

The Development of Business Rescue in South African Law

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Table of Contents

Chapter 1

General introduction

1.1	Background information.....	1
1.2	Problem statement and research objective.....	2
1.3	Delineations and limitations.....	3
1.4	Significance of the study.....	3
1.5	Structure of dissertation.....	3
1.6	Key reference, terms and definitions.....	4

Chapter 2

Judicial management

1	Background information.....	5
2	South African corporate rescue options in terms of the Companies Act 61 of 1973.....	7
3	Judicial management in terms of the Companies Act 61 of 1973.....	7
3.1	Grounds of application for judicial management.....	9
3.2	Persons who are entitled to apply initiate the judicial management process.....	11
3.3	The provisional judicial management order.....	11
3.4	The final judicial management order.....	12
4	The effects of judicial management.....	13
4.1	The moratorium.....	13
4.2	<i>Concursus creditorum</i>	14

4.3	The effects on dispositions.....	14
4.4	Impeachable transactions.....	15
4.5	The application of assets for the duration of the judicial management proceedings...	15
4.6	Cancellation of the judicial management order.....	16
5	A critical evaluation of judicial management.....	16
6	Conclusions.....	20

Chapter 3

Business rescue in terms of the Companies Act 71 of 2008

1	Background information.....	22
2	The definition of business rescue.....	23
3	Entities which can initiate business rescue proceedings.....	24
3.1	Application by the board of directors.....	24
3.2	An application to the court by an affected person.....	25
4	Commencement of the rescue proceedings.....	26
5	Stay on legal procedures/moratorium.....	26
6	The duration of the business rescue proceedings.....	27
7	The appointments and function of the practitioner.....	28
8	Administrative requirements of the business rescue practitioner.....	30
9	The introduction and application of the business rescue plan.....	30
9.1	Part A-background.....	31
9.2	Part B-The proposal.....	32
9.3	Part C-assumptions and conditions.....	33

10	Comparisons between judicial management as seen in the Companies Act 61 of 1973 and the business rescue procedure as seen in the companies Act 71 of 2008.....	35
10.1	The application process.....	35
10.2	Who may apply?.....	36
10.3	The business rescue practitioner compared to the judicial manager.....	36
10.4	The effect on the directors and employees.....	37
10.5	The business rescue plan.....	37
11	A critical evaluation of the business rescue procedure contained in the Companies Act 71 of 2008.....	38
11.1	Certain definitions of phrases.....	38
11.2	The failure to comply with procedural requirements.....	38
11.3	The failure to adapt a business rescue plan.....	39
11.4	Setting aside the resolution.....	40
11.5	The furnishing of security.....	40
11.6	Post commencement finance.....	41
11.7	The effect of the business rescue proceedings on employee contracts.....	42
11.8	The general powers and duties of the practitioner.....	42
11.9	The specific people that can apply for business rescue.....	43
11.10	The appointment of a business rescue practitioner.....	43
11.11	Multiple notifications.....	43
11.12	Uncompleted contracts.....	44
11.13	The investigation of affairs of the company.....	45
12	Conclusions.....	46

Chapter 4

Some comparative aspects of business rescue mechanisms employed in Australia, the United Kingdom and South Africa

1	Australia.....	48
1.1	Official management.....	49
1.2	Administration.....	50
1.3	Appointment of the administrator.....	51
1.4	The effects of the appointment of an administrator.....	52
1.5	Personal liability and indemnity.....	53
1.6	The moratorium.....	53
1.7	Termination of the administration process.....	54
2	The United Kingdom.....	55
2.1	Administration.....	55
2.2	Procedure to commence administration.....	57
2.3	The qualifications of the administrator.....	59
2.4	The functions and powers of the administrator.....	60
2.5	The administrator`s remuneration and his or her liabilities in the case of the remuneration.....	61
2.6	The moratorium.....	61
2.7	The rescue plan.....	62
2.8	Termination of the administration procedure.....	63
3	An evaluation of the main differences between the Australian and United Kingdom`s business rescue procedures.....	64

4	A critical evaluation on the differences between the Australian, South African and the United Kingdom business rescue regimes.....	65
4.1	The initiation/commencement of the business rescue process.....	65
4.2	The moratorium.....	66
4.3	Post-commencement finance.....	68
4.4	The qualifications and appointments of the administrator and business rescue practitioner.....	69
4.5	Debtor in possession.....	70
4.6	Uncompleted contracts.....	72
4.7	Voidable dispositions.....	73
4.8	Duration of proceedings.....	74
4.9	Discharge.....	73
5	Conclusions.....	76

Chapter 5

Conclusion

Concluding remarks.....	77
Bibliography.....	79
Reports and statements.....	83
Case law.....	84
Legislation.....	85

Chapter 1:

General introduction

1.1 Background information

“Owners of the capital will stimulate the working class to buy more and more expensive goods, houses technology, pushing them to take more and more expensive credit, until debt becomes unbearable. The unpaid debt will lead to the bankruptcy of banks, which will have to be nationalised, and the state will have to take the road which will eventually lead to communism.¹”

The above quotation is a depiction of the world’s current economic condition. Some companies have high debts and as a result may be exposed to more financial risk. The financial risk may cause disrupted income, leading to unemployment, and could possibly even see the end of the company. Unemployment will thereafter ensue and lead to poverty. Poverty will then lead to the general degradation of standard of living within communities which will in the end contribute to crime and other illegal activities becoming a means of survival.

On a commercial level, business rescue would provide some breathing space to recover from temporary liquidity complications or more permanent indebtedness if necessary by providing the company an opportunity to restructure the business operations in relation for its creditors.²

Thus business rescue offers an opportunity for the efficient rescue and recovery of financially distressed companies. This is done through re-organising the company in a manner that restores it to profitability thus avoiding liquidation.

South Africa has recently brought the Companies Act 71 of 2008³ into operation. Judicial management has from the promulgation of the Companies Act 61 of 1973⁴ been South Africa’s primary form of business rescue. Judicial management however, as will later be explored, did not obtain the level of success that the legislators may have envisioned. For this

¹ Marx *Critique of the Political Economy: The Das Capital* 1987.

² Business Rescue-Introduction. www.businessrescue.co.za/intro.htm. Date of access 08/11/2011.

³ Hereinafter referred to as the Companies Act of 2008.

