidation dividend could have been made available to creditors.

8.4.1.5 The legislature needs to consider an extension of the 25-day time period referred to in section 150(5) or alternatively prescribe different time lines for different sized companies. On almost every occasion, the practitioner is unable to meet the 25-day publication period. The time line is simply too short. The extension provisions set out in section 150(5)(a) by the court, and

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284. See Regulation 126(4)(a) and (b) to the 2008 Companies Act.

285. Section 138(3)(b) of the 2008 Companies Act as read with regulation 126(4)(6). The CIPC have not provided any indication that training courses will be made available for persons wishing to become practitioners. No education facility or professional course is available to enable aspirant practitioners from training to become practitioners notwithstanding the clear indication in section 138(3)(b) that the Minister may make (further) regulations prescribing minimum qualifications for a person to practice as a business rescue practitioner, including different minimum qualifications for difference categories of companies. The initial draft of the Companies Regulations in 2009 provided fairly extensively for a Business Rescue Regulatory Board, made up of 18 members from various backgrounds, to function "as an organ of state within the public administration, but as an institution outside of the public service". The intention (as stated in then reg 132) was for this board to be "responsible to regulate the practice of persons as business rescue practitioners" in terms of Chapter 6 by, *inter alia*, advising the Minister of Trade and Industry on qualification for BRPs, accrediting persons meeting the criteria for admission, and receiving and resolving complaints concerning the conduct of BRPs. The idea of the Business Rescue Regulatory Board was abandoned in the next draft of the regulations, published in 2010, and "Licensing of business rescue practitioners" (under reg 126) was left entirely to the CIPC. The final version of the regulation inserted subreg 126(1)(a) to enable the CIPC to not only grant licences, but also to accredit a profession, having "due regard to the qualifications and experience that are set out as conditions for membership of any such profession, and the ability of such profession to discipline its members…". The role of this regulatory board thus appears to have been somewhat decentralised, and left – at least for now – in the hands of the CIPC. The 2009 draft regulations referred to a register of accredited BRPs to be maintained, and standards and codes of good conduct to be established. The impression created was that an applicant, once admitted, would be accredited to practise as a BRP and would be subject to removal for conduct unbefitting of the office, much like in the attorneys' profession.

(b) in section 150(5) by the holders of a majority of creditors' voting interests, are nearly always used by the practitioner to obtain further extensions of the time period to publish a plan. It is recommended that different time periods should apply to small companies, medium companies and large companies (see regulation 128). On a similar basis to the differentiation on the fees for practitioners, time periods should vary, with 25 days applying to a smaller (not complex) company and a staggered time period of 45 days for a medium company and 65 days for a large company.

The three-month time period set out in section 132(3) is a very difficult time line to meet. Although the three-month time period is criticised as being too short, it really is a benchmark cut-off period that practitioners need to aim for, in order to bring about successful business rescue. The process needs to be quick, thus the imposition by the legislature of the fairly short three month time period. If a business rescue drags on indefinitely, customers and suppliers will begin to lose patience and faith in the process and the prospects of voting in a successful plan will be lowered**.**

The Act does set out the manner in which the three-month period can be extended by the filing of progress reports.[286] Again, in almost every instance the business rescue proceedings will go beyond the three-month period. Notwithstanding this, it is submitted that the three-month period should remain in place and not be formally extended by the legislature. The fact that the practitioner only has three months to finalise the business rescue process serves to ensure that the practitioner and all stakeholders attend to the restructuring of the company in an expedited manner so as to ensure that the objectives set out in section 128(i)(ii) are met. Alternatively, the three-month time period referred to in section 132(3) could also be extended for medium companies to five months, and for larger companies to seven months.[287]

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286. Section 132(3)(a) and (b) of the 2008 Companies Act.

287. The 25 business days to file a plan should be extended, in order to avoid the practitioner from having to procure extensions from the creditors. However, the legislature must not allow too much time to be given, as a shorter time period pressurises all stakeholders into applying their minds and progressing the business rescue in the shortest time possible. Creditors are aware of the fact that in our jurisdiction, extensions have become "common practice". Perhaps a reasonable long stop date should be implemented beyond which a practitioner cannot get an extension.

8.4.1.6 Business rescue practitioners should be limited by the CIPC to take on a limited number of appointments of companies under business rescue at any one point in time. As stated above, practitioners cannot do justice to the rescue task at hand by taking on multiple appointments. Practitioners should also be limited by the CIPC in taking on multiple and large appointments by the extent of their staff complement assisting them in the rescue process. Some practitioners have large numbers of support staff who can assist such practitioner in the myriad of tasks required in the conduct of the rescue process. Dealing with lawyers, suppliers, creditors, banking consortiums, debtors, trade unions and employees as well as complying with the statutory demands set for the practitioner in terms of Chapter 6 can be daunting and extremely time consuming. Thus, depending on the size of the firm undergoing the business rescue, the practitioner should determine the size and number of appointments being taken on by such practitioner (and his or her firm) at any one time.

8.4.1.7 It is recommended that the legislature introduce a mechanism to allow practitioners to interrogate directors, management, staff and any other person who can assist the practitioner in the investigations envisaged by section 141 of the 2008 Companies Act. The expectations placed on the practitioner to investigate issues such as the level of the company's financial distress, voidable transactions, the failure by the company or any director to perform material obligations relating to the company,[288] reckless trading found or other contraventions of the law relating to the company,[289] would be enhanced if an interrogation procedure, like that found in sections 417 and 418 of the 1973 Companies Act, were to be introduced into Chapter 6.

