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Business Rescue in South Africa: a critical review of the regulatory environment

A research report submitted to the Gordon Institute of Business Science, University of Pretoria, in partial fulfilment of the requirements for the degree of Master of Business Administration

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"*The affairs of this debtor were perplexed by…legal matters of assignment and settlement, conveyance here and conveyance there, suspicion of unlawful preference of creditors in this direction, and of mysterious spiriting away of property in that; and as nobody on the face of the earth could be more incapable of explaining any single item in the heap of confusion than the debtor himself, nothing comprehensible could be made of his case. To question him in detail, and endeavour to reconcile his answers; to closet him with accountants and sharp practitioners, learned in the wiles of insolvency and bankruptcy; was only to put the case out at compound interest and incomprehensibility.*"

Charles Dickens – Little Dorrit

(Quoted by John Duns in '*Insolvency: Law and Policy*')

Abstract

South Africa lacks an efficient regulatory environment that promotes business rescue. The fact that the introduction of a regulatory environment with modern business rescue principles will be a step forward in making South Africa more competitive and bringing it in line with the modern global economy makes the topic pertinent from both a political and business perspective.

At the core of the current discourse regarding business rescue is a fundamental shift in the approach to insolvency, namely that a debtor-friendly approach will encourage early intervention in the affairs of a distressed company. Initiating a state of business rescue without a court order and entering into a moratorium with the resulting impact on the rights of creditors introduces a move towards a debtor-friendly approach. This move in turn presents the problem: What form should the local regulatory environment pertaining to entering a state of business rescue and the automatic take? This report examined international practices and local developments, and includes local research. It puts forward a proposal as to what the minimum requirements for initiating a state of business rescue and the moratorium in a new regulatory environment should be. A summary of the status quo in South Africa, with recommendations, is also presented. It also identifies areas for further research.

Declaration

I declare that this research project is my own, unaided work. It is submitted in partial fulfilment of the requirements of the degree of Master of Business Administration for the Gordon Institute of Business Science, University of Pretoria. It has not been submitted before for any degree or examination at any other University.

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M N ALBERTS

15 November 2004

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Chapter 1: Introduction

1.1 Background

In recent times the discussion regarding the principles of business rescue as a viable alternative to liquidation procedures has increasingly become relevant. In the modern commercial environment the principles of business rescue have become all the more accepted and promoted and the Chapter 11 procedures in the United States of America (USA) are probably the most well known. The introduction of the Chapter 11 procedures in the USA in 1978 is credited with setting in motion the modern developments in the area of business rescue.[1] The Cork Report began a similar trend in the United Kingdom (UK) in 1982 and it is acknowledged with having laid the foundations of a business rescue culture in that country.[2]

International organisations have also contributed to the debate. The World Bank issued its 'Principles and Guidelines for Effective Insolvency and

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[1] Rajak, H. and Henning, J. (1999) 'Business Rescue for South Africa', *SALJ*, 262, (hereinafter referred to as Rajak & Henning).

[2] Finch, V. (2002) C*orporate Insolvency Law – Perspectives and Principles*, Cambridge University Press, pg. 188, (hereinafter referred to as Finch).

Creditor Rights Systems' in April 2001.[3] The United Nations' Commission on International Trade Law issued its most recent 'Draft legislative guide on insolvency law' in April 2004.[4] Both these guides discuss and recommend international best practice guidelines relating to insolvency, liquidation, and business rescue.

International principles regarding business rescue emphasise the fact that there are other interests at play in the realm of insolvency, not only the interests of creditors and insolvents. These other interests include those of the employees, suppliers, customers, revenue services, as well as the greater economic gain. Both the World Bank Guide and the UN Guide emphasise this point:

> *"The rescue of a business preserves jobs, provides creditors with a greater return based on higher going concern values of the enterprise, potentially produces a return for owners and obtains for the country the fruits of the rehabilitated enterprise. The rescue of a business should be promoted through formal and informal procedures."* [5]

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[3] The World Bank (2001) *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems*, (hereinafter referred to as The World Bank Guide).
[4] The United Nations' Commission on International Trade Law (2004) *Draft legislative guide on insolvency law*, (hereinafter referred to as The UN Guide).
[5] The World Bank Guide at pg. 6.

And

> *"Also, long-term economic benefit is more likely to be achieved through reorganization 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 reorganization proceedings which protect, for example, the employees of a troubled debtor."* [6]

In the South African context, these added benefits of a business rescue regime gain a distinctive relevance in light of government's overall macroeconomic policy of focusing on economic growth and creating employment with the premise that economic growth is more likely to be achieved by supply side measures rather than demand side measures. Rather than stimulate economic growth with increased government involvement and consumption in the economy, government must trim down and create an environment where the private sector will be willing and able to take the lead in economic growth.[7]

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[6] The UN Guide at para. 53.
[7] International Organisation for Development South Africa (2000) *Development Co-operation Report – Evaluation of ODA to the SMME Sector*.

Government wants to improve the economic plight of its citizens and it has been argued that changes in the South African insolvency law regime could assist in this economic growth imperative.[8] Recommended changes to assist in this growth imperative include making provision for specific protection for debtors to enable them to reorganise and rescue their business as well as introducing a reorganisation or rescue model that could recover more value for creditors and society than would be possible with a liquidation.[9] The aim of this report is to explore some of the specific actions that will enable debtors to reorganise and rescue their businesses in the South African context.

1.2 Terminology

For the sake of clarity, the researcher distinguishes between the terms 'insolvency', 'liquidation', and 'business rescue' and the UN Guide provides a helpful explanation in this regard:[10]

- Insolvency generally refers to the situation when a debtor is unable to pay its debts as they mature or when its liabilities exceed the value of its assets;

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[8] Rochelle, M. R. (1996) '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', *TSAR*, 315, (hereinafter referred to as Rochelle).
[9] *ibid* at pg. 317.
[10] The UN Guide at para. 8 and at para. 14.

- Business rescue and liquidation refer to the processes involved in situations of insolvency – liquidation is the process of near-term debt collection through sale and other procedures whilst business rescue aims at maintaining the debtor as a viable business utilising processes such as reorganisation.

The UN Guide also provides a valuable summary of the key elements of modern business rescue regimes:

- Submission of the debtor to the proceedings whether on its own application or on the application of creditors;

- An automatic stay/moratorium of actions and proceedings against the assets of the debtor for a limited period of time;

- Continuation of the business either by management, an independent manager or both;

- Formulation of a plan that will propose the way in which creditors and the business will be dealt with;

- Consideration and acceptance of plan by the creditors;

- Implementation of the plan. [11]

These principles can also be found in the business rescue provisions of countries such as Australia, Canada, the UK, the USA, and others.[12] It is submitted that the purpose of business rescue can be described as an attempt to assist a distressed business (as a going concern) in the hope that it will emerge from the rescue procedure in a position to satisfy the claims of creditors more effectively. Modern business rescue principles aim to reconcile two requirements of a modern economy, one being to ensure payment of debt to creditors and the other to ensure the continued existence of the business and its stakeholders. It is in this context that the term 'business rescue' is used in this report.

The UN Guide also refers to 'automatic stay' as one of the key elements of modern business rescue regimes. Some jurisdictions refer to an 'automatic stay' and others refer to a 'moratorium'. These terms are synonyms and in the interest of clarity, this report will use the term 'moratorium'. This is in the context of the ordinary legal meaning given to the word and in terms of the *Oxford Advanced Learner's Dictionary's* description of 'a temporary stopping of an activity'.

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[11] The UN Guide at para. 55.
[12] Rajak and Henning at pg. 263.

This report deals with rescue in the business environment. The words 'debtor', 'company', 'corporation', and 'distressed business' are used interchangeably and means any company, close corporation, partnership, or sole proprietor conducting business.

Chapter 2: The research problem stated

2.1 Why was this topic selected?

Although the debate about business rescue in South Africa is not a new one, the issue has increased in prominence in recent months and all indications are that business rescue reforms in South Africa's insolvency environment can be expected in the near future. South Africa's insolvency industry is experiencing a crisis. Not only is the industry perceived of as being corrupt and ineffective but the view is also increasingly being expressed that liquidation should not be the only option for a distressed business.

The topic is pertinent from a both political and business perspective. In her budget speech in Parliament on 22 June 2004, the Minister of Justice and Constitutional Development declared that the emphasis should be on rescue rather than liquidation with a view to protecting the economy, workers and their families and others. The Minister expressed the view that a regulatory environment focusing on rescue rather than liquidation would instil greater investor confidence in the country and the economy. The Minister also appointed a Ministerial Committee of Inquiry into the Liquidation Industry, which commenced its activities on 24 August 2004. It is believed[13] that the

[13] This was explained to the researcher during an interview with a respondent.

terms of reference of the committee were extended to also include business rescue in South Africa. The Minister is expected to receive the final report in November 2004

In May 2004 the Minister of Trade and Industry released a draft policy on Corporate Law Reform in South Africa and invited members of the public to submit written comment on the draft policy. Chapter 4 of the draft policy contains guidelines for new company law in South Africa. This document clearly states the intention to address the issue of a new business rescue regime with a view to creating a rescue system appropriate to the needs of the modern South African economy.[14]

The legislation report from the office of the Chief State Law Advisor dated 9 July 2004 indicates that his office is currently dealing with two bills relating to business rescue:

- Insolvency and Business Rescue [15] – the status is described as "Bill checked. Awaiting instruction regarding incorporating business rescue provisions";

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[14] The Department of Trade and Industry (2004) *Discussion paper: South African Company Law for the 21st century – guidelines for corporate reform*, pg. 45.

[15] Approved by the South African Cabinet on 5 March 2003 according to www.corprenewal.co.za.

- Business Administration – the status is described as "Busy drafting".[16] These developments indicate that the South African insolvency environment can expect changes in the near future.

2.2 What is the relevance to management in South Africa?

The introduction of modern business rescue principles will be another step forward in making South Africa more competitive and bringing it in line with the modern global economy.

Business rescue provisions also go further than the mere introduction of new rules pertaining to insolvency. At the heart of a successful regulation for business rescue is the basic assumption that business rescue is more successful in a debtor-friendly environment than in a creditor-friendly one and, as explained, it is accepted that South Africa has a creditor-friendly insolvency environment.[17] At the core of the current discussions and proposals regarding business rescue in South Africa is not only the issue

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[16] Two models for business rescue were put forward for consideration in recent years – the '*Draft Insolvency and Business Recovery Bill*'' and the '*Business Administration Bill*''. It is unclear how government intends to deal with the two bills and how these bills will link with the Department of Trade and Industry's proposed company law reforms. The researcher obtained an electronic copy of a '*Business Administration Act*' from a respondent but could not determine what the status of this document was and, if it was related to '*Business Administration Bill*' (which it seemingly was), whether it had been modified. A copy of the '*Business Administration Bill*' could not be obtained.

[17] Burdette, D. (Undated paper) *The harmonisation of the world's insolvency laws: a South African / Australian perspective*, pg. 13.

regarding the principles of rescue, but also the fundamental change to the philosophy of insolvency – that a debtor-friendly approach will encourage an early intervention in the affairs of a distressed company.

The introduction of modern business rescue provisions will also affect South African business and strategic decisions regarding the availability of credit as well as corporate governance issues (business rescue provisions provide alternative options to the board of a distressed company). Rescue provisions could have a profound influence on the nature of the liquidation industry.