⁴ Hereinafter referred to as the Companies Act of 1973.

very reason liquidations were-and-are preferred as the primary insolvency procedure, as they provide a quicker and easier method for creditors to receive payment. However in keeping with international trends and standards, business rescue will have to find its place in South Africa as the primary option for companies facing such situations. The ideals of business rescue promote the notion that companies can survive such circumstances and re-emerge successfully after being afforded a fresh start.

The concept of *a fresh start* is predominantly an American ideal that encourages the idea that a company should be afforded a second opportunity after having once failed to become a successful concern. This exact ideology has found itself being revisited in a South African context.⁵ The introduction of business rescue in the Companies Act of 2008 has seen an attempt by legislators to re-engage the laws that regulate the business rescue. Are these adjustments however relevant and what impacts will they have?

The aim of the business rescue procedures is, as stated by Smith,⁶ ‘that modern corporate rescue and reorganisation should seek to take advantage of the reality that in many cases an enterprise not only has the substantial value as a going concern, but its going concern value exceeds its liquidation value. Through judicial bankruptcy procedures, reorganisations seeks to maximise, preserve and possibly even enhance the value of a debtor`s business enterprise, in order to maximise payment to the creditors of the distressed debtor.’⁷

Business rescue therefore offers the opportunity to ensure that, firstly the company has a fighting chance of surviving the pitfalls it may have faced, secondly saving jobs and thirdly, giving a substantial return to creditors.

1.2 Problem statement and research objective

At present between 3 766-4 156 businesses are liquidated each and every year.⁸ There is a need for effective legislation that offers practical guidance and solutions to ailing companies that need rescue. I wish to assess the development of business rescue in South Africa. There will be an assessment of the development of business rescue starting from judicial management right through to business rescue in terms of the Companies Act of 2008.

⁵ Loubser “Judicial Management as a Business Rescue Procedure in South Africa” *SA Merc LJ* 137.

⁶ Smith *Insolvency Law* (1988) 10.

⁷ Burdette “Some Thoughts on the Development of a Modern and Effective Business Rescue Model for South Africa” 2004 *SA Merc LJ* 16.

⁸ Statistics SA www.statssa.gov.za/publications/P0043/P0043August2004.pdf. Date of access 08/11/2011.

The purpose of this dissertation is to scrutinise the developments that have taken place from judicial management to business rescue in order to observe whether there have been relevant progressions that will enable business rescue to be set apart from judicial management in order to become a successful procedure companies can utilise.

1.3 Delineations and limitations

I will however focus only on companies and will not be investigating closed corporations. I will also give brief outlines of the business rescue provisions of other countries to gauge how South Africa compares in terms of business rescue on a global level. The Companies Act of 2008 will be used to highlight the significant changes and amendments that have been made in order to accommodate the new business rescue provisions. Due to the recent coming into operation of the Companies Act of 2008, there has not been an abundance of reported case law in this context. Journal articles and books have provided a foundation and primary source for the majority of the research conducted.

1.4 Significance of the study

This study aims to assess whether South Africa has the appropriate mechanisms within its legislative structures to provide adequate measures to facilitate and achieve business rescue.

1.5 Structure of dissertation

The paper is structured in four chapters in order to facilitate a full assessment of the whether there have been significant developments in terms of business rescue in South Africa.

Chapter 1 is the present one introducing the topic, research question and key references.

Chapter 2 is an assessment of judicial management which deals with both the strengths and weaknesses of the procedure, starting from its historical background.

Chapter 3 is an assessment of business rescue as described in the Companies Act of 2008, contrasting this with judicial management and focusing on the shortcomings and strengths that it may possess.

Chapter 4 is an evaluation of aspects of business rescue regimes in Australia and The United Kingdom. The purpose of this chapter is to evaluate whether business rescue as seen in the Companies Act of 2008 is in harmony with international standards.

1.6 Key references, terms and definitions

The following are the definitions of certain terminology that will be used throughout the dissertation. These definitions are derived from both the Companies Act of 1973 and the Companies Act of 2008.

Affected person⁹ means a shareholder or creator of the company, any registered trade union representing employees of the company.

Company¹⁰ means a company incorporated under Chapter IV of this Act and includes anybody which immediately prior to the commencement of the Act was a company in terms of any law repealed by this Act.

Director¹¹ means a member of a board of a company.

Independent creditor¹² means a person who is a creditor of the company, including an employee of the company who is a creditor in terms of section 144(2), and is not related to the company, a director or the practitioner, subject to subsection (2).

Judicial manager¹³ means the final judicial manager referred to in section 432.

Liquidator¹⁴ in relation to a company, means the person appointed under Chapter XIV as liquidator of such company, and includes any co-liquidator and any provisional liquidator so appointed.

Rescuing a company¹⁵ means achieving the goals set out in the definition of business rescue.

Special resolution¹⁶ in relation to a company means a resolution passed at a general meeting of that company in the manner provided for by section 199 of this Act.

⁹ Section 128(1) (a) of Companies Act of 2008.

¹⁰ Section 1 of Companies Act of 1973.

¹¹ Section 1 of Companies Act of 1973.

¹² Section 128 (1) (g) of the Companies Act 2008.

¹³ Section 1 of Companies Act of 1973.

¹⁴ Section 1 of Companies Act of 1973.

¹⁵ Section 128 (1) (h) of the Companies Act of 2008.

Chapter 2: Judicial management

The purpose of this chapter is to introduce the concept of business rescue whilst assessing the immediately prior position in the South African context in regard to the Companies Act of 1973. The assessment will seek to unravel the reasons as to why there was a need for a new business rescue regime to be introduced.

1 Background information

South Africa has traditionally relied on liquidation as a procedure performed when a company is in economic trouble and faces insolvency. This places the company in a permanent position through the selling of assets and the disassembling of the company into segments. These units are then sold at the best price, subsequently bringing about the end of the company through deregistration and dissolution with no option of revival or further continuance.

A developing economy such as South Africa cannot afford commercial enterprises that contribute to industries being run down through winding-up and eventual dissolution due to temporary setbacks in cases where a business rescue order can rather be granted.¹⁷ This would provide support to the community as jobs would not be lost, ultimately helping prevent the decay of socio-economic freedoms and the reduction of the standard of living for those caught in the cross-fire of insolvency. I will therefore explore in this chapter the options available within the 1973 Act other than liquidation that have aimed aim at providing a sense of relief to both ailing companies and all creditors involved.

Within the South African context not enough attention had been given to the rehabilitation, restoration or the financial health of the debtor which was necessary in South Africa's economic climate.¹⁸

¹⁶ Section 1 of Companies Act of 1973.