8.4.1.8 Similarly, another recommendation would be to introduce formal dispute resolution forums to allow the practitioner to speedily resolve disputes within the business rescue process so as to determine claims, counterclaims and other issues. One of the biggest challenges facing practitioners is the

288. Section 141(2)(c)(i) of the 2008 Companies Act.
289. Section 141(2)(c)(ii) of the 2008 Companies Act.

prospect of protracted litigation delaying the ultimate discharge of the company from its business rescue process.[290]

8.4.1.9 The lacuna in the legislation relating to where a winding-up application is brought by a creditor and such winding-up process is suspended by the launch of a business rescue application,[291] should be dealt with by the appointment of a third party "curator" to attend to the needs and operational requirements of the company until its final status has been determined.

8.4.1.10 The legislature needs to amend section 135 to provide certainty on the ranking of post-commencement finance and to ensure that post-commencement finance ranks higher than secured creditors in the payment waterfall under business rescue. Post-commencement finance and its availability is critical in business rescue. Without it, the entire process is stillborn. The company needs to be "propped up" with funding to pay ongoing expenses, while it is going through its restructuring. The ranking of claims will be a critical factor going forward and will determine the ongoing sustainability of Chapter 6 as a workable rescue mechanism.

8.4.1.11 It is recommended that the legislature clarifies the meaning of "set-off" as referred to in section 133(1)(c) with reference to the discharge provisions set out in section 154(2). It appears that the conflict in respect of pre-commencement claims being potentially set off against post-commencement claims (as envisaged by section 133(1)(c)) is in direct conflict with the discharge of all pre-commencement debt referred to in section 154(2).

8.4.1.12 Clarification is required as to the meaning of a "concurrent creditor" subordinated in a liquidation as set out in section 145(4)(b). When compared to section 145(4)(a), no mention is made as to how a "secured creditor" subordinated to senior creditors/lenders should be dealt with. Should their

290. There have been discussions with the Arbitration Foundation of South Africa (AFSA) to consider specialised dispute resolution arbitration forums for determination (on an expedited basis) of disputes within the business rescue context.

291. Section 131(6) of the 2008 Companies Act.

voting interest also be determined at liquidation value by an independent expert or should they be entitled to vote at full value?[292]

8.4.1.13 The content and structure of business rescue plans needs to be clarified and formal guidelines published in regulations be provided to practitioners. The manner in which secured creditors, shareholders, employees, disputed claims, disputes, pending litigation, perfection of debtors' books, general notarial bonds and reservation of ownership claims are to be dealt with needs to be clarified and guidelines provided.

8.4.1.14 It is recommended that definitions need to be introduced into section 128 dealing with the definitions of "creditors", "insolvent",[293] "solvent",[294] "reasonable prospect of rescuing the company",[295] "rehabilitation",[296] "liquidation proceedings",[297] "inappropriate",[298] binding offer"[299] and "acceded".[300]

8.4.1.15 The position relevant to what is meant by a "binding offer" requires urgent clarification. It is recommended that a new definition be inserted into section 128 that defines the term specifically. As is strongly pointed out above,[301] the term "binding offer" must be defined to mean an offer put forward by an offeror for the voting interests held by an offeree which, once submitted, is binding on both the offeror and the offeree in such sale transaction. Any other interpretation renders the cram-down provision set out in section 153(1)(b)(ii) meaningless and disables viable plans from being approved as a result of the unconscionable conduct of hold-out creditors.

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292. See discussion in Chapter 7, paras 7.6.1 and 7.8.1.
293. Section 128(1)(f)(ii) of the 2008 Companies Act.
294. Section 128(1)(b)(iii) of the 2008 Companies Act.
295. Section 129(1)(b) and section 131(4)(a) of the 2008 Companies Act.
296. Section 129(1)(b) of the 2008 Companies Act.
297. Section 131(6) and (7) of the 2008 Companies Act.
298. Section 153(1)(a)(ii) of the 2008 Companies Act.
299. Section 153(1)(b)(ii) of the 2008 Companies Act.
300. Section 154(1) of the 2008 Companies Act.
301. See Chapter 7, para 7.8.2.

8.4.1.16 The legislature needs to clarify the role of the practitioner as opposed to that of the board of directors. The distinction between these two stakeholders remains unclear. What role does the board play as opposed to the business rescue practitioner?[302]

8.4.1.17 The role of the CIPC should be enhanced to deal with the following: accreditation of business rescue practitioners; proper scrutiny of reasonable prospects of the potential of rescue for a company; better policing of dishonest, incompetent practitioners; better distribution of statistics on business rescue; the publication of a list of licensed practitioners; a more streamlined process for the certification of practitioners; policing of status reports,[303] and a more enhanced role in enforcing the provisions of Chapter 6 generally.

8.4.1.18 It is recommended that the legislature clarifies exactly when business rescue proceedings commence in a compulsory proceeding.[304] It is suggested that business rescue must commence on the date when a final order of business rescue is granted by a court.

8.4.1.19 Further issues which require consideration and possible amendment to Chapter 6 are the following:

- there is no resolution of the definition of "insolvent" as contemplated by section 128(1)(f)(ii)(a) and as read with section 4 of the 2008 Companies Act;

- the curtailment of the consequent and high costs of a business rescue process compared to an informal creditor workout, including

302. See sections 137(2) and 140(1)(a) of the 2008 Companies Act.

303. Section 132(3)(a) and (b) of the 2008 Companies Act. See the recommendations of the UP Report in respect of the establishment of an "Expert Advisory Committee to the CIPC" in Chapter 8, para 8.3.1.

304. See sections 130–132 of the 2008 Companies Act.

management consulting, accounting, forensic, legal and business rescue practitioner fees;[305]

- the need for a section 129(7) notice can place already financially distressed companies under increased financial strain, especially when creditors receive notification of the company's financial distress;

- the danger of directors colluding with their nominated business rescue practitioner to hide evidence of fraud (the dual gateway to the process includes the voluntary resolution process which allows directors to nominate their practitioner of choice);

- the scepticism that may be caused by increased employee rights set out in the 2008 Companies Act. This could cause business rescue to have less support from those with majority voting rights which could undermine the viability of business rescue;[306]

8.4.1.20 Other additional suggested issues to be considered for possible amendment to Chapter 6 are the following:

- Punitive damages should be instituted for the wrongful initiation of compulsory business rescues by affected persons.