2.3 The research objectives

The concept and principles of business rescue present a vast area of research possibilities. In this regard there is a danger of the net being cast too wide. It is not the intention of this report to explore all aspects pertaining to business rescue, but rather to focus on those areas that introduce principles that will impact significantly on the creditor-friendly nature of South Africa's insolvency environment. It is submitted that two of the key elements mentioned by the UN Guide will have a dramatic impact when introduced in South Africa as they represent a clear departure from a creditor-friendly system:

- Initiating the state of business rescue without a court order;

- The moratorium. [18]

Clearly, these two principles are not the only issues that will impact on the nature of the regulatory environment, but they present an unmistakable move towards a debtor-friendly approach to insolvency. Initiating the state of business rescue presents a clear departure because the debtor, without the necessity of a court order, can initiate the state of business rescue. The moratorium follows the initiation of the state of business rescue and the result is that the actions of the debtor have an impact on the rights of the body of creditors. The actions of the debtor initiate a business rescue regime and most modern business rescue principles require a plan that has as its goal the introduction of a process in terms of which the distressed business will emerge from the rescue regime.

This agreed plan may impact on the rights of the creditors. Rajak and

[18] Most modern business rescue principles include provisions making it possible for the business in distress to initiate the rescue proceedings, without a court order (see Chapter 3 of this report). This then results in a moratorium on actions and proceedings by creditors against the assets of the business whilst providing for the continuation of the business.

Henning state[19] that:

> "*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 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*."

The concept and principles of business rescue have experienced a wave of international prominence during the last 25 years. As a result, international practices, principles, case studies, etc. provide valuable guidelines that can be applied to the South African context. However, it would be dangerous to simply copy these principles and practices in the South African business environment.

The UN Guide emphasises this issue and states:

> *"The Guide does not provide a single set of model solutions to address issues central to an effective and efficient insolvency law, but it assists…to evaluate different approaches available*

[19] Rajak and Henning at pg. 286.

and to choose the one most suitable in the national or local context." [20]

This presents the problem: What form should the local regulatory environment pertaining to entering a state of business rescue and the moratorium take? This problem cannot be explored in isolation – it needs to be investigated whilst taking cognisance of the South African insolvency environment. It is submitted that the correct approach would be to explore international practices and principles as well as local developments, conduct local research, and develop principles applicable to local circumstances.

The purpose of this report (using the research design discussed in Chapter 4 below) is to test the appropriateness of international practices and guidelines through a process of gathering qualitative data that focuses on the data from the participants in the industry.

As explained above, initiating a state of business rescue without a court order, and entering into a moratorium impacts on the rights of creditors and presents an unmistakable move towards a debtor-friendly approach to insolvency. For this reason this report will attempt to develop a basic framework and propose minimum requirements for initiating a state of

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[20] The UN Guide at para. 2.

business rescue and the moratorium in a new regulatory environment. The study will thus seek to answer the following three questions:

(i) What is the status quo pertaining to business rescue in South Africa?

(ii) What are the minimum requirements with regard to debtors and creditors for initiating a state of business rescue in a new regulatory environment?

(iii) What are the minimum requirements pertaining to the statutory moratorium in a new regulatory environment?

Chapter 3: Secondary data analysis and literature review

3.1 Introduction

As explained in Chapter 4, the exploratory technique used in this report, relies on qualitative techniques comprising the techniques of secondary data analysis, literature review, and experience surveys through in-depth interviews. This research problem presents a specific difficulty to the extent that it involves specific legal principles. In this regard the importance of the secondary data analysis should not be underestimated, especially since it presents the opportunity to examine how business rescue was implemented, from a legal perspective, internationally. It also provides a basis for some of the questions addressed in the interviews.

The chapter begins by giving a brief description of the status quo in South Africa. It then focuses on business rescue as applied in three other countries namely:

- Australia;
- The UK;
- The USA.

There are three main reasons why these countries were selected:

(i) Business rescue developments in these countries represent some of the latest developments internationally. As explained above, the Chapter 11 procedures in the USA introduced in 1978 are credited with setting in motion the modern developments in the area of business rescue[21]. From a legal perspective, South Africa has strong links with the UK to the extent that our legal system is based, amongst others, on English law.[22] Insolvency law in Australia is almost entirely statutory and is similar to South African insolvency legislation therein that there is a split scheme of insolvency regulation, involving separate regulation of individual and corporate debtors.[23] Australia also borrowed judicial management from the South African system in an attempt to introduce some form of rescue procedure.[24] This was, however, removed from the Australian statute books in 1992 after it was concluded that it was a failure and the country proceeded to introduce business rescue provisions as they are practised today.

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[21] As discussed in Chapter 1.
[22] South Africa's legal system is based on Roman-Dutch law with strong influences from English law and specifically English common law.
[23] Duns, J. (2002) *Insolvency – Law and Policy*, Oxford University Press, pg. 6, (hereinafter referred to as Duns).
[24] See section 3.3.1 below.

(ii) The three countries selected are English-speaking countries. This made research resources more accessible and comprehensible and should result in more accurate data. Germany, for example, introduced business rescue provisions recently, but the language barrier presented research problems.

(iii) Because of South Africa's global status as a 'developing economy' the researcher contemplated research into business rescue in other jurisdictions regarded as 'developing economies' such as China, India and some South American countries. However, this presented two problems. Firstly, the language barrier as described above. Secondly, these countries (India and China specifically) [25] do not have developed business rescue systems and seem to be on par with South Africa to the extent that business rescue regimes need to be developed and implemented.

A review of the principles applicable to the business rescue regimes in Australia, the UK, and the USA is provided with a brief focus on the development and the mechanism of the business rescue systems in these

[25] For a discussion on the situation in China refer to Ng, C. Y. M. (2004) 'One country, two systems – insolvency administration in the People's Republic of China', *The Managerial Auditing Journal*, 17: 7, pg. 363 - 373.

countries. This is followed by a more detailed discussion on initiating a state of business rescue and the moratorium.

The objective of this review was to look at the research problem from an international perspective. The research problem involves certain international legal principles and it follows that international practices can contribute to local developments. The purpose was thus to use the opportunity to determine what international practices are and also to obtain a clear understanding of business rescue in the international context. It also provided the basis for formulating the discussions with the respondents as set out below.

3.2 The status quo in South Africa

Currently, the South African regulatory environment provides three options as possible business rescue mechanisms:

- Judicial management as provided for in the Companies Act (No 61 of 1974) (hereinafter referred to as the Companies Act of SA);

- Compromises in terms of section 311 of the Companies Act of SA;

- Informal arrangements with creditors.

For various reasons, none of these mechanisms proved to be particularly successful in creating a regime or culture of business rescue in South Africa.[26] The regulatory environment pertaining to insolvency does not comply with modern international principles of business rescue and there is a need to introduce a modern and effective business rescue model. The insolvency regulatory environment has been described as creditor-friendly, while internationally it is accepted that business rescue functions at its optimum in a debtor-friendly environment. [27] Thus, as business rescue requires a debtor-friendly approach to function effectively, it could contribute to the insolvency environment becoming more debtor-friendly.[28]

The industry is currently faced with the uncomfortable situation where there are separate government initiatives relating to business rescue:

- The Department of Trade and Industry recently launched a series of workshops in response to its Corporate Law Reform policy document, which makes provision for business rescue;

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[26] Burdette, D. (2004) *The development of a modern and effective business rescue model for South Africa – Pre- consultation working document*, The Centre for Advanced Corporate and Insolvency Law, University of Pretoria, pg. 4.

[27] *ibid* at pg. 5.

[28] Hunter, M. (1999) 'The nature and Functions of a Rescue Culture', *Journal of Business Law*, November Issue, 491.
In describing the regulatory environment in Britain prior to the introduction of modern business rescue provisions Hunter states at pg. 493: "*The rights of the unpaid judgement 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 objectives*".

- The Department of Justice is drafting a Business Administration Bill that is apparently earmarked for implementation by end of 2004. This bill has been impending for a long time, but nothing has been forthcoming;
- The Ministerial Committee of Inquiry into the Liquidation Industry, set in motion by the Minister of Justice and Constitutional Development, commenced on 24 August 2004. It is understood[29] that the terms of reference of the committee were extended to include business rescue in South Africa. The Minister is expected to receive the final report in November 2004.

The industry participants have also endeavoured to formalise their activities and established the Association of Business Administrators of South Africa (ABASA). ABASA is a section 21 company and the Memorandum, Articles of Association, and Rules of ABASA were finalised recently.

The Interim Executive was elected on 11 October 2004 and apparently wants to promote contact with government, assist in drafting a Business Administration Bill, and focus on membership recruitment. In addition, ABASA has been given prominence by a number of individuals giving

[29] This was explained to the researcher during an interview with a respondent.

evidence to the Ministerial Committee of Inquiry into the Liquidation Industry.[30]

3.3 Australia

3.3.1 Introduction

Australian corporate insolvency law is well established as part of the legislation relating to companies and corporations and has developed to be very distinct from that of personal insolvency law.[31] Insolvency relating to individuals is dealt with in the Bankruptcy Act of 1966, while the insolvency of corporations is dealt with in the Corporations Act of 2001 (the Corporations Act). While the insolvency provisions are primarily to be found in Chapter 5 of the Corporations Act, the Corporations Regulations and the relevant Rules of Court also support the Corporations Act with regard to insolvency issues.

The Australian Law Reform Commission conducted a comprehensive review of individual and corporate insolvency law and published its report, generally referred to as the Harmer Report in, 1988. Since the report was published, there have been many amendments, including important amendments relating to business rescue.[32]

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[30] Information obtained from www.corprenewal.co.za
[31] Duns at pg. 40.
[32] *ibid* at pg. 31 and at pg. 39 – 41.

It is significant to note that Australia used to have what was called 'Official Management' as an alternative to liquidation. The Corporate Law Reform Act of 1992 repealed the system of 'Official Management' under which creditors could appoint an insolvency expert as an official manager. This form of administration was borrowed from South Africa's system of judicial management and it allowed for the appointment of an official manager who would manage the company until it reached a state of financial well-being and was able to pay all its debts in full. Administration was not widely used in Australia for a number of reasons, one being the fact that there was a lack of flexibility and another one being that it placed a cumbersome task on the official manager in terms of his reporting to creditors. It was also a costly and formal procedure caused mainly by the fact that it relied on court applications to be instituted.[33]

Australian law presents no limitation in terms of informal arrangements between corporate creditors and debtors. Such informal arrangements are a simple, flexible, and inexpensive alternative to the procedures in the Corporations Act. In this regard informal arrangements in Australia are similar to those in South Africa.

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[33] Keay, A. R. (1998) *Insolvency – Personal and Corporate Law and Practice*, John Libbey & Company (Pty) Ltd, pg. 274, (hereinafter referred to as Keay).

The Corporations Act makes provision for two formal arrangements with a view to rescuing a business rather than liquidating it or winding it up:

- A scheme of arrangement;
- Voluntary administration.[34]

Schemes of arrangement make provision for debtor corporations and their creditors to come to an agreement that avoids liquidation subject to the court's approval and is similar to the section 311 of the Companies Act of SA schemes of arrangement. However, the focus of this report is the formal business rescue provisions provided for in the Corporations Act. In Australia this process is known as 'voluntary administration'.

3.3.2 Voluntary administration

In 1992 the Harmer Report highlighted the deficiencies of the formal alternatives to winding up a business at that stage and referred to the established alternatives in other jurisdictions (such as administration orders in the UK and Chapter 11 in the USA). The Harmer Report also discussed what it referred to as the desirable features of an alternative such as:

- Limited court involvement;
- Methods to avoid delays;

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[34] Duns at pg. 447.

- Provision of a moratorium to provide breathing space for the corporation and its creditors to consider the options available.[35]

What followed was voluntary administration as provided for in part 5.3A of the Corporations Act. The stated aims of this voluntary administration suggest that it has a wider value-based role to play. It is not only aimed at improving the efficiency of corporations but also aims to provide for the business, property and affairs of an insolvent company to be administered in a way that maximises the chances of the company, or as much as possible of its business, continuing its existence.[36] The voluntary administration process is summarised below.