¹⁷ Cilliers and Benade et al *Corporate Law* (2000) 478.

¹⁸ Smits "Corporate Administration - A Proposed Model" 1999 *De Jure* 80.

The entire process of bankruptcy¹⁹ has been described as:

“A conservative insolvency process which effects the immediate or prompts cessation of the business activities of an insolvent debtor; a sale of the assets usually in the piecemeal form, and ultimately, the distribution of the proceeds to creditors. The debtor enterprise or corporation is usually extinguished during, or as a result of the process.”²⁰

This process provides an orderly and efficient means of maximisation of the debtor’s estate that allows a somewhat guaranteed return in terms of relief for the creditors. However liquidation has not always given back the full amount of resources invested and creditors have been known even to contribute in order to ensure the process is completed as seen in *Synman v the Master*.²¹ In this case the free residue generated by the sale of the company assets was insufficient to cover the entire cost of the liquidation of the company. The result was that the secured creditors were all called upon to provide financial assistance for the liquidation. At the end of the case it proved that even creditors with security were forced to cover the costs of liquidation and therefore not receive any substantial amount of their money back. Business rescue aims to provide a solution to this problem, through keeping the company alive and ensuring that creditors in fact receive a considerable proportion of what they invested.

Alternatives in the form of financial reconstruction such as judicial management and statutory composition found their place in South African law and legal practice. Their purpose was to enable the debtor’s enterprise to continue as a going concern. This was imperative as the company’s failure affects the employees, suppliers, distributors, and entire communities simultaneously.²² The Insolvency Act 24 of 1936 creates preference in affording employees protection under such financial situations. Section 98A²³ confers such a preference to the employees directly after the cost of execution has been settled. Protecting these interests in effect protected the community and enabled people an opportunity to live life at a reasonable standard without experiencing poverty.

¹⁹ *Bankruptcy* is defined as being in a position where the debtor is unable to pay her or his debts in full, *Oxford Advanced Learners Dictionary*.

²⁰ Smits 1999 *De Jure* 80; Harmer “Comparison of the Trends in National Law: The Pacific Rim” 1997 *Brook J Int L* 140 (Harmer).

²¹ 2003 1 SA 239 (T).

²² Loubser “Judicial Management as a Business Rescue Procedure in South African Corporate Law”, 2004 *SA Merc LJ* 16.

²³ Insolvency Act 24 of 1936.

The function of business rescue is to rescue and reorganise the juristic body, namely the company, to the extent that the enterprise not only has a substantial value as a going concern but actually exceeds its liquidation value.²⁴

Corporate rescue is described as the revival of companies on the brink of economic collapse and the salvage of economically viable units to restore production capacity, employment and continued rewarding of the capital and investment.²⁵ Although it is not entirely without criticism, business rescue offers the opportunity to save jobs and most importantly in terms of the creditor`s interest facilitate the full payment of debt by the debtor.²⁶ South Africa, unlike most countries, has had an established, functioning business rescue regime that was legislated into existence by the South African Companies Act 46 of 1926.²⁷ Its development can only improve the procedure and add on the foundations that have already been laid down.

2 South African corporate rescue options in terms of the Companies Act 61 of 1973

As stated above South Africa has traditionally used liquidation procedures above all other business rescue options. Liquidation has been maintained as the preferred premier procedure due to its precedence and reputation received as a result of success, accessibility and the guaranteed practicality.²⁸

3 Judicial management in terms of the Companies Act 61 of 1973

The purpose of judicial management in terms of section 427²⁹ was that

“Where there is a reasonable probability that, if it is placed under judicial management, it will be enabled to pay its debts or meet its debts or to meet its obligations and become a

²⁴ Smits 1999 *De Jure* 80.

²⁵ Kloppers “Judicial Management – A Corporate Rescue Mechanism In Need of Reform?” 1999 *STELL LR* 3; Paul Omar “Thoughts on the purpose of Corporate Rescue” 1997 *The Company Lawyer* 127; Belcher *Corporate Rescue* (1997) 11-13 who defines corporate rescue “as a major intervention necessary to avert eventual failure of the company”; Brown *Corporate Rescue* (1996) 3 defines it simply as “the survival of the company or a substantial part of the business.”

²⁶ Rajak and Henning “Business Rescue for South Africa.” 1999 *SALJ* 262.

²⁷ *Ibid.*

²⁸ Smits 1999 *De Jure* 80.

²⁹ Companies Act 61 of 1973.

successful concern, the court may if it appears just and equitable, grant a judicial management order in respect of that company.”³⁰

The preservation of the company is seen as of importance in the essence of business rescue.³¹As noted by the comments in Parliament³² judicial management qualifies as a corporate rescue procedure and is therefore relevant to this discussion.³³

Judicial management involved the combination of the normal principles of company law in regard to management of the company and the principles of insolvency can give effect and create maximum benefit for the creditors and the members of the company.³⁴

It was a process in terms of which a company experiencing a non-permanent financial difficulty as a result of poor management, negligence by management, or any other unforeseen financial situation was placed in the hands of a judicial manager³⁵ who took the company with the sole purpose of restoring it into a state of profitability and optimum performance.³⁶Judicial management was not to be instituted or continued as an alternative method of liquidation³⁷ and it should not be initiated or continued merely on the basis that while it subsisted the company`s assets might be sold more advantageously.³⁸ It however could be converted into an alternative procedure such as liquidation if there was evidence to show that the initial reason for which it was commenced was not to buy time or deceive creditors.³⁹

³⁰ Shrand *The Law and Practice Of Insolvency-Winding Up Of Companies and Judicial Management* (1977) 325.

³¹ *Ibid Hoek & Others v Pan African Tanneries Ltd & Another* 1951 2 PH E20 (W) obiter by Clayden. J.

³² *Hansard House of Assembly Debates Vol 6 1926-02-25 col 996-997.*

³³ *Klopper Stell LR* (1999) 3.

³⁴ Cilliers and Benade et al *Corporate Law* (2000) 479.

³⁵ It must however be noted that the court still maintains a discretion as seen in the case of *Maynard v Office Appliance (SA) (Pty) Ltd* 1929 WLD 290, where Barry J rejected an application for the appointment of a judicial manager based on the allegation that there had been mismanagement in the conduct of the company`s affairs and pointed out the financial situation of the company can be dealt with by reducing the cost of management and increasing the capital of the company which can subsequently be dealt with by the directorship of the company. This is an example of how the court will assess each case based on its individual merits and not grant every company that seeks to have a judicial management order.