- Specialised courts should be created for business rescue and liquidation applications (to ensure efficiency and consistency of judgments).

- Prosecution against officers and directors during business rescue should be prevented, since the assistance from officers and directors may be required by the practitioner to give effect to the restructure of the company.

305. It is submitted that business rescue is probably too expensive for smaller companies. Smaller companies might (and do) find it difficult to raise PCF and cover the attendant costs of business rescue.

306. In practice, this has not become an issue. Concerns relating to employees (or trade unions) filing applications for business rescue and thereby elevating employees to becoming the drivers of the business rescue process, have not yet come to fruition.

- Punitive costs for the violation of the moratorium should be awarded when a creditor knows that such conduct would prejudice the prospects of rescue.

- Protection for the interests of security holders should be increased (i.e. the practitioner should have an obligation to ensure that the value of an asset or assets over which one holds security does not depreciate unnecessarily during business rescue).

- Transactions in which the practitioner engages which are not in the ordinary course of the business of the company in distress, should require court approval.

- Neither the practitioner nor the company should have an opportunity to use the "cash proceeds" of collateral belonging to a creditor (cash received or receivables from a debtor) without negotiating and agreeing such position with the secured creditor.

- The court should be in a position to determine the ranking of post-commencement finance (i.e. to declare certain secured PCF to rank *pari passu* with pre-commencement secured debt provided that the pre-commencement secured creditor is sufficiently protected by its security). This would provide an incentive to funders to provide PCF.

- Our law needs to possibly introduce a classification of creditors' claims into classes (i.e. differentiate between unsecured and secured creditors – e.g. bond and trade creditors) and particularly deal with the position of contingent creditors.

- Our law does not deal with the assignment of contracts concluded by the company in distress and a third party. The practitioner should be able to assign contracts, when a company is in distress, without the consent of the counterparty (i.e. there should be no prohibitions on assignment). Currently, a practitioner could in effect merely modify this particular provision of the agreement as per the legislation.

- Creditors who contribute substantially to the progression of business rescue should possibly have their expenses paid by the company in distress as determined by a court (i.e. this would be an incentive for creditors to facilitate the progression of business rescue instead of frustrating it).

- The appointment by the board of a business rescue practitioner by way of a section 129 resolution should be ratified by the creditors in order to eliminate bias in favour of the company or directors.

- A practitioner should not be able to partially cancel or suspend a contract thereby binding the counterparty to an agreement that it never intended to conclude. The practitioner should be able to continue with, suspend or reject contracts in their entirety instead of partially.

All of these recommendations flow from ongoing practical difficulties being encountered in practice. Although the provisions of Chapter 6 are workable, the aforementioned enhancements or proposed amendments would certainly contribute to a more effective implementation of Chapter 6 in the future.

8.4.2 CONCLUSION

The present economic climate has placed business under severe pressure in the last few years and since the economic collapses of 2011. In South Africa, the knock-on effect has been and continues to be felt, with large numbers of businesses going out of business (closing their doors), filing for liquidation and with many turning to business rescue as a possible lifeline.[307]

An understanding of the interplay between business rescue and liquidations is essential in gaining insight into how business rescue operates and to appreciate the extent to which it is gaining ground as a reorganisation process in South Africa. It is submitted that as industry has become more acquainted with the business rescue process, more and more business

307. See discussion in Chapter 2, para 2.4.

rescue matters will become evident with every chance that companies will be rescued as opposed to being placed into liquidation.[308]

When a business or company is in financial trouble but the potential still exists to rescue it in order to avoid its final liquidation or ultimate dissolution, various rescue options can be considered instead of a formal liquidation process. If management recognises the signs of financial distress early enough, it is possible for management to commence negotiations with all of the company's creditors in an attempt to reach some kind of compromise that would assist the company in overcoming its financial difficulties. The possibility of an informal compromise or workout may in certain instances yield a positive outcome, but in some instances some creditors are not willing to cooperate. Such unwillingness might result in a formal liquidation application. In such an instance there is a need for a moratorium or stay of liquidation procedures in favour of a formal statutory procedure such as business rescue.[309]

It is submitted that the business rescue process as introduced by Chapter 6 must be embraced in good faith by all stakeholders. It provides South Africans with the opportunity to move corporate restructuring from a "pro-creditor" system to one of "pro-debtor".[310]

For many years, South Africa was left in the doldrums of an archaic judicial management system, with few alternatives other than liquidation. Drawing from the best that international restructuring regimes had to offer, Chapter 6 of the 2008 Companies Act found its way into our new Company Law Statute, bringing us, belatedly, into line with the standards set by international corporate rescue regimes.[311]

South Africa has certainly learned its lesson from the old (and outdated) judicial management regime. The need for a sustainable recognition of creditors' claims being compromised and being forced (if in the minority) to take "the restructured deal" has found its way into the new business rescue legislation.[312]

308. See Chapter 5.1, together with Chapter 6, para 6.3.
309. See discussion in Chapter 7, para 7.4.
310. See Chapter 8, para 8.2.
311. See Chapter 3, sections 3.2 and 3.4; Chapter 6, paras 6.1.–6.3.
312. Ibid.

Companies that are already insolvent and have naturally come to an end of their corporate life must be placed into liquidation and those capable of being rescued must be saved. Clearly, if there is no chance of rescuing the company, then there is no need to continue to "flog the proverbial dead horse". If liquidation is the only alternative, then the practitioner and the creditors must release the company from its rescue proceedings and place it into liquidation.[313]

The modern rescue culture (which started all those years ago in the UK and the US) supports the notion that there is always a need to save debtor companies that are candidates for rescue to be saved and which have genuine recovery prospects. These companies are entitled to receiving the protection of the moratorium and the opportunity to have the business restructured, rationalised and to exit into a solvent trading position. The "rehabilitated" patient must be given a second chance!