3.3.2.1 Initiating the process

Voluntary administration[37] commences when an administrator is appointed. The appointment can take place in three possible ways:

- A resolution passed by the directors;
- Appointment by a liquidator or provisional liquidator;
- Appointment by a creditor who has a claim on all or a substantial part of the company's property.

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[35] *ibid* at pg. 448 - 449.
[36] *ibid* at pg. 449.
[37] *ibid* at pg. 449 – 465.

An important feature of voluntary administration is that the procedure is open to companies that are not insolvent at the time the resolution is passed. It is sufficient for the directors to be satisfied that it is likely that the company will become insolvent at some time in future.[38]

The role of the appointed administrator is to take charge of the company's affairs, carry on the business, investigate the company's affairs, and make recommendations to the creditors as to what options they may have. The administrator is obliged to convene at least two meetings. The first meeting must be held within five days of administration commencing. The purpose of the meeting is to determine whether the creditors want to appoint a committee of creditors and if so, who the members will be. They may also appoint a new administrator. The second meeting is the important one because at this meeting the creditors decide on the way forward, and possibly pass any one of three resolutions:

- That the company execute a 'deed of company arrangement';
- That the administration should end;
- That the company should be wound up.

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[38] Sellars, A. (2001) 'Corporate Voluntary Administration in Australia', *Paper presented at the Forum for Insolvency Reform in Asia, Bali Indonesia on 7 and 8 February 2001*, pg. 3 - 4, (hereinafter referred to as Sellars).

Keay is of the view that voluntary administration has enjoyed huge success and that it is employed far more than was originally envisaged and he explains that the regime is also utilised by what can be described as large corporations and not only small and medium corporations. [39]

3.3.2.2 The moratorium

The appointment of an administrator serves as the starting date of the moratorium.[40] The moratorium remains in place until the second creditors' meeting is held. The administrator is obliged to convene the second meeting within the convening period and the meeting must be held within five working days of the end of the convening period. The convening period is 21 days from the starting date of the administration.[41]

The administrator cannot extend this moratorium of his own accord. A court application to have it extended is required before the convening period expires and it appears that the courts require good reason for the stay to be extended. Duns[42] explains:

> "*The courts have stated that they will be reluctant to extend the period and that such extensions should be the exception rather than the rule. However, the courts have also indicated their*

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[39] Keay at pg. 272.
[40] Duns at pg. 450.
[41] *ibid* at pg. 457.
[42] *ibid* at pg. 457.

willingness to grant extensions if this is necessary in order to promote the objectives of the Part. (sic)"

The meeting cannot be postponed for more than 60 days otherwise the administration comes to an end (except if the court orders otherwise). When it comes to an end, the legal effect of the administration ends and thus the moratorium also ends.

When the creditors decide to accept a 'deed of company arrangement', the Corporations Act obliges the deed to specify details of any further moratorium to apply,[43] which means that the creditors can agree to a further moratorium. Sellars[44] explains that the corporation has 21 days after the end of the creditors' meeting to determine the company's future and to execute the deed. When the deed is executed, the administration of the company ends and the moratorium on actions against the company is replaced by more limited restrictions on actions against the company.

Sections 440A, 440D, and 440F institute a moratorium on, amongst other things, legal proceedings, winding up proceedings and execution on property. In this regard it does present an interference of a more onerous nature on the rights of creditors, especially secured creditors.[45]

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[43] *ibid* at pg. 460.
[44] Sellars at pg. 8 - 9.
[45] Keay at pg. 285.

The legislature's aim with the moratorium is to protect the corporation from actions while the administrator is creating a plan for future action. The moratorium assists the administrator in that his attention is not deflected through having to defend legal proceedings and it prevents the costs usually incurred in defending these actions. The Australian courts have consistently upheld the view that to allow actions and court proceedings to proceed would be against the intentions of the Corporations Act and would interrupt the proper course of the administration.[46] The moratorium also serves another purpose. It assists to promote equality between creditors in that it provides the opportunity for creditors to advance their own interests as opposed to the interests of the creditor body. There are exceptions to the moratorium specifically pertaining to secured creditors. This normally applies in a situation where a corporation attempts to frustrate the actions of a secured creditor by appointing an administrator. The Corporations Act makes provision for many more exceptions that go beyond the scope of this report. Suffice it to say that it is clear that there are exceptions to the moratorium and these exceptions need to be considered carefully, while bearing local law and circumstances in mind.

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[46] *ibid* at pg. 298.

3.3.2.3 The role of the court

A distinguishing factor of the Australian system of voluntary administration is the fact that the court does not necessarily have to be involved. In fact, it was a crucial objective when voluntary administration was introduced, to maximise speed and efficiency by eliminating unnecessary court involvement.[47] Although the courts do not have to be involved, they can play a vital role as Keay[48] explains:

> "*(The court)…has an important supervisory role to play and it is to ensure that there is a maintenance of the balance between the interests of all creditors…The non-involvement of the court distinguishes the Australian procedure from both the English procedure and the American Chapter 11 process…If the courts are involved this increases cost and reduces the speed…*"

And

> "*While Australian courts are not given a directing role and do not necessarily have to be involved in any given administration, the courts can play a very important role in part 5.3.*"

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[47] Sellars at pg. 9.
[48] Keay at pg. 315.

3.3.3 The success of voluntary administration

Sellars[49] quotes figures of the monthly statistics of the Australian Securities and Investments Commission that compare the number of voluntary administrations and deeds of company arrangement with that of insolvent liquidations. These figures indicate that administrations are now the most popular formal procedure for dealing with corporations in financial difficulty, and that administration has been a tremendous success in Australia. Anderson[50] supports this and believes that the use of the voluntary administration procedure has come at the expense of the use of a court ordered winding up procedure. At a time when the total number of insolvencies has been increasing, there has been a reduction in the number of court appointed liquidators from 4 508 in 1991-92 to 2 035 for 1996-97. At the same time there was growth in the appointment of administrators from 827 in 1993-94 (the first full year of the provisions) to 1 936 in 1996-97. Further, all other types of administration, including schemes of arrangement and receivership, have declined in number. Figures for 1999-2000 show that a total of 1 693 administrations were commenced, twice as many as compared to court ordered liquidations.

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[49] Sellars at pg. 10.
[50] Anderson, C. (2001) 'The Australian Corporate Rescue Regime: Bold Experiment or Sensible Policy', *International Insolvency Review*, Volume 10, 108.

3.3.4 Conclusion

There have been some concerns expressed from time to time about voluntary administration. Most complaints relate to the creditors who allege that directors are abusing the system, for example, by appointing a 'friendly' administrator who acts in the interests of the directors when advising on the best course of action rather than the interests of the creditors. Apparently the number of complaints about alleged abuse has decreased in recent years which may indicate that creditors are becoming more familiar with the way voluntary administration operates and their own roles, rights and responsibilities in the system.[51]

Australian corporate insolvency law is well established as part of the legislation pertaining to companies and is quite distinct from that of personal insolvency. This seems to indicate that a unified insolvency law is not a prerequisite for having a successful business rescue regime.

Australia's current business rescue regime is the result of a law reform commission that conducted a comprehensive study of insolvency law in Australia, as opposed to the fragmented process followed in South Africa.

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[51] Sellars at pg. 11.

Some of the fundamentals of voluntary administration are:

- Limited court involvement;
- Strict regulation to avoid any delays – including prescribed (short) periods within which to have meetings and prepare a rescue plan;
- A moratorium to provide breathing space for the debtor and the business rescue specialist.

Voluntary administration is available to companies that are not insolvent as it is sufficient if the directors believe that the company will become insolvent in the future. This enables the directors to enter business rescue timeously leaving enough time for rescue actions to be implemented.

Voluntary administration can be entered into without a court having to be involved. It is a crucial objective of voluntary administration to maximise speed and efficiency by eliminating unnecessary court involvement. However, where necessary, courts can play a vital role.

3.4 The UK

3.4.1 Introduction

There has been vigorous and ongoing public and academic debate in the UK for many years on the issues of business rescue and the moratorium. The Cork Report recommended in no uncertain terms that English law should acknowledge the benefits that might flow from having insolvency procedures

that would encourage the rescue of a company rather than focus primarily on the efficient realisation of assets.[52] Some of the proposals of the Cork Report were implemented in the UK's Insolvency Act of 1985 and re-enacted in the Insolvency Act of 1986. Goode[53] states that these legislative changes initiated what has become known as the rescue culture. He describes a rescue culture as a philosophy of reorganising companies so as to restore them to profitable trading and enable them to avoid liquidation.

For purposes of this section, the focus is on the developments after the enactment of the Insolvency Act of 1986. The instruments available for implementing reorganisation or business rescue in the UK are:

- A contract based arrangement outside of the statutory environment;
- Administration;
- Company Voluntary Arrangements (hereinafter referred to as 'CVAs');
- Re-organisation in terms of section 425 of the UK Companies Act. [54]

As in South Africa and Australia, informal arrangements are essentially a contract between the parties (the debtors and creditors) and can be initiated by the directors or the creditors. Re-organisation in terms of section 425 of

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[52] Milman, D. and Durrant, C. (1999) *Corporate Insolvency: Law and Practice*, Sweet & Maxwell Limited, pg. 32, (hereinafter referred to as Milman and Durrant).
[53] Goode, R. M. (1997) *Principles of Corporate Insolvency Law*, Sweet & Maxwell Limited, pg. 269, (hereinafter referred to as Goode).
[54] *ibid* at pg. 270.

the UK Companies Act is not unlike the Schemes of Arrangement discussed above[55] or the mechanism of compromises provided for in section 311 of the Companies Act of SA. For purposes of this report, the important procedures are the administration order procedure and the CVA procedure, as they present some of the more innovative features of the 1986 Insolvency Act, aimed at the rescue and rehabilitation of ailing companies.[56]

3.4.2 Administration orders

The Insolvency Act of 1986 introduced the concept of administration orders that envisaged a new system with a view to ensuring the survival of the company or, if survival was not possible, through which the creditor could obtain a better return than would be possible through winding-up procedures.[57] The Insolvency Act provides two main conditions before an administration order can apply. Firstly, the company must be, or must be likely to become, insolvent. Secondly, the court needs to be satisfied that one or more of the goals set out in the Insolvency Act are attainable[58]. These goals are:

- The survival of the company, or a part thereof, as going concern;

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[55] See section 3.3.1above.
[56] Fletcher, I. F. (2002) *The Law of Insolvency*, Sweet & Maxwell Limited, pg. 21, (hereinafter referred to as Fletcher).
[57] *ibid* at pg. 451.
[58] Milman and Durrant at pg. 34.

- The approval of a CVA;
- The sanctioning of a compromise or arrangement in terms of section 425 of the Companies Act;
- A better realisation of assets than would be possible in a winding-up.

3.4.2.1 Initiating the process

Administration is initiated through a court procedure when the company, its directors or creditors, presents a petition. The petition must state that the company is, or is likely to become, insolvent and that an administration order is likely to promote one of the purposes set out above. The petition contains affidavits from the directors and should give a clear picture of the company's financial position with details relating to assets, liabilities, cash flow, profit and loss estimates, availability of finance during administration etc.[59] An opinion from an independent expert recommending administration is also usually essential in practice, although not obligatory.[60] The petition is presented and notice is given to the prescribed (and affected) parties after which the court can exercise its discretion, make the order, and appoint an administrator or, dismiss the application.

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[59] Goode at pg. 282.
[60] Milman and Durrant at pg. 35, in practice the report is normally prepared by the proposed administrator.