³⁶ *Burdette* 342; Section 427(1) of the Companies Act of 1973; *Silverman v Doornhoek Mines Ltd* 1935 TPD 249; Cilliers and Benade *Corporate Law* 478.

³⁷ *Millman NO v Swartland Huis Meubileerders (Edms) Bpk* 1972 1 SA 741 (C).

³⁸ *Meskin Henochsberg on The Companies Act* (1975) 760; *Millman v Swartland Huis Meubuedes Edm (Bpk)* 1972 (1) SA 741 (C).

³⁹ *Ibid.*

3.1 Grounds of application for judicial management

Companies which had been placed in positions could have applied for judicial management, notwithstanding that they had been placed in exceptional circumstances,⁴⁰ to meet the following prerequisites that,

- Firstly *the company was unable to pay its debt or would probably be unable to meet its obligations*, which is referred to as *commercial insolvency* and must be proven.⁴¹ The actual or balance-sheet insolvency test, where the liabilities of the company exceed the value of its assets, is not recognised as grounds for a successful application for judicial management order.⁴² It must also be proven that the company is unable to meet its *obligations*. However the Companies Act of 1973 did not give a definition of the words *obligations* or the inability which may therefore in its wider meaning include the probable future inability of the company to meet its obligations. Thus meaning if the company was likely to become unable to pay its debts, the unlikelihood⁴³ was justifiable grounds for commencement of the procedure.
- The second was that *the company has not been prevented from becoming a successful concern*.⁴⁴ The Companies Act of 1973 was however vague as regards indicating at what point or under which specific circumstances a company would be defined as not being a successful concern, since the company not been able to meet its obligations and pay outstanding and future debts had already become an unsuccessful concern.⁴⁵ Such a requirement adds difficulty to proving all grounds for a judicial management order to be approved. There must be reasonable probability that it will be in the position to pay debts or meet obligations and become a successful concern.⁴⁶ The court must be satisfied that there is a reasonable prospect that the company will be enabled to pay its debts if placed under judicial management; therefore a provisional judicial management order may not be used to ascertain whether judicial management

⁴⁰ *Silverman v Doornhoek Mines Ltd* 1935 TPD 349.

⁴¹ Loubser *Some Comparative Aspects of Corporate Rescue In South African Company Law* (LLD dissertation 2010 Unisa) 21.(LLD thesis UNISA,2010,hereinafter `Loubser`.

⁴² Loubser 22, This differs from the grounds recognised for the application for a business rescue proceedings in terms of the Companies Act 2008 in which the inability to pay debts and the balance sheet *acid test* are both accepted as distinctive grounds.

⁴³ Loubser 22.

⁴⁴ Section 427 (1) (a) and (b) of the Companies Act of 1973.

⁴⁵ Loubser 22.

⁴⁶ Pretorius *Hahlo South African Company Law, Through the Cases* (1991) 737.

will succeed in rescuing the company.⁴⁷ There will be substantial difficulty in proving that if judicial management is granted it will enable the company to pay its debts or become a successful concern. This requirement was extremely restrictive and tended to prevent the applications from being successful.⁴⁸ The expertise and knowledge of the court must be questioned as to whether it had the necessary competence and proficiency in considering whether a company would become a successful concern as there were no regulations that defined a successful concern. It was unclear as to what test the court actually applied to distinguish between a success and an unsuccessful concern of the future.

- Thirdly *the application must be just and equitable*, meaning that judicial management must be the most appropriate measure that was not extraordinary but most suitable to the situation at hand.⁴⁹ Once again the question arises of whether the court had the competence and knowledge to make such a relevant assessment as there were no clear guidelines on how to adjudicate such situations. In the case of *Makhuva v Lukoto Bus service (Pty) Ltd*⁵⁰ the court held that the mere fact that the alleged problems were capable of internal resolution by the majority of the shareholders would preclude it from finding that it would be just and equitable to place the company under judicial management.⁵¹ The courts had precedent and extensive experience, but analysing the actual functioning of a company may have needed an individual that had some expertise in the financial field such as an accountant with the technical ability to calculate and identify with some level of precision the probability of success or failure.
- Although all of the above requirements may have been complied with, the success of the application was still dependent upon the court's discretion. In the case of *Tenowitz v Tenny Investments*⁵² the court refused to grant a final order of judicial management,

⁴⁷ Loubser 23. Section 427(1) Act 61 of 1973. This was also stressed by the Appellate Division (as it was then) in *Noordkaap Lewendehawe Ko-operasie Bpk v Schreuder en 'n Ander* 1974 3 SA 102 (a) at 110.

⁴⁸ Loubser 22, Rajak and Henning 1999 SA L J 262 267-268, Smits 1999 *De Jure* 86.

⁴⁹ Loubser 25.

⁵⁰ 1987 (3) SA 376 (V).

⁵¹ Loubser *Case Book on The Law Of Partnership, Company Law And Insolvency Law* (1991) 148.

⁵² 1979 (2) SA 680 (E).

due to the fact that the applicant had not discharged the onus of proving that the company would become a successful concern in a reasonable period of time.⁵³

3.2 Persons entitled to apply to initiate the judicial management process

There was no clear differentiation between which persons could make an application for winding up and an application for judicial management. Persons who may apply are described in section 346 of the Act to be,

- the ailing company,
- one or more creditors (including contingent or prospective creditors) and,
- one or members referred to in section 103(3) irrespective of whether they has been registered as members of that company.

3.3 The provisional judicial management order

A provisional judicial management order was then granted containing the direction the company should have been under during the process leading up to which the appointment of the provisional judicial manager who was then vested with the necessary powers and duties, subject to the rights of the creditors of the company.⁵⁴ At this point those within the management of the company were relieved of their powers.⁵⁵ The master, who maintained custody and control of the company assets thereafter, would then transfer those powers to the provisional judicial manager who would subsequently transfer them to the final judicial manager.⁵⁶ It was mandatory for the provisional judicial manager to express his or her opinion on the prospects of the company becoming a successful concern, and if necessary to list all the relevant factors that played a part in preventing the company from once again becoming a successful concern.⁵⁷ The introduction of a provisional order provides the opportunity for the creditors to put forward the opinions and concerns in acceptance of or

⁵³ Meskin 760.