The proverbial shift in mind-set from a creditor-friendly approach (pro-creditor) to one being debtor-friendly (pro-debtor), flows naturally from proper application of the business rescue regime. Rather than let financially distressed companies wallow in the depths of burdensome and never-ending debt obligations, the company gets a second chance to make its business work again.[314]

The fact that the voluntary entry into business rescue occurs by the mere passing of a section 129 resolution, reflects the legislature's intention to make rescue and restructuring an easier mechanism to secure a "fresh start", and supports a shift to a more debtor-friendly approach.[315]

The current shift in mind-set was best stated by Judge Claassen in *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others; Farm Bothasfontein (Kyalami) (Pty) Ltd v Kyalami Events and Exhibitions (Pty) Ltd and others*:[316]

313. See obligations of the practitioner to terminate business rescue proceedings in Chapter 7, paras 7.3.4 and 7.8.2
314. See Chapter 8, para 8.2.
315. See Chapter 7, para 7.3.1.
316. *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others; Farm Bothasfontein (Kyalami) (Pty) Ltd v Kyalami Events and Exhibitions (Pty) Ltd and others* 2012 (3) SA 273 (GSJ) 438 at para 12.

> The general philosophy permeating the business rescue provisions is the recognition of the value of the business as a going concern rather than the juristic person itself. Hence the name "business rescue" and not "company rescue". This is in line with the modern trend in rescue regimes. It attempts to secure and balance the opposing interests of creditors, shareholders and employees. It encapsulates a shift from creditors' interests to a broader range of interests. The thinking is that to preserve the business coupled with the experience and skill of its employees, may, in the end prove to be a better option for creditors in securing full recovery from the debtor. To rescue the business, provision is made to "buy into" the procedure without fear of losing such investment in an ailing company, by securing repayment as a preferential repayment, as part of this "post-commencing financing". Post-commencement creditors are thus offered a "super-priority" as an incentive to assist the company financially. The facility of a business rescue is now also available to close corporations.

The mind-shift has occurred and rescue culture is coming to the fore. Significant companies have already been rescued, in terms of the first part of the definition of rescue. However, the shift in mind-set remains work in progress. Most South African companies, directors and bankers need to resist the temptation of "sinking the Titanic" and placing the financially distressed company into liquidation. Of course, the historical notion of "becoming insolvent" and the sense of failure and shame which goes with it, must be considered by management when they choose business rescue as an alternative. However, as time goes on and we continue to see significant companies being rescued, confidence in the process will increase and no doubt business rescue as a concept will gain traction in the South African distressed market place. The banks will play a significant role here.[317]

The successes of business rescue in the cases of Pearl Valley Golf Estate in the Western Cape,[318] Advanced Technologies and Engineering Company in Gauteng (ATE),[319] Meltz Success, Moyo Restaurants, ODM, President Stores, Southgold and Ellerines have all contributed to a renewed vigour in the business rescue space and in renewed confidence in the possibility of successful outcomes.[320]

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317. South Africa has a stable, well-managed and well-regulated financial sector, which is a great asset. There is a limited range of banks able to lend against strong security and at lower risk. When a company is in financial distress, banks often believe they have sufficient security and that they do not need to throw their weight behind the business rescue process. Most often, they seem to regard business rescue as an irritating obstacle blocking the path to an orderly recovery.
318. Standard Bank of South Africa Ltd acquired Pearl Valley Golf Estate (Pty) Ltd out of a business rescue plan which was successfully implemented, in January 2013.
319. ATE was acquired by the Paramount Group out of a business rescue proceeding in March 2013.
320. The latest statistics reflect an increasing trend towards business rescue being on the increase and liquidations on the decrease – see http://www.statssa.co.za and Chapter 8, para 8.3.3.

The ability to achieve a strategic acquisition within a short time frame by using the business rescue process, is one which requires an early identification of a distressed asset, the immediate availability of cash to fund an acquisition, as well as a commitment to propping up the company by introducing funding (PCF) to pay ongoing expenses and overheads, while the company is undergoing its restructuring and/or its acquisition process in business rescue.[321]

Despite initial reservations, South Africa has embraced the opportunity to resuscitate companies in distress that, without Chapter 6, would have been placed in liquidation with all of the negative outcomes flowing therefrom.[322]

The negative (and early) perceptions of business rescue as a process were initially described by the author as follows:

> Is BR nothing more than re-arranging the deck chairs on the Titanic? … or will the process prove to be the renaissance for saving companies in financial distress, thus boosting the economics of the region …?[323]

It is further submitted that these questions will be answered in disparate ways by different people. Certainly, many companies in business rescue are merely delaying the inevitable and would often end up in a formal liquidation process. Some practitioners recognise that not every company is a candidate for business rescue and very shortly after appointment, the practitioner would place the company into liquidation.

The legal and banking fraternity are applying the old proverb of "horses for courses". Some companies will not make the finish line, while other will canter home with a lot of running still to give!

The real challenge will be to get creditors to buy into the new business rescue culture. Historically, creditors have always driven the outcome of distressed companies. From the very outset, our courts struggled with the notion of creditors' rights being protected in a business rescue situation. This creditor-friendly culture still appears to influence our Courts

321. See discussion in Chapter 7, para 7.7.
322. See statistics referred to in Chapter 8, para 8.3.3.
323. The author posed this question at a seminar on business rescue held in Johannesburg and Cape Town in April 2013.

and proves that you cannot change society's culture and perceptions overnight by new legislation.[324]

In the case of *Swart v Beagles Run Investments 25 (Pty) Ltd and Others*, the first judgment on application for commencement of the new business rescue proceedings in the North Gauteng High Court, the court refused to grant the application because the company was hopelessly insolvent. Makgoba J stated that "[w]here an application for business … entails the weighing-up of the interests of the creditors and the company the interests of the creditors should carry the day".