Once appointed, the administrator takes over the running of the business, convenes creditor's meetings and makes proposals to creditors on how he envisages attaining the objectives of the administration as set out in the petition.[61]

Rescue is the administrator's central objective and the process comprises a temporary freeze during which proposals, and suggestions with a view to ensuring the company's survival can be devised.[62]

3.4.2.2 The moratorium

The presentation of the petition introduces a statutory moratorium over the affairs of the company that commences with the presentation of the petition and remains in place pending the hearing of the petition. The moratorium imposes a suspension on the pursuit of most types of claims, [63] secured or unsecured, against the company and covers:

- Enforcing security;
- Instituting or continuing legal proceedings against the company;
- Repossessing goods in the company's possession;[64]

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[61] Goode at pg. 278.
[62] Finch at pg. 278.
[63] Goode at pg. 290.
[64] Finch at pg. 277.

- Attempting any form of execution against company assets.[65]

There are a number of exceptions to this initial moratorium. For example, it is possible to pursue these claims when leave from the court is obtained.[66] When the petition for the administration order is dismissed, the initial moratorium comes to an end.

3.4.2.3 The role of the court

If the court grants the administration order, a final moratorium is in place for as long as the court order remains in force. [67]

Anyone affected by the actions of the administrator has wide powers to approach the court to contest these actions and to ask for relief. The court, in its turn, has extremely wide powers to manage and control the actions of the administrator[68] and this brings about that the court has a very important role to play regarding the moratorium and its effectiveness.[69]

3.4.2.4 The failure of administration orders

Statistics in the UK indicate that the use of administration orders was extremely low. In the first ten years of their existence an average of only 171 administration orders per year were granted – with a high of 211 in 1990, a

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65 Milman and Durrant at pg. 37.
66 Finch at pg. 266.
67 Fletcher at pg. 468.
68 Finch at pg. 278.
69 *ibid* at pg. 288.

year in which there were 15 051 company liquidations and 4 318 administrative receiverships. This figure rose to 338 in 1998 when there were 13 203 company liquidations, and to 440 and 438 in 1999 and 2000 respectively.[70] This indicates that administration orders, as a means of avoiding liquidation, are simply not happening.[71] Why then are administration orders failing in their business rescue and rehabilitation objectives? Finch[72] is of the view that there are a number of factors that contribute to the failure of administration orders:

- Procedural costs are extremely high which is mainly the result of the high level of court involvement and judicial supervision;
- Because the court needs to be satisfied that the company is, or is likely to become, insolvent, administration orders can only be resorted to at the late stages of corporate decline, when the chances for rescue are remote;

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[70] Fletcher at pg. 515.
[71] Milman and Durrant at pg. 51.
[72] Finch at pg. 281- 289.

- The court plays an important role and the moratorium stands to be reduced by the court's discretion to allow the enforcement of claims against the company during the moratorium.[73]

In short, the failure of administration orders to promote business rescue lies in the inherent shortcomings created by the costs of the court involvement and the ineffectiveness of the moratorium caused by discretionary court involvement.

3.4.2.5 Recent amendments to administration orders

The failure of administration orders resulted in the publication of numerous papers and recommendations[74] that eventually found their way into the Enterprise Act of 2002 that came into force during 2004.[75]

The Enterprise Act introduced a streamlined system of administration by providing 'without court' order routes into administration with a focus on speed and ease of use as well as simpler means of exiting from administration. It also imposed a new duty on the administrator to perform his functions as quickly and efficiently as reasonably possible, and it introduced time limits for the procedure.

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[73] As Finch explains at pg. 289, in exercising its discretion the courts tend to balance the rights of the petitioning creditor against the rights of other creditors while avoiding taking into account the wider public, employee- or trade interests that may have an interest in the potential rescue.

[74] Fletcher at pg. 518.

The revised administration procedure puts rescue at the heart of administration and where companies can be saved, they should be saved. As discussed above[76] the Insolvency Act required administration orders to meet one or more of four goals. The Enterprise Act replaced the four goals with one overarching purpose, namely that company rescue is primary and if that is not possible, then the administrator should try to achieve a better result for the creditors than would be obtained through normal liquidation. Only if neither of these objectives is possible may the administrator realise property to make a distribution to creditors.

3.4.3 Company Voluntary Arrangements (CVAs)

The Cork Report also proposed a form of arrangement that need not be an order of court, but would still result in a formal and binding agreement between a company and its creditors. This procedure was envisaged to complement the administration order that required a court order. As a result the Insolvency Acts of 1985 and 1986 made provision for CVAs.[77] A CVA is an arrangement regarding satisfaction of the company's debts and it results from a proposal made by the directors to the creditors that is then accepted.

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[75] www.insolvency.gov.uk.
[76] See section 3.4.2.
[77] Fletcher at pg. 425.

The directors remain in control of the company and have the power to continue running the business.

3.4.3.1 Initiating the process

A CVA can be entered into whether the company is insolvent, or likely to become insolvent.[78]

The CVA is initiated by a written proposal from the directors to the creditors.[79] The proposal must identify the individual, known as the 'nominee', who has agreed to be responsible for the CVA, and the proposal and a statement of the company's affairs must be delivered to the nominee. The nominee has 28 days to consider the contents of the proposal with a view to submitting comment to the court on the viability thereof. The nominee's report should also include a recommendation as to whether the nominee regards it necessary for the members and creditors to be summoned to a meeting. This meeting creates the opportunity where the proposal will be approved with or without modification. Once the proposal has been formulated and refined with the nominee's input, it requires sufficient support from the company's members and creditors to be accepted.

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[78] Goode at pg. 324.
[79] *ibid* at pg. 327.

3.4.3.2 The moratorium

The CVA procedure does not result in a statutory moratorium. Also, while the nominee does have to report to the court on the viability of the CVA, the court plays no part in the decision as to whether the CVA will go ahead or not. Once the scheme has been approved it becomes the responsibility of the nominee, now called a supervisor, to ensure that the CVA is put into effect.[80]

3.4.3.3 The failure of CVAs

Statistics in the UK regarding the prevalence of CVAs since their inception in 1987 are disappointing. In the period between 1989 and 1993, when the annual rate of company failures rose to an average rate of well above 20 000 per annum, the average rate of concluded CVAs remained below 100 with the highest number being 137 in 1991.[81] These numbers rose to 475 CVAs in 1999 when there were 14 230 company failures.[82] A large number of academics, writers, and commentators agree that the single biggest reason for the failure of CVAs, as a mechanism for business rescue and rehabilitation is the lack of a formal moratorium.[83] One of the largest and most

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[80] Milman and Durrant at pg. 47 - 49.
[81] Fletcher at pg. 426.
[82] Finch at pg. 334.
[83] Fletcher at pg. 426, Finch at pg. 335, Goode at pg. 336, and Milman and Durrant at pg. 52.

comprehensive surveys conducted on the subject of CVAs in the UK revealed findings that supported the introduction of a moratorium. The findings indicated that, unless companies were given a proper chance to enter into a CVA, the mechanism's potential would not be realised.[84]

3.4.3.4 Recent amendments to CVAs

Proposals for reform were enacted in the Insolvency Act of 2000 and were introduced in 2002. The new provisions introduced a moratorium if a company meets the qualifying conditions i.e. satisfies two or more of the requirements for being a small company specified in the UK Companies Act.

Before a moratorium is obtained, the directors need to submit the terms of the proposal and a statement of the company's affairs to the nominee. The nominee then needs to indicate to the directors whether the proposal has a reasonable chance of success and approval and whether there are sufficient funds available for the company to carry on its business.[85] These requirements aim to avoid a situation where directors can exploit the moratorium as a delaying tactic.[86] The moratorium comes into force when the

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[84] Pandit, N. R., Cook, G. A. S., Milman, D., Chittenden, F. C. (2000) 'Corporate rescue: Empirical evidence on company voluntary arrangements and small firms', *Journal of Small Business and Enterprise Development*, 7:3.
[85] Finch at pg. 337.
[86] Fletcher at pg. 447.

documents are filed with the court and ends on the day when the creditor's meetings are held, unless an extension is granted as allowed by the UK Companies Act. The time limit for holding of the meetings is 28 days from the beginning of the moratorium unless it is extended in line with the provisions of the UK Companies Act.

3.4.4 Conclusion

The UK's statutory business rescue system has its origin in the Cork Report – a commission that consulted widely during its activities as opposed to the fragmented process followed in South Africa. There is also a constant attempt to address and rectify inadequacies in the statutory rescue environment as illustrated by the Enterprise and Insolvency Acts of 2000.

The main criticism of the UK system relates to its format and implementation through the Insolvency Acts of 1985 and 1986. Administration orders were stifled through cumbersome legal procedures, high procedural costs, and an insolvency requirement that resulted in rescue orders being sought at a late stage of corporate decline. CVAs were doomed to failure because of the lack of a statutory moratorium that resulted in a lack of breathing space for the distressed company.

Recent statutory amendments resulted in vital changes to the UK's rescue environment:

- It introduced a streamlined system providing 'without court order' routes for administration;
- Rescue is at the heart of the administration – administrators are obliged to attempt to save a company that can be saved;
- CVA provisions were amended to provide for directors to enter into a CVA without court orders and with a statutory moratorium.

3.5 The USA

3.5.1 Introduction

The laws of the USA that govern business rescue and liquidations are divided between Federal and State law. The most significant rescue operations and liquidations are administered under the jurisdiction of the Federal Bankruptcy Court pursuant to the Bankruptcy Reform Act of 1978 (hereinafter referred to as the Bankruptcy Code). The Bankruptcy Code intends to establish processes with a view to achieving two objectives:

- Collection and equitable distribution of the debtor's assets;
- Relief from debt for the benefit of the debtor.[87]

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[87] Wheeler, M., Oldfield, R. (Ed) (2001) *KPMG – International Corporate Recovery Procedures* (3rd edn), Blackstone Press, pg. 386, (hereinafter referred to as KPMG).

The Bankruptcy Code is divided into eight chapters dealing with these objectives.[88] Seven chapters have odd numbers with the exception being Chapter 12. Chapter 11 is the principal rescue chapter of the Bankruptcy Code and thus the focus of this report will be on the workings of Chapter 11.

The Bankruptcy Code has a built-in bias favouring reorganisation and rescue over liquidation and the USA Supreme Court has confirmed this on more than one occasion:

> "*…the fundamental purpose of reorganization* (sic) *is to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources.*"

And

> "*By permitting reorganization* (sic)*, Congress anticipated that the business would continue to provide jobs, to satisfy creditors' claims, and to produce a return to for its owners…Congress presumed that the assets of the debtor would be more valuable if used in a rehabilitated business than if 'sold for scrap'.*"[89]

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[88] Albergotti, R. D. (1992) *Understanding Bankruptcy in the US – A handbook of Law and Practice*, Cambridge – Blackwell Business, pg. 8, (hereinafter referred to as Albergotti).

[89] Treister, G. M. (1996) *Fundamentals of Bankruptcy Law* (4th edn), The American Law Institute, pg. 419 - 420, citing *NLRB v. Bildisco & Bildisco, 465 U.S. 513, 528 (1984)* and *United States v. Whiting Pools Inc., 462 U.S. 198, 203 (1983)*, (hereinafter referred to as Treister').

3.5.2 Chapter 11

The philosophy behind Chapter 11 proceedings has a long history of remedies against business debtors, including rescue and reorganisation. The interesting reason for this is to be found in the historical roots of the USA legal and social system. As a colony of the British Empire, the USA relied on capital from England, i.e. the lenders were in England and the debtors in the USA. With a history as a nation of people that forged a new life based on the freedom of the individual, the USA government was extremely wary with respect to any intrusions into people's entrepreneurial liberty.[90]

Schwehr explains[91] that the core of today's Chapter 11 proceedings can be traced back to the 'equity receiverships' in the late 19th century. This legal creation was invented with the building of railroads across the USA where great financial risk was involved. The risk was great because the capital was secured upon the rail tracks and the train itself whose material value was less and out of all proportion to the much larger capital expenditure necessary to build the railway. As a result, it made commercial sense to keep the railroads

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[90] Schwehr, B. (2003) 'Corporate Rehabilitation Proceedings in the United States and Germany', *International Insolvency Review*, 12: 11-35, pg. 12 - 13, (hereinafter referred to as Schwehr).