⁵⁴ Section 428 of the Companies Act of 1973, all property of the company concerned shall be deemed to be in the custody of the Master until a provisional judicial manager has been appointed and has assumed office.

⁵⁵ Cillier and Benade 761. The directors of the company may no longer issue anymore share capital in the company this is seen in the case of *Bank Bpk v Registrateur Van Banke* 1996 1 SA 330 (A).

⁵⁶ Section 433 of the Companies Act of 1973.

⁵⁷ Loubser 27.

opposition to the final order.⁵⁸ In line with the procedures followed in terms of the Companies Act of 1973, the application would have to be come before the court at least two times prior to the final judicial management order being approved.⁵⁹ Reports from each of these meetings are then prepared and taken to court in order to consider the matter in order to decide whether or not to grant judicial management.⁶⁰

In terms of section 432(2)⁶¹ the court had to gauge the opinions of the members of the company, the reports of the provisional judicial manger, the master, and the registrar of the companies and decide whether or not to grant the final judicial management order.

In the case of *Ladybrand Hotel (Pty) Ltd v Segal and another*,⁶² three aspects were mentioned by Erasmus J that played a pivotal part in the determination of whether a final order could be granted: *First*, the dearth or lack of information brought before the court; this information included trading and profit and loss accounts over a few months which gave a true reflection of the conduct of the applicant business in as regards various rates, taxes and future foreseen expenditures. *Second* the merits of the application or such information as might be gathered from the papers. This including the opinions of the creditors, and members of the company, the report from the judicial manager, the report from the Master and the Registrar which would all be weighed up by the court. *Last* the affidavits of the provisional judicial manager. This was a factual report based on the observations and opinions of the judicial manager.

In this specific case the reports from the judicial manger and the master conflicted. It was here that the third requirement was used by the court in order to gather as much factual information as possible and, using its discretion it held.⁶³

3.4 The final judicial management order

The final judicial management order granted by the court must contain;

⁵⁸ Loubser 27.

⁵⁹ Ibid.

⁶⁰ The report of the provisional judicial manager under section 430, Section 432(2) of Act 61 of 1973.

⁶¹ The Companies Act of 1973.

⁶² 1975 (2) SA 357(O).

⁶³ Loubser 29. Loubser mentions section 346(1) (f) Act of 1973 specifically authorises a provisional manger to apply for the winding up of the company if the provisional judicial management order is discharged. Meskin et al *Henochnsberg* at 941 submits that this does not exclude the *locus standi* of a creditor or any of the other possible applicants listened in section 346(1).

- a) Directions whereby the management of the company was vested in the judicial manager subject to the supervision of the court, as to when the provisional judicial manager was to hand all matters over to the final judicial manager from which the judicial manager was thereafter discharged;
- b) Such other directions as to the management of the company or any matter incidental thereto as the court might consider necessary.⁶⁴

However, once the company was under final judicial management, the court could not grant leave that any action, proceedings or execution against the company could be proceeded with.⁶⁵

4 The effects of judicial management

4.1 The moratorium

Upon the granting of the provisional judicial management order, it was directed that while the company was under judicial management, processes against the company were stayed and could not proceed without leave and the granting of the stay by the court. This was specifically known as a moratorium. The *moratorium* can be defined as a temporary stopping of an activity through some form of agreement.⁶⁶ The cessation of legal and commercial activity gave the company and judicial manager the opportunity to operate without pressure from creditors. This window opportunity allowed the company to re-organise itself. In terms of section 427 on application to the court an order could be made containing these directions and describing the provisions of the moratorium.⁶⁷

As stated above the judicial management order provided for a specified period, in *which* proceedings for all actions, proceedings, execution of all writs, summonses and other processes which the company faces are suspended.⁶⁸ In the case of *Transkei Development Corporation Ltd v Oshkosh Africa (Pty) Ltd*⁶⁹ it was held that no *concursum creditorum* was created by a judicial management order, which as a result created an automatic ‘set-off’ between the debts incurred before and those incurred after judicial management even if the

⁶⁴ Section 432 of the Companies Act of 1973.

⁶⁵ *Wire industries steel products and engineering Co (coastal) Ltd v Surtees and Heath* 1953 2 SA 531 (A).

⁶⁶ Hornby *Oxford Advanced Learner`s Dictionary* 1995.

⁶⁷ Section 427(2) (c) of the Companies Act of 1973.

⁶⁸ Section 428(2) of the Companies Act of 1973.

⁶⁹ 1966 (3) SA 344 (W).

judicial management order put a moratorium on claims against the company.⁷⁰ The moratorium was not limited to civil actions and would also include a stay on criminal actions against the company, but did not discharge or free the company from payments of its debts.⁷¹ The courts maintained a strong discretion in deciding whether or not to grant a judicial management order.⁷² It must once again be stressed the expertise and competence of the court in assessing the need for such a stay is in question. Did the courts have the necessary skills to assess such a financial situation and issue an appropriate order? A moratorium was one of the major advantages of the business rescue proceedings and the likelihood of judicial management succeeding without it is extremely low.⁷³

4.2 *Concursus creditorum*

It must be taken into account that unlike in liquidation and sequestration no *conkursus creditorum* was created by a judicial management order.⁷⁴ This implied that there was no specific preference conferred on the creditors for the duration of the judicial management order nor does it freeze the claims against the company concerned.⁷⁵

4.3 *The effects on dispositions*

The judicial manager had the authority to apply to the courts for the setting aside of voidable and undue preferences to which the company was bound where it was unable to pay its debts.⁷⁶ The powers conferred on the judicial manager allowed him or her to reverse financially prejudicial contracts transacted by the company's management in addition to ensuring the retrieval of company assets that were important to the sustenance of the

⁷⁰ Loubser 32.

⁷¹ Loubser 32; Section 359(1)(a) of the Companies Act of 1973, in respect of the effect of liquidation on the legal proceedings and section 20(1)(b) of the Insolvency Act 24 of 1936 in respect of the effect of sequestration on an insolvent's property, specifically referring to a stay on civil proceedings.

⁷² Section 428(3) Act 61 of 1973-The Court which has granted a provisional judicial management order, may at any time and in any manner, on the application of the applicant, a creditor or member, the judicial manager or the Master, vary the terms of such order or discharge it. The court as seen in 428(1) Act of 1973 may dismiss the application or make any order that it deems just.

⁷³ Loubser 33.

⁷⁴ *Lief No v Western Credit (Africa) (Pty) Ltd* 1966 3 SA 344 (W).