Generally, creditors go along with the process. The fundamental principle, of course, is that creditors would always get a better outcome (dividend) than they would receive in a liquidation.[325]

In practice, very few creditors (including the banks) will intervene in the application for business rescue and attempt to convert those proceedings into proceedings for liquidation, unless the company is abusing the provisions of Chapter 6 and has no real or sustainable plan to trade out of its financial predicament and where there are no real prospects of potential acquirers seeking to acquire the company out of business rescue. Insofar as the banking fraternity is concerned (and where they are generally secured creditors), to force a viable company into liquidation with the heavy casualties of job losses is not a "politically correct" course of action.

Directors are also taking the opportunity to restructure debt in a business rescue scenario, rather than face liquidation.[326] Fear of personal liability (which can be sterilised in a business rescue) for directors would drive them to carefully explore the option of business rescue.[327]

Customers and suppliers reliant on the debtor company's survival may very well vote in favour of a business rescue rather than watch the opportunity of continued supply and the opportunity to provide continued services to the company disappear. Business rescue, if

324. See Chapter 8, para 8.2.
325. Ibid.
326. Statistics released by Stats SA in November 2015 show that the total number of liquidations has decreased by 18,3 per cent year on year in November 2015 when compared with the same period in 2014 – see http://www.statssa.co.za.
327. See discussion in Chapter 7, para 7.5.5.

properly conducted, can again build up confidence in the continued operation of the company and obtain support for the company's continued existence.[328]

Of course, the fact that the company was placed into a business rescue process as a result of financial distress could in itself reduce confidence in the prospects of the business continuing into the future on a solvent basis with limited access to continued funding. The stigma of an "insolvent" company (albeit that it has been rescued) may never allow companies to come back from the brink of financial disaster. However, it is submitted that continued successes and a healthy track record of companies exiting the business rescue process on a solvent and viable basis, will continue to see South African companies in financial distress receiving the "second chance" that all interested and concerned parties would have hoped for.[329]

In conclusion, the question must be asked as to whether the research questions have been answered and the research objectives have been achieved.[330]

It is clear that the historical development of insolvency law in South Africa paved the way for the need to introduce a rescue system in South Africa. The failure of judicial management coupled with a heavy reliance on informal work-outs with the inability to restructure without a framework of a moratorium, left financially distressed companies with no alternative but to apply for liquidation. The resultant negative impact on the South African economy and the significant impact on job losses required South Africans to look elsewhere; to international models of corporate rescue already operating in foreign jurisdictions. South Africa could no longer favour the creditor at the expense of the debtor company, its shareholders and employees. The "advantage to creditors" model had become archaic and out of kilter with the application of core and essential modern rescue themes in modern rescue systems.[331]

Discharge of creditors from debt and the restructuring of the affairs of the ailing debtor company supported the notion that South Africa required a movement towards a "pro-debtor" regime through a formal rescue mechanism. Socio-political pressures, coupled

328. See Chapter 7, para 7.6.3.
329. See appraisal of business rescue successes in Chapter 8, para 8.3.2.
330. See Chapter 1, paras 1.2 and 1.3 for research questions and objectives. See discussion in Chapter 2, para 2.3.
331. See research questions in Chapter 1, para 1.2.1 and Chapter 2, paras 2.1–2.2.

with the introduction of the CPA and NCA, all carried with them a marked shift of culture from “liquidation at all costs” to the rehabilitation model of corporate rescue.[332]

The adoption of the US model of a “fresh start” and the concept of allowing a debtor company to be restructured and placed back into the South Africa economy mirrored the systems applicable in foreign jurisdictions. South Africa, from 1994, had accepted that job retention, the sustainability of business and the “corporates’” contribution to the South African economy, was more important than just looking after secured creditors in a liquidation or winding-up process.[333]

Judicial management was seen to have severe shortfalls and, in the main, highlighted the fact that the expectation of creditors to receive payment of their full debt in a judicial management was in conflict with modern principles of rescue. The natural successor had to be a modern regime of rescue, which incorporated best practice standards of corporate rescue in line with those applicable in modern rescue regimes.[334]

Looking to jurisdictions such as the US, the UK, Canada and Australia, South Africa could identify the marked shortfalls in judicial management and further recognise the need for the introduction of a modern rescue regime[335] which accepted the need for creditors having to take a compromise on their debt. Corporate rescue mechanisms set up by UNCITRAL, the World Bank, the IMF and the European Union reflected a position where South Africa had clearly fallen behind in restructuring legislation.[336] The need to introduce international standards of best practice so as to rescue companies, promote economic stability and growth, retain jobs and maximise the value of assets though a restructuring process were heavily promoted in foreign jurisdictions. The South African legislature had no option but to recognise that judicial management was indeed a failure and that the alternative of liquidation should only be used as a last resort. Some mechanism had to be interposed between the two; a business rescue mechanism which allowed for a moratorium and time

332. See research questions in Chapter 1, paras 1.2.2 and 1.2.3. Also see Chapter 2, para 2.4.
333. See research questions in Chapter 2, para 2.4. See Chapter 5, paras 5.3–5.5.
334. See research questions in Chapter 2, para 1.2.1 and Chapter 3, paras 3.1–3.4.
335. See rescue systems applicable in modern rescue regimes in Chapter 5, paras 5.1–5.2.4.
336. See research questions in Chapter 1, para 1.2.4 and Chapter 4, paras 4.1–4.3.5.

for a company to consider a restructuring and potential rescue of its business. This mind-set was known in international jurisdictions as a "corporate rescue culture".[337]