[91] *ibid* at pg. 13.

intact since the best use of the assets was in all probability keeping it (the assets) as a going concern. However, for these assets to be used readily required either new capital or new reorganised financial conditions were necessary. There were no bankruptcy laws and solutions for these problems had to be found by the creditor's lawyers, and thereafter these solutions had to be overseen by judges i.e. 'equity receiverships'.

3.5.2.1 The 'debtor in possession'

As the major reorganisation and rescue sector of the Bankruptcy Code, Chapter 11 may be used by most entities including partnerships, corporations, and individuals.[92] A debtor will generally remain in control throughout the proceedings (although legally he is transformed into a quasi-trustee in bankruptcy) called the 'debtor in possession'.[93] The term 'debtor in possession' requires some explanation. While the Bankruptcy Code is drafted in terms of the powers and duties of the 'trustee' as representative of the estate, in Chapter 11 a trustee is only appointed when one is needed. Normally the debtor as 'debtor in possession' remains the estate's representative and has the powers and duties of a trustee, except when a trustee is appointed which then shifts the control from the debtor to the

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[92] Albergotti at pg. 11.

[93] Westbrook, J. L. (1993) *Chapter 11 Reorganisation in the United States* in *Insolvency law – Theory & Practice*, Ed Rajak, H., Sweet & Maxwell, London, pg. 347, (hereinafter referred to as Westbrook).

trustee.[94] A trustee is normally appointed when 'cause' has been established or when the appointment is in the interest of creditors. Examples of 'cause' would be when the debtor has acted fraudulently or has mismanaged the estate.[95]

3.5.2.2 Initiating the process

A Chapter 11 is started with the filing of a petition. There are no prerequisite statutory tests or conditions for Chapter 11 such as insolvency or imminent insolvency, although a case can be dismissed early if it appears that it was filed in bad faith or without a reasonable opportunity for success.[96]

The Chapter 11 debtor may convert the case to a Chapter 7 liquidation bankruptcy at any time provided that a trustee has not been appointed and that creditors did not file for the Chapter 11, thus making it involuntary. Any other interested party may also seek the conversion or dismissal of the Chapter 11 if there are statutory grounds for doing so. Statutory grounds may include continuing operational losses without prospects of rehabilitation, inability, or failure to propose an effective plan, failure to pay certain fees and

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[94] Treister at pg. 423.
[95] Howard, M., Zinman, R. M., (2002) *Bankruptcy Overview: Issues, Law and Policy* (4th edn), American Bankruptcy Institute, pg. 78, (hereinafter referred to as Howard).
[96] Westbrook at pg. 348.

charges, and any unreasonable delay that is to the detriment of creditors.[97] Should the Chapter 11 not be dismissed or converted, and a trustee not be appointed, the 'debtor in possession' remains in charge and his duties include accounting for property, examining and responding to claims and filing monthly and other operating reports to the 'US Trustee'. The 'US Trustee' plays a supervisory role and is responsible for monitoring the debtor in possession's compliance.[98]

3.5.2.3 The moratorium

The filing of the petition establishes a moratorium on any action to collect against the debtor or its property and even a letter of demand may constitute contempt of court.[99] No formal notice to creditors is required.[100] The concept behind the moratorium is to provide the debtor with enough breathing space to allow him to formulate an acceptable plan for reorganisation. The aim of the moratorium is to strike a compromise between the rights of the affected parties and the prospect of having rescue or liquidation in an orderly manner.[101]

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[97] Treister at pg. 425.
[98] Howard at pg. 79.
[99] Westbrook at pg. 348.
[100] Albergotti at pg. 80.
[101] *ibid* at pg. 69.

Sections 362 (a) and (b) of the Bankruptcy Code sets out the actions subject to the moratorium, such as:[102]

- All judicial and quasi-judicial proceedings relating to pre-petition activities of the debtor;
- Enforcement of pre-petition judgements against debtor or its property;
- Any action to obtain possession of property from or held by the estate or to exercise control over property of the estate.

This section also sets out the numerous actions not subject to the moratorium. The moratorium in terms of section 362 on actions against property continues until the court lifts the moratorium or, until the property is no longer in the estate. In terms of any other action, the moratorium continues until the case is closed, or dismissed, or a discharge is either granted or denied.[103]

Section 362 also provides an opportunity for parties, such as secured creditors, to approach a court to lift the moratorium.[104] The 'debtor in possession' is required to protect the position of a secured creditor against any decrease in value of its security that results from the imposition of the

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[102] *ibid* at pg. 70 - 79.
[103] *ibid* at pg. 80.
[104] Westbrook at pg. 348.

moratorium.[105] The court can terminate, annul, or modify the moratorium for 'cause'. 'Cause' includes situations where the creditor's interest in the property is not adequately protected.[106]

3.5.2.4 The plan and the periods allowed for the moratorium

The rescue process contains phases, including the development or formulation of the plan of reorganisation, the voting on the plan, and obtaining confirmation of the plan by the court. These phases can determine the duration of the moratorium.[107]

The Bankruptcy Code stipulates a 120-day period after the filing date of the petition during which the 'debtor in possession' has the right to propose and file a rescue plan. This is called the exclusivity period. Within a second period of a further 60 days the proposed plan needs to be accepted. The court can either reduce or extend the exclusivity period up to 180 days. This period is very important for the debtor, as it provides him with the opportunity to control the process of proposing a rescue plan and the courts frequently extend it. If the debtor has not filed the plan within the exclusivity period, or a proposed plan has not been accepted, any party in interest can file a plan.

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[105] KPMG at pg. 388.
[106] Albergotti at pg. 82.
[107] Schwehr at pg. 16.

The plan must also contain the proposed measures to achieve reorganisation.[108] Voting is by classes of creditors and approval requires a majority in number and two-thirds in amount of each class. Confirmation of the plan by the court discharges a debtor from all legal obligations not specified in the plan with nearly no exceptions.[109]

3.5.3 Conclusions

Reorganisation and rescue in the USA provides an example of a regime that has at its core the principle of debtor-friendliness and the desire to rescue the distressed business. It illustrates that a debtor-friendly approach does not necessarily imply a system that is to the detriment of the creditors and that a balancing act is possible. However, it is possible to raise criticism against the 'debtor in possession' principle. The argument is that in a large number of cases the distress of the company was caused through bad management. To let the inadequate management remain in total control is seen as not addressing one of the causes of the distress.

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[108] *ibid* at pg. 18 - 19.
[109] Westbrook at pg. 349 - 350.

Another criticism against the USA system is the delay and the costs caused by long delays. Cases are protracted[110] and it seems that courts are keen to extend the exclusivity period.[111] Costs, delays, and the like are all issues that exacerbate abuse and are contra the experience in most modern business rescue regimes.

[110] Howard at pg. 17.
[111] Schwehr at pg. 18.

Chapter 4: Research methodology and process

4.1 Introduction

Cooper and Schindler[112] explain that the essence of business research lies in the fact that it should enable quality decisions. Some of the prerequisites for good research are described as purpose clearly defined, a detailed research process, application of high ethical standards, limitations frankly revealed and the findings presented unambiguously. These were the criteria that the researcher used in the compilation of this report.

4.2 Research design

The research design and strategy selected for this project were determined by the following factors that are inherent in the research problem:

- The required results of the research are non-statistical in nature;
- Insight into and understanding of the research problem are required rather than exact data;
- The research problem requires a high level of professional and expert knowledge – both in the practical and academic sense – and it also

[112] Cooper, D. R., Schindler P. S. (2003) *Business Research Methods*, McGraw Hill/Irwin, pg. 15, (hereinafter referred to as Cooper and Schindler).

requires a reasonably advanced understanding of the legal principles involved;

- The research problem is controversial to some extent and tends to solicit strong reaction.

For this reason the research was archival, exploratory, and qualitative in nature. According to Cooper and Schindler, exploration is specifically useful when the purpose of the study is to investigate a broad observable fact or situation and it is uncertain what the problems and issues are that may be incurred during the study. Exploration provides the opportunity for a researcher to develop clear concepts and to establish priorities. Different techniques are available in the exploratory approach but exploration relies heavily on qualitative techniques.[113] The researcher used the exploratory techniques of secondary data analysis and experience surveys through in-depth interviews.[114]

The use of secondary data analysis involved a search using catalogues, subject guides, and electronic indexes, attempting to be creative and with a view to obtaining first-rate background information and quality leads. This

[113] *ibid* at pg. 51.
[114] *ibid* at pg. 152 - 153.

was followed by a study of secondary literature that included books, published documents, draft documents, journals, articles, and legislation.

The experience surveys involved in-depth interviews that were conducted on a semi-structured and conversational basis. The researcher provided some structure through a list of designated questions. This served to focus the discussion on business rescue in general and on entering a state of business rescue and the moratorium specifically. As recommended in Cooper and Schindler[115] the researcher attempted to discover from the respondents what the important issues were through being flexible enough to allow for exploring various avenues that emerged during the interviews.

4.3 Population and sample

While South Africa has a sizeable liquidation industry, business rescue is a relatively small discipline consisting of:[116]

- Turnaround management firms;
- Individuals at legal and professional services firms;
- Restructuring executives at banks and other lenders;

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[115] *ibid* at pg. 154.

[116] As explained, South Africa does not have a formal business rescue regime (except for the failed judicial management system). The practitioners of this discipline are generally referred to as 'turnaround managers', 'corporate doctors' or 'corporate rescue practitioners' and they mainly operate in the arena comprising informal arrangements with creditors.

- Academics;
- Liquidators.

Given the nature of the research problem as well as the industry, the population is small and comprises individuals in the industries and professions mentioned above. Non-probability, convenient sampling combined with judgement sampling was used since it makes provision for practical considerations. It also allowed freedom to choose individuals who are well regarded in terms of their knowledge of the research area. Judgement sampling is described as the process where the researcher selects sample members to conform to some criterion.[117] In this case the criterion was that the interview subjects were expected to be experienced and qualified to give informed opinions and detailed information on the research problem. While probability sampling is a more reliable technique than non-probability, the reason for selecting non-probability sampling was based on the accessibility to, and availability of, respondents with the required knowledge and experience.

For this research the sample size was nine – a relatively small sample size resulting from the nature of the industry, the research problem, and the

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[117] *ibid* at pg. 201.

research design. In one instance two respondents were interviewed together which explains why nine individuals' responses were recorded as eight interviews below.

The respondents were:

Name	Designation and Firm/Company	Experience and involvement in business rescue
John Evans	Director: Reorganisation Services – Deloitte Johannesburg	- CA (Australia) - Involved in the area of insolvency and business rescue since 1998 with experience in Australia, the UK and South Africa - Executive committee member of the Association of Business Administrators of South Africa
Louis Strydom	Partner: Crisis Management Services – Responsible for Africa at PricewaterhouseCoopers Inc (Pretoria)	- CA (SA) - Joined Pricewaterhouse-Coopers in 1986 - Leader of business unit responsible for business rescue in Africa
Basil Nel	Director: Basil B Nel Administrators (Pty) Ltd	- CA (SA) - 28 years senior partner at PricewaterhouseCoopers - National partner responsible for business recovery and liquidation at PricewaterhouseCoopers

Name	Designation and Firm/Company	Experience and involvement in business rescue
Christo Faul	Director: Credit Recovery at Standard Bank – Corporate and Investment Banking	- LLB, CA (SA) - 14 years experience in business rescue in the financial institutions sector
Dave Burdette	Professor: University of Pretoria – Department of Commercial Law and Head of the Centre for Advanced Corporate and Insolvency Law	- Executive committee member of the Association of Business Administrators of South Africa - Drafted the Unified Insolvency and Business Recovery Bill - Involved in the activities of the Ministerial Committee into the Liquidation Industry
Stephan Claassen	Head: Debt Restructuring at First National Bank Corporate Bank	- Admitted attorney - Co-drafted the Business Administration Bill - 7 year's experience
Catriona Robertson	Senior Legal Counsel: Debt Restructuring at First National Bank Corporate Bank	- Co-drafted the Business Administration Bill - 6 year's experience
Patrick Daly	Director: Daly Inc	- Admitted attorney - 15 year's experience in insolvency - Executive committee member of the Association of Business Administrators of South Africa - Co drafted the Business Administration Bill

Name	Designation and Firm/Company	Experience and involvement in business rescue
Eileen Fey	Partner: Business Rescue Services – PricewaterhouseCoopers Inc (Cape Town)	- Involved in liquidation industry at PricewaterhouseCoopers since 1987 - Experience in administration of insolvent estates, cross-border insolvencies in the UK, Transkei and Zimbabwe

As explained above, the data was collected during the in-depth interviews. These interviews involved a personal interaction between the researcher and the respondents, and allowed for the researcher to use probing questions whenever clarity was required.