⁷⁵ Harvey *Turnaround Management And Corporate Renewal In a South African Perspective* (2011) 71.

⁷⁶ *Ibid*, as regulated by sections 26- 34 of the Insolvency Act 24 of 1936 dealing specifically with dispositions without value, voidable preferences, undue preferences to creditors, collusive dealings before sequestration, proceedings to set aside improper disposition, voidable sale of business.

company's business.⁷⁷ The judicial manager could not however refuse to perform in terms of any uncompleted contracts, due to the fact that the company would not enjoy protection against specific performance already performed to the extent that the moratorium applied.⁷⁸ Employment contracts were not expressly mentioned and therefore remained unaltered by the judicial management proceedings; unlike within liquidation proceedings where employment contracts were immediately suspended by liquidation order and thereafter automatically terminated within 45 days of the appointment of the final liquidator.⁷⁹

4.4 Impeachable transactions

The law as it applied in insolvency law in regard to impeachable dispositions was equally applicable in the case of a company law to a company which had been placed under judicial management, thus allowing the court to set aside actions at the instance of the judicial manager.⁸⁰ Voidable dispositions could be classified as either fraudulent conveyances or preferences that might cause further insolvency. An unexecuted contract was a contract that could be seen to have been conducted in the ordinary course of business, but due to some or other reason, could not be completed.

4.5 The application of assets for the duration of the judicial management proceedings

Without the leave of the court, the judicial manager could not dispose of the company assets other than in the ordinary course of the company's operations.⁸¹ All moneys available in the business were to be used to pay the costs of judicial management, conduct the company's

⁷⁷ Loubser 33; Section 436 of the Companies Act of 1973- Every disposition of its property which if made by an individual could for any reason be set aside in the event of his insolvency, may if made by a company unable to pay its debts, be set aside by the Court at the suit of the judicial manager in the event of the company being placed under judicial management, and the provisions of the law relating to insolvency shall *mutatis mutandis* apply in respect of any such disposition.

⁷⁸ Bertelsmann et al Mars 222-225.

⁷⁹ Loubser 33. Section 38 of the Insolvency Act 24 of 1936 with in conjunction with section 339 of the Companies Act.

⁸⁰ Cilliers and Benade 763.

⁸¹ In regard to the case of *In Ex parte vermaak* 1964 3 SA 175 (O) a sale of all the company assets as a "going concern" was authorised by court, but was however not authorised in the case of *In Ex parte Paterson: In re Good Earth Estates (Pty) Ltd* 1974 4 SA 281 (E). The court in both instances has the discretion to authorise or not authorise such transactions. The different outcomes will most likely be dependent upon the merits of each case.

business and as far as possible satisfy the claims of the creditors which arose before the date of the order.

4.6 Cancellation of the judicial management order

In terms of section 440 of the Companies Act of 1973 the judicial manager or any other interested party could apply to the court to cancel the order. The judicial manager had to prove that:

- a) He or she maintained the *locus standi* under section 433(1) to bring forward such an application because he/she had formed the opinion in good faith that the continuance would not produce successful results,
- b) That the order should be cancelled under section 440, due to the fact that operation was not beneficial in any way,
- c) And finally that a winding-down order should ensue immediately.⁸²

Mismanagement or incompetence by the judicial manager did not constitute a valid ground for the cancellation of the judicial management order.⁸³

5 A critical evaluation of judicial management

- Judicial management was seen as an extraordinary measure⁸⁴ and not as a primary option in terms of debt relief or business rescue, due to the fact that the creditors of a company that were unable to receive payment for their outstanding debts had the right *ex debito justitiae* to liquidate the company and therefore pass by judicial management altogether.⁸⁵
- There had generally been a lack of confidence in judicial management that had placed it as a second tier option for affected persons finding themselves in such situations.

⁸² Cilliers and Benade 770.

⁸³ Ibid.

⁸⁴ Burdette *A framework for corporate insolvency law reform in South Africa* (LLD thesis 2002 UP ,hereinafter Burdette)346.

⁸⁵ *Tenowitz v Tenny Investments (Pty) Ltd* 1979 2 SA 680 (E).

The lack of success attached a stigma to the entire process as being counter-productive to any solution.⁸⁶

- The requirement that there must be a *reasonable probability* that the company would become a successful concern⁸⁷ posed a burden of proof that was too onerous and it should rather have been one of a *reasonable possibility*.⁸⁸ There was a difficulty for the court even to determine the success or failure of a company. An effective business rescue regime should give a company access to forms of protection from a prior stage to the point in time where it can be properly discharged.⁸⁹ As a requirement it might have scared off pessimistic business individuals even where there was actually a chance of success. This requirement can rather be asked in determination of granting the final judicial management order after the provisional process has been passed. Judicial management would have a better chance of becoming successful if it could be made accessible to the ailing company at an earlier stage.⁹⁰
- In order for a company to establish whether it can ever become a successful concern it must demonstrate that it maintains adequate financial resources to facilitate its revival.⁹¹ However this will be difficult to prove as, at the time of application the company must have been in an insolvent state. This was contradictory as it was close to impossible hold in possession any substantial financial resources while in a state of insolvency.
- The insolvency requirement⁹² hampered the process of saving a company before the situation becomes dire and can no longer be resolved. Klopper was of the opinion that the earlier a company submitted itself into judicial management; the better were the chances of a successful outcome.⁹³ It must be clearly defined that a company would have the opportunity to apply for judicial management where it was foreseeable that the inability to pay debts will occur. The earlier the process began the better the

⁸⁶ Harvey 71.

⁸⁷ Burdette 347.

⁸⁸ Klopper 375-377.

⁸⁹ Harvey 71.

⁹⁰ Ibid.

⁹¹ Ibid.

⁹² Burdette 349.

⁹³ Klopper 357-377.

chances of success was. The greater the probability of success was, the higher the confidence would be in the judicial management proceedings, which will ultimately mean that more creditors would opt for it and attempt to maintain the company as a going concern rather than liquidate and see the end of the company as a juristic entity altogether.