The need to consider a shift in South Africa from a "pro-creditor" system to that of a "pro-debtor" system was directly linked to an understanding of a corporate rescue culture which was sorely needed in corporate South Africa.[338] International corporate rescue culture supported the notion of growing and monitoring a sustainable economy with the promotion of business through viable corporate entities.[339] The need to drive an economy by the provision of credit required a need to balance growth with a need (if necessary) of reorganisation and providing a failing and financially distressed corporate entity with a second chance. Risk of failure is a natural consequence of trading one's business through a limited-liability corporate-driven entity. Corporate rescue as a concept is a fundamental mechanism to drive the success of corporate entities and the promotion of any country's economy.[340]

Corporate rescue as a concept has the fundamental premise of "discharge of debt" coupled to it at every level.[341] The willingness and ability of a creditor to accept a "debt haircut" and a compromise of its claim is a fundamental and core theme of rescue. Balancing the conflicting interests of debtor companies being offered the opportunity to make a fresh start with the interests of competing creditors with claims against the company's assets is challenging. If rescue is truly focused on rescuing the financially distressed entity, then creditors have to make the necessary contribution to serve the objective of saving the corporate entity, that is, the acceptance of a debt discharge.[342]

A requirement of any modern rescue is the application of the common international rescue themes referred to above. These themes and core principles promote successful rescues and the company's reorganisation.[343]

337. See research questions in Chapter 1, para 1.2.5.
338. See Chapter 3, para 3.4.
339. See research questions in Chapter 1, para 1.2.5 and Chapter 5, para 5.3.
340. See Chapter 5, para 5.3.
341. See research questions in Chapter 1, para 1.2.6 and Chapter 5, para 5.4.
342. See Chapter 5, para 5.5.7.
343. See research questions in Chapter 1, para 1.2.4 and Chapter 5.

When one considers the various corporate rescue themes that have been analysed above, a key feature is the need to ensure that the composite themes of international corporate rescue practice serve to ensure the resuscitation of the debtor company in distress and to ensure continued longevity or a distribution better than would result from a liquidation.

The seven core fundamental common rescue themes material set out above[344] are certainly the drivers of rescue mechanisms and have key indicators which measure the efficacy of the rescue system. The eligibility and ease of entry into rescue is a measure of the number of participants in the business rescue process. Once the process is started, the stay or moratorium provides the company with the important breathing space to allow the debtor, its supervisor and other stakeholders to work towards the common goal of rescue, while a rescue plan is being negotiated and drafted. During the process there is a need for a "captain" of the ship. That person is the business rescue practitioner who has the ability to manage the process, engage with directors, creditors, employees, suppliers and other stakeholders. Key contracts of supply have to be considered, together with the size and need to reconfigure the workforce. At the same time, the practitioner must consider the availability of post-commencement finance and a possible sale of the company or its business, and decide whether the entity can be saved or will end up in liquidation. Ultimately, the process culminates in a viable and workable plan which usually compromises debt, restructures contracts and reconfigures the workforce, allowing the company to continue to trade on a solvent basis into the future. If not, the alternative is the distribution of a better dividend than creditors would receive in a liquidation. The ability to cram down the plan on dissenting creditors is an essential feature of any restructuring process. The ability to ensure that there is a discharge of the company from debt and ultimately from the rescue process results in the objective of rescuing the company. If all of these fundamental drivers or themes find themselves part of the design of a rescue regime, it is submitted the rescue regime is operative and functional. The success of a corporate rescue plan will often depend on the vantage point of who is measuring the success. Shareholders, directors, managers, employees, creditors and suppliers will all have their own views on the level of success. Often the ability of the company to continue to

344. See Chapter 5, para 5.5.

trade on a solvent basis, with or without new owners, coupled with the preservation of the corporate entity, would be a strong indicator that the rescue process had been successful.[345]

The question is whether or not international rescue and restructuring standards are being applied successfully in South Africa as a result of the introduction of Chapter 6 of the 2008 Companies Act.[346]

The introduction of Chapter 6 by the 2008 Companies Act in May 2011 mirrors many of the features and core essential themes found in international models of rescue.[347] Through careful drafting (albeit not perfect), many of the fundamental features have indeed found their way into the legislation. With the assistance of the South African judiciary, interpretation of the provisions of the legislation have assisted us in the development of the jurisprudence of business rescue in South Africa. Issues such as the impact of liquidations on the business rescue process, the meaning of the section 133 moratorium and the conceptualisation of the binding offer (cram-down) procedure have all been dealt with by the courts and have served to enhance our understanding of the practical mechanics of the rescue dispensation and how they are to be applied in practice.[348]

Clearly, there are shortcomings in the legislation which have been dealt with above.[349] Recommendations for reform have been made.[350]

The research objectives set out at the outset have been achieved.[351] When one considers the extent of the shift from pre-2011 to date, corporate South Africa has embraced rescue as a viable alternative to liquidation. This has indeed resulted in a shift from a pro-creditor to a pro-debtor dispensation.[352] There has been an acceptance that the benefits of delivery of a better return for creditors in a business rescue far outweigh delivery of negligible dividends in a liquidation. As set out above, preservation of the corporate entity in South Africa, through the business rescue process now appears to have been established as the desired outcome. Although we still have the principle of "advantage to creditors" prevalent in the

345. See discussion in Chapter 7.
346. See research questions in Chapter 1, para 1.2.4, Chapter 5, para 5.5 and Chapter 8, para 8.1.
347. See research questions in Chapter 1, para 1.2.8. See Chapter 7.
348. See research questions in Chapter 1, para 1.2.7.
349. See research questions in Chapter 1, para 1.2.9 and Chapter 8, paras 8.2.1 and 8.4.1.
350. See research objective in Chapter 1, para 1.3.1 and Chapter 8, para 8.2.
351. See Chapter 1, para 1.3.
352. See research objective in Chapter 1, para 1.3.1 and Chapter 8, para 8.2.