4.4 Data analysis and the limitations of the research

Although limited quantitative data was revealed in the gathering of the secondary data, the research design resulted in almost purely qualitative information and data being gathered. In this regard qualitative interpretation and assessment were used and content analysis was applied. Responses were grouped according to themes, concepts and priorities identified. The frequency of mention and the emphasis placed by respondents were taken into account in interpreting the results.

The relatively small sample of individuals interviewed carried the risk of the respondents being prone to provide answers in line with the researcher's expectations. However, at no time did the researcher get any impression that this was the case. In fact, in all the cases the respondents appeared open and honest, and in most cases passionate about the subject. All the respondents were qualified to give informed opinions from their perspective, being professional and active in some way in the research area, and all respondents revealed strong opinions on the various issues discussed.

4.5 The research questionnaire

The structure and the designated questions were as follows:

Business Rescue Questionnaire and guide for discussion

A) Putting business rescue into context – are we talking about the same thing?

1.

Discuss the respondent's understanding of the concept of business rescue. Discuss the following: Business rescue aims at maintaining the debtor as a viable business utilising processes such as reorganisation. Comment on the World Bank Guide which states: '*Also, long-term economic benefit is more likely to be achieved through reorganization 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 reorganization proceedings which protect, for example, the employees of a troubled debtor'.

2.

Discuss the UN principles in general: Submission to the proceedings on own application or application of creditors; Moratorium on actions and proceedings against the assets a limited period of time; Continuation of the business either by management, independent manager or both; Formulation of a plan; Acceptance of plan by creditors; Implementation of plan.

3.

Comment on the status quo in SA: General; Judicial management; Compromises in terms of section 311 of the Companies Act; Informal arrangements with creditors – Discuss whether this is sufficient, or do we need change?

B) Initiating the proceedings

4.

The initiation of business rescue, by court application or not? What about initiation by just filing a prescribed document? What does their experience indicate?

5.

Who initiates the process, the debtor and/or creditors?

6.

What are the requirements for this initiation process?

7.

If the process was initiated without a court application, who must be responsible for the administration, the Master of the High Court? If not the Master, who else?

C) The moratorium

8.

Should there be a moratorium and to whom should it apply?

9.

How long must the moratorium last and how should the periods work, should there be a initial/partial moratorium for example?

10.

What will end the moratorium and what will extend the moratorium?

4.6 Results of the research

4.6.1 Interview 1

A) Putting business rescue into context – are we talking about the same thing?

1	Agreed – successful reorganisation is a lot more beneficial than liquidation.
2	Agreed – Respondent placed emphasis on the timing of the initiation of rescue – early recognition is crucial.
3	Judicial management a dismal failure – too difficult to raise finance. Section 311 too complex. Informal arrangements work – but have risk that one discontented creditor can negate an agreement. Respondent was very critical of the liquidation industry – claimed that liquidators run down companies purposefully (when they are judicial managers for example) and that an analysis of Liquidation and Distribution Accounts of the past ten years will show a miniscule

	payment to concurrent creditors – a major reason why business rescue provisions were important. Respondent was of strong view that the government's involvement in this area was not thought through properly as demonstrated by their fragmented approach.

B) Initiating the proceedings

4	Important that it is possible to initiate without court proceedings. Early initiation is crucial.
5	Directors/debtors must be able to initiate. Respondent unsure about procedure pertaining to creditors.
6	Filing of a document that explains the situation.
7	Not the Master of the High Court. We need a new body to manage business rescue. 'Courts have no place in running a business'.

C) The moratorium

8	It is vital that a moratorium comes into existence. It should apply to all creditors.
9	Suggests a 28-day moratorium from the day of filing – on the 28th day a plan must be presented to indicate the way forward.
10	Respondent was unsure.

D) Additional data

It is vital that some accreditation takes place – respondent suggested that a panel of rescue professionals be set up comprising retired business professionals, for example.

4.6.2 Interview 2

A) Putting business rescue into context – are we talking about the same thing?

1	Agreed – these principles are very important.
2	Agreed – we need an environment where entrepreneurs can flourish, create jobs, and survive “speed bumps”.
3	Judicial Management is simply not working. Informal arrangements have the risk that one creditor can liquidate and endanger the arrangement.

B) Initiating the proceedings

4	Initiation through filing (after a special resolution for example) is necessary. The respondent’s professional experience in one of the countries analysed in this report’s literature review indicated that a process without courts worked well.
5	Directors/debtors must be able to initiate rescue but the process must include the appointment of an administrator. Creditors must also be able to initiate.
6	No court order is necessary.
7	The Master makes theoretical sense to handle the administration but there is doubt whether this will work in practice. The Master has a bad track record.

C) The moratorium

8	A moratorium is imperative and it should apply to all creditors equally.
9	30 days is enough time for preparation of plan by the business rescue specialist and thus the moratorium must be in place for this period.
10	The moratorium should only be extended by a court and only with extremely good reason.

D) Additional data

A panel of accredited business rescue specialists is a necessity. A peer review system should be implemented for business rescue specialists.
Three years of experience in Australia indicated that the system works well and the respondent gave the following statistics based on his experience: – 30% of distressed businesses are liquidated; – 20% of distressed businesses go into rescue and are liquidated later; – 50% of businesses are saved.

4.6.3 Interview 3

A) Putting business rescue into context – are we talking about the same thing?

1	Agreed – liquidation must be an option only in cases that warrant it.
2	Agreed.
3	These systems are not accessible enough, although certain changes to judicial management provisions in Companies Act can make situation more acceptable.

	However, the best option is to include new and specific business rescue provisions in the new Insolvency Act yet to be promulgated. The fact that government drives the process from two departments is extremely confusing and inhibits progress. At the moment it is totally unclear who drives the process from government perspective. The Department of Justice is involved through the Ministerial Committee on the Liquidation Industry and the Department of Trade and Industry is involved through the activities initiated by the draft policy on Corporate Law Reform. There are a lot of stakeholders and interested parties in the industry and they are not properly co-ordinated. The formation of Association of Business Administrators of South Africa (ABASA) was a civil initiative and as a result this organisation has no statutory or government mandate which limits its influence.

B) Initiating the proceedings

4	A debtor needs to be able to initiate rescue without a court order, for example, when the special resolution of directors is registered with the Registrar of Companies. A creditor needs to bring a court application to initiate business rescue.
5	Both directors/debtors and creditors can initiate, although he foresees that debtors will mostly initiate the process. One needs to be beware of abuse and the fact that creditors can select another business rescue specialist at first meeting may address this issue.
6	Requires: – Special resolution; – Filing of document with Master explaining the circumstances, who is the business rescue specialist, statement that the entity may become insolvent in future and, a declaration that business rescue provides a likelihood of recovery.
7	Master must handle administration, despite problem at Master's office.

	It is unrealistic in the South African context to expect a new body to be set up.

C) The moratorium

8	A moratorium must be applicable to all creditors and this is vital for the successful implementation of business rescue. The company and business rescue specialist requires space and protection to the necessary.
9	The moratorium should last until business plan is accepted, with the timing as follows: – First meeting of creditors within 14 days; – Plan to be presented and accepted within 60 days after first meeting; – Can extend another 30 days with court permission. The respondent is of the view that South African circumstances require a longer period than Australia, for example.
10	The moratorium stops when the plan is accepted, when the company is liquidated, or when court order is obtained.

4.6.4 Interview 4

A) Putting business rescue into context – are we talking about the same thing?

1	The respondent did not agree with the statement completely. The respondent was of the view that there needs to be distinction: – Turnaround management falls in the arena of the Companies Act; – Business rescue falls in the arena of insolvency.
2	Based on the premise that business rescue falls in the arena of insolvency, the respondent agreed with the statement. Rescue is only

	applicable when the business is insolvent or close to insolvency. The respondent prefers the Canadian rescue model as he regards it as efficient.
3	Compromises and informal arrangements work well in the arena of turnaround.

B) Initiating the proceedings

4	Initiation by filing should be an option.
5	Both debtors and creditors can initiate.
6	The filing of a document with Master explaining the circumstances including insolvency requirement is sufficient.
7	The Master of the High Court should definitely not handle the administration.

C) The moratorium

8	A moratorium is necessary in a business rescue environment as set out above.
9	The respondent did not commit to specific number of days, but she but believes in a 'quick diagnostic review'.
10	A court should be able to stop or extend the moratorium.

4.6.5 Interview 5

A) Putting business rescue into context – are we talking about the same thing?

1	The respondent agreed totally with the statement. He emphasised the debtor-friendly and the creditor-friendly approach

	in different jurisdictions and explained that you need more debtor-friendly environment for business rescue to work. In South Africa a shift has taken place: Where liquidation and sequestration was a embarrassment 10 years ago it is no more because liquidation has become a debt collecting tool. He is of the view that business rescue will bring different focus to the insolvency environment.
2	All these principles are vital to business rescue.
3	Judicial management is a failure because: – Liquidators were appointed as judicial managers; – No proper *concursus creditorum*; – It did not invoke a complete moratorium. Informal arrangements present a great risk in terms of section 424 of the Companies Act and sections 29 to 31 of the Insolvency Act with regard to possible allegations of collusion. The business rescue industry is currently operating informally through informal arrangements. It is risky situation that an industry as important as this operates unregulated. The government policy to date is unclear as to where responsibility for business rescue will be and business in South Africa needs clarity as soon as possible. The respondent proposed a separate act that deals with business rescue.

B) Initiating the proceedings

4	The debtor needs to be able to initiate without a court order and creditor needs to bring a court application.
5	Both.
6	The debtor can file for business rescue when it is likely to be unable to pay its debts, or is likely to become insolvent or is de facto or commercially insolvent. It must show that there is a reasonable possibility that the company can be rescued as a going concern or that the business administration

	process will create a reasonable possibility that a better result would be achieved for the debtor company's creditors than in liquidation.
7	Master of the High Court.

C) The moratorium

8	A moratorium is vital and needs to apply to all creditors.
9	A first meeting must be held within 10 days after rescue was initiated, a second meeting (where plan will be approved) must be held within 60 days after the first meeting.
10	The moratorium can be lifted by an order of court or when the entity is liquidated.

D) Additional data

Liquidators should not be appointed as business rescue specialists. There needs to be accreditation for business rescue specialists and respondent recommended:

- Attorney, minimum admitted 5 years and practised for own account/partner/director for minimum 3 years;
- Accountant, minimum admitted as auditor 5 years and practised for own account for minimum 3 years;
- Liquidator, minimum 8 years of experience and member in good standing of AIPSA, ABIB or IPSA;
- Other – appropriate equivalent qualifications and minimum of 5 years practice and 3 years for own account/partner/director.