- The wide use of liquidators as judicial managers⁹⁴ was nonsensical as they had not received adequate training in keeping a company afloat. Liquidators had the function of selling the business for as much as they could get. Judicial management on the other hand strived to maintain the business and restore it as a fully functioning profit-making vehicle. The only constructive point was that the judicial manager must furnish security to guarantee that he or she would perform their duties to the best of their professional capacity.⁹⁵ The unfettered discretion held by the master to appoint any person as a judicial manager was also of great concern as he/she could appoint any person that had not been precluded from being a liquidator in terms of the Companies Act of 1973.⁹⁶ The lack of stringent regulation in terms of the qualifications of judicial managers could have been seen be a big reason for the high failure rate.⁹⁷
- The reliance on court proceedings⁹⁸ and the powers of the courts expressly assigned to them by the Companies Act of 1973 in terms of the this process⁹⁹ implied the influence and relevance the court will play that would automatically signify that the cost of running such a procedure was already extremely high, making it an expensive and unattractive option and placing it out of the reach of small to medium business

⁹⁴ Burdette 350.

⁹⁵ Sections 429(b) (i) of the Companies Act of 1973, The Master shall without delay appoint a provisional judicial manager (who shall not be the auditor of the company or any person disqualified under this Act from being appointed as liquidator in a winding-up) who shall give security for the proper performance of his duties in his capacity as such, as the Master may direct, and who shall hold office until discharged by the Court as provided in section 432(3) (a).

⁹⁶ Loubser 37. This is as seen in section 372 and 373 of the Companies Act 1973.

⁹⁷ Loubser 38. Olver in *Judicial Management* explains that already in the year 1926, that judicial managers should possess special business qualifications in order to be considered for appointment.

⁹⁸ Burdette 348.

⁹⁹ *Wire Industries Steel Products & Engineering Co (Coastal) Ltd v Surtees NO and Heath NO* 1953 2 SA 531(A).

enterprises.¹⁰⁰ Creditors who had already lost time and money would seek very cheap, quick and simple methods of ensuring some level of return was received.¹⁰¹ The mandatory involvement of the court would cause delays and mean escalating costs to which the creditors might be made liable to contribute.

- Judicial management had subsequently to its enactment attracted scepticism and adverse criticism.¹⁰² Representations were made by Van de Vries Commission in 1970 for the abolition of judicial management on the grounds that it had a low success rate, and it stated that,

“We have thoroughly examined the system of judicial management and the characteristics of the alleged abuses, and we have arrived at the conclusion that the principal deficiency is that at the time of the granting of the order, there is no proper and reliable assessment of the likelihood of the rehabilitation of the company. The test in our view should be whether the company will be able to overcome its present difficulties and to become a successful concern. In too many cases this is determined by the applicant alone who may not be qualified to make such assessment.”¹⁰³

The above quotation signifies that although judicial management is not viewed as a complete success, the underlying function was not the problem. It is the fact that as a system it was incomplete and needs to be attuned to the procedure it was envisioned to be. Judicial management as a business rescue procedure did not need to be repealed, but rather adapted to the modern day dynamics it so required.¹⁰⁴

- A serious practical shortcoming of judicial management was that, it affected the creditworthiness and confidence of a company adversely.¹⁰⁵ This disadvantage was long lasting and was still felt even after the order had been set aside.¹⁰⁶ This would disable the company from trading effectively and ultimately inhibit the chances of the

¹⁰⁰ Rajak and Henning 1999 *SALJ* 262-263.

¹⁰¹ Harvey 72.

¹⁰² Loubser “Judicial Management as a Business Rescue Procedure in South African Corporate Law” 2004 *SA Merc LJ* 16.

¹⁰³ Shrand and Keeton *Company Law and Company Taxation in South Africa* (1974) 305.

¹⁰⁴ Burdette 352 and Klopper 378-379.

¹⁰⁵ Cilliers and Benade et al 478.

¹⁰⁶ Ibid.

company actually surviving and becoming a successful concern. This occurred through the reluctance on the part of company's suppliers in honouring or continuing agreements that were previously entered into.¹⁰⁷

- There was no express statutory provision for the development or drafting of a formal rescue plan.¹⁰⁸ There was no specified structure or plan. The judicial manager was not under any pressure to complete his tasks within determined objectives, whilst he or she still received remuneration regardless of whether the entire process was successful or not. This inevitably opened the door to abuse of the entire process where, without qualified expertise, the judicial manager was left to carry out his/her functions without any real oversight or control.
- The directors of a company lost their powers and authority to manage the company as soon as the company was placed under provisional judicial management.¹⁰⁹ There was no specific mention of any duties to be fulfilled by the directors; it must therefore be assumed that the directors of a company would be automatically stripped of their office, when the company was placed under judicial management.¹¹⁰

6 Conclusions

Judicial management when enacted had the purpose of creating an alternative relief measure to debtors and creditors alike. It had however through the years not reached its desired level of success. It was however a procedure that could be improved on and learnt from for use in the future.

Judicial management has managed to find its place as a guidance tool that supplements the Companies Act of 2008.¹¹¹ Section 427(1) of the old Act provided for the circumstances in which a company might be placed under judicial management.¹¹² This section was used by the practitioners, to aid them in their business rescue procedure as there was a lack of

¹⁰⁷ Harvey 72.

¹⁰⁸ Loubser 41.

¹⁰⁹ Sections 428(2) (a) and 432(3) (a) of the Companies Act of 1973.

¹¹⁰ Loubser 41.

¹¹¹ *Swart v Beagles Run Investments* 25 2011 5 SA 422(GNP).

¹¹² Section 427(1) of the Companies Act 1973.

substantial precedent to help in coming up with an appropriate solution.¹¹³ Business rescue is not supposed to draw on the provisions of the Companies Act of 1973, but however sought certainty in the manner in which it was applied in terms in precedent within this instance.

The law is ever growing and so too should procedures such as judicial management evolve into more effective procedures. Its failures and success should be hallmarked to prevent repetition in the future and should be used to create more efficient and effective means of relief for debtors and payment to creditors. In terms of the evolution of business rescue within South Africa, judicial management was a great stepping stone in that all its flaws and shortcomings have been exposed, creating the building blocks for the establishment of a better option that still holds the same ideals and objectives of judicial management, but has better execution and results. The introduction of a system that would see the preservation of employment contracts and increased returns for creditors and stakeholders correcting the mistakes in judicial management would see the emergence of a relevant and effective system that was long overdue.¹¹⁴

¹¹³ *Swart v Beagles Run Investments* 25 2011 5 SA 422 (GNP).

¹¹⁴ Harvey 72.