sequestration of individuals, that principle is being watered down through legislation like the NCA, the CDA and now through Chapter 6.[353]

Is business rescue a true alternative to liquidation in South Africa? Have creditors accepted that their expectation to be repaid in full must be placed behind the need for the debtor company to be rescued, with the resultant "debt haircut" that is part and parcel of a business rescue process?[354] Prior to the introduction of Chapter 6, creditors (especially those that were secured) were quite satisfied to take their secured dividend in a liquidation. Politically, that is no longer an option. Financial institutions (especially the banks) now have to take a step back and consider the business rescue option. It provides a mechanism to keep the company from being destroyed with the resultant job losses (a highly politicised and undesirable outcome), destruction in values of the business and its detrimental knock-on effect on the South African economy. The consequent compromised dividend delivered to creditors out of the business rescue mechanism (despite being a secured creditor) has to be considered and often accepted by such creditors within the context of the newly established rescue philosophy in South Africa.[355]

Universally, we have seen how liquidation is the last resort mechanism which will feature when there is no alternative prospect of a restructuring. The dividends paid on a liquidation will in almost every case result in a negligible (if not zero) dividend.

All jurisdictions should have an alternative to liquidation. A feature of modern-day insolvency practice in any jurisdiction must include a corporate rescue mechanism designed to resuscitate debtor companies in financial distress. The outcome will always be to allow the company to continue trading on a solvent basis, or alternatively distributing a dividend to creditors that would be better than a liquidation dividend.

Lastly, has it been established whether or not the provisions of Chapter 6, despite their shortcomings, are being practically and effectively implemented in everyday restructuring practices?[356] It is submitted that South Africa's business rescue legislation is certainly working. Provided a case can be made out that there is a "reasonable prospect" of the

353. See Chapter 2, paras 2.2–2.4.
354. See research objective in Chapter 1, para 1.3.3 and Chapter 8, para 8.2.
355. See Chapter 8, paras 8.2, 8.3.2 and 8.3.3.
356. See research objectives in Chapter 1, para 1.3.4 and Chapter 8.

company being rescued, then such company should be able to gain all the advantages of the business rescue process.

International principles of corporate rescue are applicable and are operative in Chapter 6. All of the core features, themes and concepts have been included in the legislation. Indomitably, the most essential feature of any restructuring mechanism must include a stay or moratorium on claims. Without this breathing space, any attempt at restructuring the company will be doomed to failure. The statutory freeze on creditors enforcing their claims and the prohibition on execution against assets provides the essential breathing space for a practitioner to negotiate with all stakeholders (particularly aggressive creditors) from a position of strength. Generally, it appears that once creditors are on the restructuring "bus", it is difficult for them to get off. There does not appear to be a huge appetite on the part of creditors to interfere in the business rescue process by pushing companies into liquidation. Creditors, after all, have little choice but to come along on the ride! They have a choice between settling on a compromised claim, as opposed to a negligible (if not zero) claim in a liquidation. The principle of insolvency law has always been to level the playing field, whether it is a ranking in a liquidation scenario or in a business rescue. Equal and fair treatment must be a feature of a corporate rescue process.[357]

South Africa's Chapter 6 imposes a moratorium which commences immediately after the date of the commencement of business rescue. The moratorium immediately calms down all stakeholders who have no choice but to engage meaningfully with the practitioner in an effort to restructure the company as quickly as possible. In particular, liquidation proceedings are suspended while the business rescue process is underway. Very little opportunity exists for creditors to intervene in the moratorium and our courts are loath to derail the rescue process once it has commenced.[358]

The other key feature and driver in the entire process is the practitioner in his or her supervisory capacity. The business rescue practitioner's task is a high-stakes one. It is up to him or her to engage with all stakeholders across the board and persuade such persons that the company is indeed capable of being rescued. His or her skill set revolves around the ability to understand the company's business, its prospects of success and most importantly

357. See discussion in Chapter 8, para 8.1.
358. See Chapter 7, para 7.4.

to establish whether the company has a future. Engagement with the erstwhile directors and employees is essential. The ship must be steadied and management must continue to keep the company afloat. Coupled with managing shareholders and creditors, the practitioner does not have an enviable task.[359]

South Africa has not yet accredited any profession for the purpose of appointing members of such profession as business rescue practitioners However, the current incumbents are generally doing a satisfactory job. Some practitioners, mainly from the accounting professions, are making a name for themselves in the business rescue business and particularly where there are (or have been) real prospects of rescue. The skill set of these practitioners is paramount. Many of such practitioners have shown great courage in dealing with the brand-new legislation in a very positive and able way. Of course, we still have numerous practitioners that take on companies where there was never any real prospect of rescue and where such companies were only candidates for liquidation. The deliverables for many of these practitioners have been nothing more than to whittle down liquidation dividends by an even further degree.[360]

There has been a levelling of the playing field when it comes to appointments in the larger and more lucrative business rescue proceedings. There are a number of highly knowledgeable, experienced, level-headed and competent business rescue practitioners taking appointments in companies where valuable assets are being preserved for new owners, who are set on taking the business of the company forward on a solvent basis. These companies have substantial assets, good management, a large number of employees, and creditors who are willing to give the company a second chance. Ultimately, business rescue is probably tailor-made for larger companies, although smaller privately owned companies can certainly reap the benefits of a restructuring as well. These smaller companies would be rescued where there is a sound asset base or a sustainable business worth rescuing.[361]

Many South Africa practitioners have shown an ability to rescue the company and manage it in a manner which has resulted in the company continuing to trade on a solvent basis,

359. See Chapter 7, para 7.5.
360. See discussion in Chapter 7, para 7.5.1.
361. Ibid.

albeit with new owners, and where creditors have received business rescue dividends in excess of what they would have achieved in a liquidation. Once business rescue practitioners accept the fact that they are "solvency practitioners" and not "insolvency practitioners", the number of companies entering and exiting the business rescue process successfully will increase.[362]