4.6.6 Interview 6

A) Putting business rescue into context – are we talking about the same thing?

1	Agreed, liquidation is happening in situations where it is not the applicable solution. Especially in new South African economy with BEE issues at play business rescue can play a role in saving viable businesses.
2	Agreed – the respondent particularly likes the Australian system.
3	All three mechanisms are a dismal failure, we have an unregulated business rescue industry, and we need to address the situation. The subject is approached on too much of an ad hoc basis in South Africa, there is a lack of proper co-ordination that has the result that not all stakeholders are involved.

B) Initiating the proceedings

4	It is important that it is possible to initiate business rescue without court proceedings and early initiation is crucial.
5	Both debtors and creditors must be able to initiate.
6	Filing of a document that explains the problem, the possible insolvency, and the fact that the business is viable should be sufficient.
7	The Master will not be the appropriate body to handle the administration, but the controlling body must be in Justice Department. The rescue and insolvency industries should be separated.

C) The moratorium

8	A moratorium is important and should apply to all creditors.
9	The moratorium needs to be as short as possible, 21 days at the most.
10	In complex matters there needs to be some flexibility to extend the period, the respondent did not comment on whether this requires court approval.

D) Additional data

Accreditation for business rescue specialists is vital, there needs to be a panel with specialists. In the UK they also admit retired business people to appear on these panels and this can work here.

4.6.7 Interview 7

A) Putting business rescue into context – are we talking about the same thing?

1	Agreed – it is extremely important to understand the larger context, especially in South Africa.
2	Agreed with these principles especially in the South African context.
3	Judicial management simply too cumbersome. Informal arrangements work but are subject to risks in terms of: – One creditor can jeopardise total agreement; – Inherent risk in terms of section 424 of the Companies Act and sections 26 to 31 of the Insolvency Act – especially since the creditor (especially when it is a large financial institution) may get involved in the business decisions of the debtor.

	The main cause of the procrastination is government where the involvement of two departments creates confusion and results in bickering. The Ministerial Committee on the Liquidation Industry resulted in further delays, as the respondent understands that the terms of reference was extended to include investigation into business rescue in South Africa.

B) Initiating the proceedings

4	The debtor needs to be able to initiate the process without a court order and creditor needs to bring a court application.
5	Both.
6	The debtor can file for business rescue when it is likely to be unable to pay its debts, or is likely to become insolvent or is de facto or commercially insolvent. It must show that there is a reasonable possibility that the company can be rescued as a going concern or that the business administration process will create a reasonable possibility that a better result would be achieved for the debtor company's creditors than in liquidation.
7	He would prefer a new designated authority but this should not delay the implementation of business rescue provisions, if needs be, the Master can handle the administration.

C) The moratorium

8	There should be a total moratorium applicable to all creditors.
9	Initial moratorium should be 60 days with the possible extension to 90 days.
10	Upliftment can take place when the plan is accepted, or by an order of court or, when the entity is liquidated.

4.6.8 Interview 8

A) Putting business rescue into context – are we talking about the same thing?

1	Agreed – the preservation of jobs is probably the most important issue, especially in the South African context. Liquidation comes at a cost and business rescue will salvage some of these costs.
2	Agreed – we need to be aware of the deficiencies in the USA's system – especially that the long moratorium makes it ineffective.
3	Current mechanisms a dismal failure, we need change desperately as we cannot operate in the current informal environment. The single biggest problem is government's approach. The two departments are attempting to 'score political points'. This approach has the result that not all stakeholders are involved, which places the whole process in a difficult position.

B) Initiating the proceedings

4	Debtor needs to be able to initiate without a court order and creditor needs to bring a court application.
5	Both.
6	The debtor can file for business rescue when it is likely to be unable to pay its debts, or is likely to become insolvent or is de facto or commercially insolvent.
7	The Master must handle the administration and issues such as disciplinary actions. However, the Master must not have a discretionary role such as appointment of business rescue specialist.

C) The moratorium

8	Should apply to all creditors – and there must be *concursus creditorum* as per the date of business rescue.
9	The moratorium should last until the business plan is accepted, with the timing as follows: – First meeting of creditors within 14 days; – Plan to be presented and accepted within 60 days after first meeting; – The moratorium can be extended another 30 days with court permission.
10	Only a court can extend beyond the 60 days.

Additional data

Accreditation is a problem. There should be a formal statutory accreditation similar to the legal profession. The liquidation industry is an example of what happens when you do not have proper accreditation systems in place.

4.7 Analysis and interpretation of the results of the interviews

4.7.1 Introduction

The results of the research are non-statistical in nature and mostly qualitative information and data were gathered. With regard to the analysis and interpretation of results, qualitative interpretation and assessment were used and content analysis was applied. Responses were analysed according to themes, concepts and priorities used and identified during the interviews.

The frequency of mention and the emphasis placed by respondents were taken into account in interpreting the results. The interviews were structured to follow the issues highlighted by the research problem i.e. the uniqueness of the South African situation, the process of initiating the business rescue regime and the moratorium. In most interviews a number of other issues relating to the subject matter were mentioned. However, the majority of interviews revealed a single major concern with the respondents that were not part of the research problem and the designated questions. This relates to the accreditation of the professionals in a local business rescue industry. This information was captured under the heading 'Additional information'. The results of these interviews are analysed and interpreted below under the following headings:

- Business rescue and the liquidation industry in South Africa;
- Initiating the proceedings;
- The moratorium;
- Additional data.

4.7.2 Business rescue and the liquidation industry in South Africa

The respondents were unanimous that the current situation in South Africa was untenable. The liquidation industry has experienced dramatic changes in recent years and a shift has taken place. Where liquidation/sequestration

was regarded as a personal embarrassment 10 years ago it is not so anymore. To a large extent liquidation has become a debt-collecting tool.

There was overall agreement that the South African situation requires a new and specific rescue regime that will encourage a more debtor-friendly environment where entrepreneurs can flourish, create jobs, and survive what one respondent referred to as 'speed bumps'. Especially in the current South African economy the respondents indicated that business rescue could play an important role in saving viable businesses.

With regard to the various rescue options currently available, the interviews produced the results set out below.

4.7.2.1 Judicial management

Judicial management failed for various reasons such as:

- The system is too cumbersome and not accessible enough. This is largely due to the lengthy court procedure and the relative high burden of proof in alleging that the business is capable of being saved;
- It is too difficult too raise finance because of perception problem;
- Liquidators are mostly appointed as judicial managers and not business rescue/turnaround specialists;
- There is no proper *concursus creditorum*;
- It does not invoke a complete moratorium.

4.7.2.2 Schemes of arrangement in terms of section 311 of the Companies Act of SA

Schemes of arrangement were regarded as too complex and too cumbersome. The complicated court procedures also increased the costs that by implication exclude smaller companies from using this option.

4.7.2.3 Informal arrangements

Informal arrangements are the most prevalent system in South Africa's current unregulated business rescue environment. Because this system relies on agreement between all the parties involved, the single biggest problem with this system is that a single discontented creditor can jeopardise the agreement.

Two respondents also raised the issue that there is an inherent risk in terms of section 424 of the Companies Act of SA and sections 26 to 31 of the Insolvency Act for large financial institutions in South Africa. This is because the large financial institutions, through their respective business rescue divisions, actively involve themselves in the activities of the distressed business. The respondents at the financial institutions acknowledged that they were aware of this, but stated that they were comfortable that they have not overstepped the line.

4.7.2.4 The government approach

Most of the respondents were, to some extent, critical of the governments approach to business rescue stating that government's involvement was not thought through properly. The fact that government is driving the process essentially from two departments is regarded as extremely confusing and the respondents are of the view that this inhibits progress. The lack of proper co-ordination has the result that not all stakeholders are involved.

4.7.3 Initiating business rescue proceedings

The respondents were unanimous that it was of the utmost importance for a new business rescue regime to provide for the debtor to initiate the proceedings and create the opportunity for the debtor to enter into a state of business rescue without the necessity for court proceedings. The debtor can file for business rescue when it is likely to be unable to pay its debts, is likely to become insolvent or is de facto or commercially insolvent. This 'out of court' procedure should comprise the filing of a document (after a special resolution for example). The document should state that there is a reasonable possibility that the company can be rescued as a going concern or that the business rescue process will create a reasonable possibility that a better result would be achieved for the creditors than in liquidation.

All respondents were unanimous that creditors should be able to place a debtor in a state of business rescue. Most respondents were of the view that

the creditor should be obliged to obtain a court order to place a debtor in a state of business rescue, while other respondents were unsure.

Most respondents agreed that the immediate or early appointment of a business rescue administrator combined with an early meeting of creditors where creditors can accept or reject the appointment of the business administrator would address abuse of the system.

All respondents emphasised that early filing/initiation is crucial for success.

The respondents were divided in terms of where this filing should take place and who should be responsible for the administration of business rescue. Some of the responses were:

- It should not be the Master of the High Court, a new body to manage business rescue is necessary;
- Although the Master of the High Court makes theoretical sense, there is doubt whether it will work in practice;
- The new controlling body must be in Justice Department;
- A new designated authority would be preferable but this should not delay the implementation of business rescue provisions. If needs be, the Master must handle the system.

These responses emphasised the issue that an efficient administration is required for business rescue to succeed and that there is doubt whether the Master's office has the capacity to meet these requirements.

4.7.4 The moratorium during business rescue

The respondents were unanimous that it is vital for a moratorium to come into existence and that it should apply to all creditors. There was agreement that the debtor and the business rescue specialist require space and protection.

Respondents were divided on the duration of the moratorium and suggestions varied from a 21-day moratorium to a one of maximum 90 days. Some respondents argued that South African circumstances require a longer period than Australia, for example. However, it was clear that the moratorium should be reasonably short and respondents did not regard a lengthy moratorium as functional.

Respondents generally agreed that the moratorium should be uplifted when the rescue plan is accepted, or by an order of court or, when the entity is liquidated.

Respondents also generally agreed that a moratorium should only be extended past the statutory date through a court application and that very good reason needs to be provided before it is granted.

4.7.5 Additional data

As explained, the majority of interviews revealed a single major concern with an issue that did not form part of the research problem and the designated questions. This related to the accreditation of the professionals in a local business rescue industry.

Respondents across the board regarded a panel of accredited business rescue specialists as a necessity. Minimum standards, qualifications, and levels of experience to be accredited are regarded as critical. Some respondents suggested that a peer review system be implemented while other suggested that retired business professionals also be used to form a basic core panel.

Chapter 5: Conclusions

5.1 Introduction

Chapter 2 presented the research problem: What form should the regulatory environment pertaining to entering a state of business rescue and a moratorium take? It was suggested that these problems be investigated by looking at international practices and principles as well as local developments, conducting local research, and developing principles applicable to local circumstances. The secondary data analysis and literature review described in Chapter 3 and the research described in Chapter 4 were the methodologies used in this regard. The aim was to be able to suggest a basic framework, proposing what the minimum requirements for initiating a state of business rescue and the moratorium in a new regulatory environment should be by seeking to answer the following three questions:

(i) What is the status quo pertaining to business rescue in South Africa?

(ii) What are the minimum requirements with regard to debtors and creditors for initiating a state of business rescue in a new regulatory environment?

(iii) What are the minimum requirements pertaining to the statutory moratorium in a new regulatory environment?

5.2 What is the status quo pertaining to business rescue in South Africa?

The respondents agreed that the current systems of business rescue in South Africa, i.e. judicial management, section 311 compromises, and informal arrangements, were a failure. Coupled with government's view that the liquidation industry should expand its horizon and acknowledge the national interests of job preservation and business rescue and not only the interests of liquidators, secured creditors and their lawyers, the principle of business rescue has become an important topic for South African business.

It is unclear who drives the process from government's perspective. Not only are the Department of Trade and Industry and the Department of Justice involved via the two bills and the corporate law reform project, but there is also the Ministerial Committee on the Liquidation Industry whose mandate has apparently been extended very recently to include inquiries into business rescue in South Africa. One of the respondents interviewed for this project (who is actively involved in this committee) is of the view that these recommendations will have a profound influence on how this subject will be approached in South Africa in the near future. The subject is approached on too much of an ad hoc basis, there is a lack of proper co-ordination with the result that not all stakeholders are involved.

The respondents agreed that the current situation is untenable. Seen in light of the fact that a new and specific rescue regime will encourage a more debtor-friendly environment where entrepreneurs can flourish, survive, and create jobs, this situation is not acceptable.

It is clear that government needs to act responsibly and co-ordinate all activities aimed at developing the concept of business rescue in South Africa. To have two government departments competing for prominence in an issue that is of national commercial importance is not in the interests of the country and its people.

The secondary data analysis revealed that Australia's current business rescue regime is the result of a law reform commission that conducted a comprehensive and inclusive study of insolvency law in Australia. The same process was followed in the UK with the Cork Report. This emphasises the fact that the fragmented process followed in South Africa is not ideal.

5.3 Initiating business rescue proceedings

The respondents were unanimous that it was of the utmost importance for a new business rescue regime to provide for the debtor to initiate the proceedings and create the opportunity for the debtor to enter into a state of business rescue without the necessity for court proceedings. This was resonated in the review of the practices in the countries discussed in Chapter 3. In both the Australia and the USA the process can be initiated

without court applications and it is regarded as one of the success factors in the two countries. In the UK, the original legislation pertaining to administration orders required a court application that resulted in cumbersome legal procedures and high procedural costs. The UK system was amended recently by eliminating unnecessary court involvement with a view to maximising speed and efficiency. The interviews as well as the literature review emphasised that the idea was not too eliminate the court from business rescue altogether, but rather to limit unnecessary court involvement. As illustrated in the Australian model, courts can play a vital role in ensuring successful, fair, and equitable business rescue proceedings.

A major criticism against Chapter 11 proceedings in the USA is the many delays caused by court involvement at a later stage of the process and notably the eagerness with which courts extend the exclusivity period.

All respondents agreed that creditors should be able to place a debtor in a state of business rescue. Most respondents were of the view that the creditor should be obliged to obtain a court order to place a debtor in a state of business rescue.

Most respondents agreed that the debtor must be able to file for business rescue not only when the company de facto or commercially insolvent, but also when it is only possible the company may become insolvent in future. As shown by the research and the systems in Australia, the UK, and the USA, it is important that insolvency is not a prerequisite for business rescue. It is

crucial that business rescue is entered into timeously leaving enough time for rescue actions to be implemented. Voluntary administration in Australia is available to companies that are not insolvent and Chapter 11 in the USA has no insolvency or imminent insolvency requirement. In the UK the failure of administration orders was partly blamed on the insolvency requirement that resulted in rescue orders being sought at a late stage of corporate decline. All respondents emphasised that early filing/initiation is crucial for success.

Most of the respondents agreed that the 'out of court' procedure should comprise the filing of a document with some minimum requirements. One minimum requirement was a statement to the effect that there is a possibility that the company can be rescued as a going concern or that the business rescue process will create a reasonable possibility that a better result would be achieved for the company's creditors than in liquidation. All the respondents required the immediate or early appointment of a business rescue administrator combined with an early meeting of creditors where creditors can accept or reject the appointment of the business administrator. The aim of these provisions is to address possible abuse of the system. This early appointment of a business administrator attempts to address possible abuse of the system. In both the UK and Australia this early appointment is an integral part of the system while the USA has its unique 'debtor in possession principle' that is subject to criticism.

The respondents were divided in terms of where this filing should take place and who should be responsible for the administration of business rescue. These responses emphasised the issue that an efficient administration is required for business rescue to succeed and that there is doubt that the Master's office has the capacity to meet these requirements.

Suffice it to say that in Australia, the UK, and the USA additional provision is made for the administration of business rescue (and liquidation) procedures with the USA having, for example, the Federal Bankruptcy Court.

5.4 The moratorium

All the respondents emphasised the importance of a moratorium being imposed as the debtor and the business rescue specialist requires space and protection. This is supported by the secondary data analysis where the importance of the moratorium is emphasised by the failure of CVAs in the UK. The lack of a statutory moratorium resulted in a lack of breathing space for the distressed company that in turn resulted in CVAs not being used as a business rescue tool.

This moratorium should apply to all creditors. Some respondents emphasised the importance of a *concursus creditorum* coming into existence as the company enters the state of business rescue. This was echoed by the systems in Australia, the UK, and the USA. With regard to which creditors are subject to the moratorium, all three countries have reasonably intricate

systems setting out the rights and obligations of classes of creditors according to local legal principles.

Respondents were divided on the duration of the moratorium and suggestions varied between a moratorium of 21 days to one of maximum 90 days. The respondents who were involved in the drafting of the Business Administration Bill seemed to prefer a longer moratorium of up to 60 days with the possibility of a further extension of 30 days through a court application. The other respondents preferred a shorter period ranging between 21 days and 30 days with a maximum of 60 days. Some respondents argued that South African circumstances require a longer period than Australia, for example. The need for a short moratorium is reflected in the Australian system where there is a deliberate attempt to employ methods to avoid delays. This strict regulation to avoid any delays and the prescribed (short) periods within which to have meetings and prepare a rescue plan is regarded as one of the reasons for the success of voluntary administration. The first meeting of creditors is to be held within five days after the administration has commenced and the second meeting is to be held within five working days of the end of the convening period. The convening period is 21 days from the start date of the administration. Administration orders in the UK had no limit to the duration of the moratorium and these orders were ineffective against certain holders of security. This situation changed when the Enterprise Act of 2002 came into force earlier this year and introduced time limits to the administration

procedure. A too long a moratorium can be damaging and in the USA the enthusiasm with which courts extend the exclusivity period is blamed for the long delays and resulting high costs. It is clear that the moratorium should be reasonably short and that a lengthy moratorium is not regarded as functional.

Respondents generally agreed that the moratorium should be uplifted when the rescue plan is accepted, or by an order of court, or when the entity is liquidated. Respondents also generally agreed that a moratorium should only be extended past the statutory date through a court application and that very good reason needs to be provided before it is granted. This approach could also be found in the systems investigated in the three countries.

5.4 Additional data

The respondents identified a system of accreditation as important in establishing a successful business rescue regime. Both the Australian and UK models support this view and regard a system of accreditation for business rescue specialists as a necessity. Minimum standards, qualifications, and levels of experience is regarded as critical. In the UK retired business professionals were identified to play important roles on these business rescue panels. In both countries a distinction is also made between business rescue specialists and liquidators.

Chapter 6: Recommendations and areas for further research

6.1 Introduction

This report attempted to develop basic recommendations with regard to the process of initiating the process of business rescue and the moratorium, using a combination of international principles and practices and local research. Whether these business rescue provisions form part of the Companies Act (like the Australian system), or part of the Insolvency Act (Like the UK system) or constitute new and autonomous legislation (like the USA system) seem to be of lesser importance. What is important is to have a system that complies with international standards and also addresses the uniqueness of the local circumstances. What follows are some recommendations and suggestions as to a broad framework pertaining to the process of initiating the process of business rescue and the moratorium.

6.2 Recommendations

6.2.1 Business rescue in South Africa

The current fragmented approach to establishing business rescue in South Africa is a reason for concern. A fragmented process has the risk of not consulting all stakeholders. This results in a situation where the intellectual

capital of professionals, experts, and academics are not utilised to its full possibility. It also creates a situation where buy-in of all stakeholders is not guaranteed which makes the process of implementing a new system all the more difficult.

The fragmentation starts at the highest level i.e. within the country's government departments. The situation is unfortunate and the government needs to take action as a matter of urgency and consolidate the process. As explained in this report, business rescue moves beyond the realm of insolvency and can be a useful tool in addressing some of the core problems of the country.

6.2.2 Initiating business rescue proceedings

Key recommendations

i) Both debtors and creditors need to be able to initiate the rescue procedure. While debtors should be able to initiate the procedure without the necessity of a court order, creditors and third parties have to approach a court to initiate the procedures.

ii) This out of court procedure must comprise the filing of a document after the required decision by the debtor. The nature of the required decision will depend on the nature of the company for example, in the case of a company it will be made through a special resolution accepted by the directors.

iii) A debtor can file for business rescue when it is insolvent but this is not a prerequisite, the possibility of insolvency in future is reason enough to enter into business rescue.

iv) The document that the debtor files must contain certain basic information:

- The declaration that the debtor is insolvent or may become insolvent;
- The reasons for the current distress;
- The declaration that the business is viable and can be saved;
- The business rescue process will create a reasonable possibility that a better result would be achieved for the company's creditors than in liquidation.

v) A business rescue specialist (a business administrator) must be appointed when the debtor files for business rescue and the administrator must ensure an early meeting of creditors. This early meeting should take place within the first two weeks after the initiation of the rescue proceedings. Creditors can use this first meeting to accept or reject the appointment of the business administrator.

vi) The ideal is that an independent statutory body should be responsible for the filing of the documents initiating business rescue, and the administration of the process. If this is not possible for some reason, and this becomes the responsibility of the Master of the High Court, it is recommended that a separate division be set up to deal with business rescue. This division requires special attention and expertise and it is necessary that the system operate efficiently with a view to build trust in the process ab initio.

6.2.3 The moratorium

Key recommendations

i) A moratorium is vital – the debtors and business rescue specialist require breathing space and protection to focus on the rescue plan.

ii) The moratorium needs to be effective from the date of filing the request for business rescue to avoid that any single creditor can jeopardise the process.

iii) The moratorium needs to be applicable to all creditors – for the same reason as above and a *concursus creditorum* should come into being at the same time as when the moratorium comes into being.

iv) The moratorium needs to be reasonably short and in the South African context 30 days or less is probably too short. The recommendation is

30 days with a possible extension of an additional 30 days (giving a total of 60 days. This total of 60 days is inclusive of the 10 to 14 days provided for the first meeting of creditors.

V) Any extensions beyond the 60 day period should be allowed on court application only and then only under extraordinary circumstances.

vi) The moratorium should be uplifted when the rescue plan is accepted, or by an order of court or, when the entity is liquidated.

6.3 Areas for further research

The introduction of business rescue legislation in South Africa should not detract from the continuing debate on the requirements for a successful business rescue regime. The example of the UK that implemented drastic statutory reform in recent times[118] serves as an example of the importance of continuous improvement. In light of this, further research can be conducted in nearly all of the aspects of business rescue.

However, the research and interviews revealed that there is one area that is extremely important and that forms the basis of the ongoing debate between the stakeholders in the rescue industry. This is the issue of accreditation that raises questions such as:

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[118] See chapter 3.4 above.

- Who should be accredited as business rescue specialists?
- What should the minimum academic qualifications be?
- Should practical experience be a requirement?
- Should there be a basic training and an 'entry examination' to test skills?
- Who should be responsible for managing this accreditation process?
- Is it necessary to create a statute to manage this profession analogous to the attorney's profession?

The researcher is also of the view that the impact of business rescue on corporate governance provides another area for further research. For example, in terms of corporate governance principles responsible management would, when necessary, put in place the necessary steps to set the company on the right path. This raises the question of what the liability would be had the directors not reverted to business rescue when they had the opportunity.

Another area for further research involves the aspect of liability of the business administrator. The business administrator represents the debtor on the one hand and he is required to act in the best interests of the creditors on the other hand. There is a certain level of possible conflict in this situation. This raises the question pertaining to the liability of the administrator. When will he be liable to the debtor and/or the creditors for acts committed during

the course of the rescue process, and will the liability be based on acts of negligence and/or gross negligence? This area also requires further research.

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