Critics of the debtor-in-possession concept would be pleased with the outcome in South Africa. Leaving management in charge of the "sinking ship" has always remained a controversial concept. One of the practitioner's challenges is to interface and interact with the directors (and management) in a very short space of time to ensure that a successful restructuring can occur which is to the benefit of all stakeholders. Disheartened and threatened, many corporate directors will struggle to assist meaningfully in this process. In South Africa, most directors, having placed the company into a business rescue process, will genuinely attempt to assist the practitioner in his or her restructuring endeavour. Those directors who have signed personal suretyships to certain creditors will hope that with their cooperation, the principal obligation due will be compromised and thereafter discharged in the sanctioning of the plan. This, in itself, is an incentive for directors to cooperate and participate in the rescue process.[363]

Formal proceedings in most jurisdictions have the ability to cram down the plan on disenchanted creditors. The "cram-down" provisions play an important role in ensuring that a "good plan" is voted in and sanctioned by voting creditors. Cram-down is the "poison pill" for dissenting creditors and for those creditors who want to hold out for a better deal.[364]

South Africa has carefully thought through its cram-down procedures with the concept of the "binding offer" on creditors who vote down a plan (although recently watered down by the SCA). Coupled with the ability to set aside an "inappropriate vote", we have seen very few plans not going through at the voting stage, due to the fact that dissenting creditors do not want to be bought out at liquidation value. The ability of a restructuring procedure to ensure that historical debt is discharged is a feature in most international jurisdictions. The

362. Ibid.
363. See discussion in Chapter 5, para 5.5.3 and Chapter 7, para 7.5.
364. See Chapter 5, para 5.5.6 and Chapter 7, para 7.8.2.

age-old concept of a fresh start and the ability of the debtor company to start up again, freed of its creditor debt, is a *sine qua non* to successful restructuring.[365]

Chapter 6 delivers a discharge of debt once a plan has been approved and sanctioned by the requisite majority of creditors. Thereafter, in most cases the practitioner would stay on board for a fairly short period of time while the business rescue plan is being implemented. By leaving behind historical debt, the company and its management (or new owners) are able to concentrate on resuscitation and ongoing trading on a solvent basis.[366]

The UIB, once introduced into our law, may still play a significant role in the way business rescue might be expanded upon to play additional roles in the restructuring of debt. The UIB was drafted by the State Law Advisers with proposals by the NEDLAC Task Team and circulated as a first draft on 30 June 2010. At that date the UIB was termed the Insolvency and Business Recovery Bill. Subsequent to the publication of the draft, the 2008 Companies Act was published which introduced Chapter 6 as the recovery standard for business rescue of companies.

The ultimate intention of the UIB (latest draft published as a Working Document in 2015) is to consolidate all insolvency-related legislation into a single new Act. This would no doubt be welcomed by all stakeholders in the insolvency industry in South Africa. Insolvency needs to have a boost to its image. It is now playing "poor second cousin" to business rescue, now fast becoming the "flavour of the month", with the moratorium on claims being hard to resist.

The Deputy Minister of Justice and Constitutional Development confirmed (on 12 October 2015) that Government would be considering applying the provisions of Chapter 6 to individuals, partnerships and trusts by way of the UIB. However, at this stage, the UIB remains unfinished and work in progress.[367]

The business rescue arm of the Department of Trade and Industry remains a significant and important department of the CIPC. The CIPC remains focused on accreditation of business rescue practitioners so as to ensure that a standard of practice is reached, allowing business

365. Ibid.
366. See Chapter 7, para 7.9.
367. See discussion in Chapter 2, para 2.2.

rescue to grow into a professional industry with competent supervisors having the requisite experience. Once accreditation occurs, a "roll of practitioners" might become available to directors and affected persons, all of whom can consider which practitioner to approach for pre-assessment and appointment purposes.[368]

It is submitted that once business rescue has real "teeth" and a track record in the country, it is submitted that this will be a catalyst for cross-border activity (possibly into Africa) as well as for post-commencement funding to become available in the right companies.

Any restructuring process is not for the faint-hearted. South Africa has been a leader on the continent for innovative thinking when it comes to the development of a rescue culture.

With foreign offerors, venture capital funds, hedge funds and distressed funds starting to look at South Africa as a new frontier to acquire companies in distress, it is predicted that the business rescue industry will grow substantially in the next few years. Opportunity to effect "cheap" or "bargain" acquisitions by the purchase of shareholdings for nominal values and compromising creditors' claims at huge discounts, might result in business rescue becoming the new mechanism to acquire value assets in South Africa.

The cooperation of creditors with the practitioner and managing the divergent interests that crystallise in a business rescue between employees, management and the company will be a further hurdle and one which must not be underestimated. As business rescue practitioner David Hotz stated: "[B]usiness rescue is like the scrum in a rugby match, everyone has to take the pain and hardship … but as long as everyone is pushing in the same direction, success can be achieved …".

The introduction of Chapter 6 of the 2008 Companies Act in May 2011 encompasses many international "business rescue" principles and has fundamentally changed the manner in which financially distressed companies are dealt with in South Africa.

It is further submitted that the influence that foreign legal rescue systems have had on the manner in which Chapter 6 of the 2008 Companies Act has been implemented, is immense. There has been a radical shift internationally in thinking by lawyers, advisors, accountants

368. See Chapter 8, para 8.3.1.

and the courts. South Africa has followed these worldwide trends and saving companies has become a priority. In doing so, a South African corporate rescue culture has emerged.

Business rescue is here to stay. The South African government has been courageous, bold and innovative in introducing this rescue legislation and South Africans should embrace the new dispensation and ensure that South Africa develops into a world leader in the restructuring of distressed companies.

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