Chapter 3:

Business rescue in terms of the Companies Act 71 of 2008

The purpose of this chapter is to investigate the new business rescue provisions contained in the Companies Act of 2008. The concept of business rescue will be explained highlighting its distinctive divergences from that which was enacted previously in the Companies Act of 1973. I will conduct a critical analysis of business rescue in order to effectively contrast the Companies Act of 2008 against the provisions of the Companies Act of 1973. This is in order to investigate whether or not there has actually been effective progress. I will also endeavour to explore whether the new provisions have been formulated successfully in ways that will enable companies to utilise them.

1 Background information

Section 7 of the Companies Act of 2008, sets out to establish the purpose of the Act mentioning the promotion of the South African economy by

“(b)(i) Encouraging entrepreneurship and enterprise efficiency,

(ii) Creating flexibility and simplicity in the formation and maintenance of companies,

(c) Promotion of innovation and investment in South African markets,

(d) Re-affirm the concept of company as a means of achieving economic and social benefits, and to

(k) Provide for efficient rescue and recovery of financially distressed companies in manner that balances the rights and interests of all relevant shareholders.”

The above provisions embody the concept of business rescue. The foreign¹¹⁵ concept of a fresh start shifts the ideology of placing heavy constraints on debtor (distressed company), and instead introduces a capitalist approach that rather creates the platform for re-entry into the economy and gives debtors the opportunity to re-emerge in whichever industry they were

¹¹⁵ Foreign in the sense that it is not the original train of thought that was followed in South African law.

involved in, contributing positively once again to their surrounding economic spheres.¹¹⁶ By means of enhanced business rescue procedures, distressed companies have the opportunity of maintaining their status as going concerns in terms of section 7(c) of the Companies Act of 2008. This will ultimately boost businesses in South Africa, improving investments and trade through the consistency and reliability of the companies that are in harmony with international standards¹¹⁷ and which will simultaneously ensure that jobs are kept and economic and social benefits for all are maintained by the community as seen in 7(d) of the Companies Act of 2008.¹¹⁸ South Africa has been based on a “creditor friendly approach” in terms of which the concept of business was not a priority and the emphasis was on liquidation and the protection of the rights of creditors.¹¹⁹ The emphasis has shifted to the development of commercial procedures focusing primarily on the debtor or distressed company.¹²⁰ It is however a disadvantage that the Companies Act of 2008 focuses on companies and close corporations exclusively and neglects enterprises such as partnerships, business trusts and sole proprietorships.¹²¹

2 The definition of business rescue

The business rescue procedure is defined in section 128¹²² of the Companies Act of 2008 as;

- (i) “the temporary supervision of the company, and of the management of its affairs, business and property,
- (ii) a temporary moratorium on the rights of claimants against the company or in respect of property in its possession,
- (iii) the development and implementation, if approved, of a plan to rescue the company or, if that is not possible, a plan that would achieve a better return for the company’s creditors than the payment they would have received if the company had simply been liquidated immediately.”

¹¹⁶ Gross *Failure and Forgiveness-Rebalancing the Bankruptcy system* (1997) 116.

¹¹⁷ Mahomed et al *South African Law Commission Project 63, Interim Report on Review of the Law of Insolvency: the Enactment in South Africa of UNCITRAL’S model Law On Cross-Border Insolvency* 1999.

¹¹⁸ Loubser 2004 *SA Merc LJ* 137.

¹¹⁹ Braatvedt *Chapter 6 of the South African Companies Act 71 of 2008 Reviewed* (2010). www.hg.org/article.asp?id=19587. Date of access 08/11/2011.

¹²⁰ Ibid.

¹²¹ Meskin *Henochsburg on the Companies Act Volume* (2011) 18.1.

¹²² The Companies Act of 2008.

Even though the Companies Act of 2008 uses the term business rescue this can also be classified as a corporate rescue procedure in which not only the business is being rescued but the entire company or corporate entities are part of the package.¹²³ The definition refers to the rehabilitation of a company and a plan to rescue the company in a manner that maximises its chances of survival. Rescue refers to the reorganisation of the company to re-establish it as a profitable entity and ultimately to avoid liquidation so as to preserve the company and ensure it becomes a viable contributor to the economic life of the country once again.¹²⁴

The new business rescue proceedings are contained in the new Companies Act of 2008¹²⁵ and not in any other insolvency legislation, which gives rise to the inference that it has been primarily designed for companies¹²⁶ thereby sidelining other business forms that do not fall within the field of application of the Companies Act of 2008. The business rescue proceedings will in addition have full application in terms of close corporations until close corporations as a business form disappears.¹²⁷

3. Entities which can initiate business rescue proceedings

3.1 Application by the board of directors

In the application of section 129¹²⁸ if the board of directors as a result of a resolution by the members in a general meeting believes that there are reasonable grounds to consider that

- (a) the company is financially distressed, and
- (b) there appears to be a reasonable prospect of rescuing the company.

This is a significant improvement on judicial management as the procedure is faster and cheaper to commence. There is no court involvement at this stage of the proceedings whereas

¹²³ Davis et al *Companies and Other Business Structures in South Africa* "Business Rescue proceedings and Compromises" (2009) 165.

¹²⁴ Cassim et al *Contemporary Company Law* (2011) 781; Insolvency Law and Practise: Report of the Review Committee, and *Powerdrill v Watson* 1995 2 AC 394 Lord Browne- Wilkinson at 442.

¹²⁵ Chapter 6 that specifically deals with business rescue and compromises with creditors.

¹²⁶ Loubser *Some Comparative Aspects Of Corporate Rescue In South African Company Law* (LLD dissertation 2010 Unisa) 48; Section 1 defines a company as "a juristic person incorporated in terms of this Act", when it came into operation, as well as one that was registered or converted from a close corporation to a company in terms of the Companies Act 61 of 1973, and a company that was in existence and recognised as a company by the Companies Act 61 of 1973 immediately before the date on which the Companies Act of 2008 comes into operation.

¹²⁷ Loubser 48; Item 6 of Schedule 3, (1A) the provisions of Chapter 6 of the Companies Act, read with the changes required by the context, apply to a corporation.

¹²⁸ The Companies Act of 2008.

the High court had to be approached at least twice.¹²⁹ A director who believes that the company is in financial danger and has been outvoted by other directors, may not apply as an individual to the court in his or her capacity as a director even though he or she may face criminal and personal liability for trading in an insolvent state,¹³⁰ placing the director in a compromised position as he or she does not possess a direct means of approaching the court. Therefore the director's liability in this instance should be mitigated and there should be provisions made to rectify this shortfall in the regulations and create a platform that allows a director to have an option of being heard by the court in his or her own capacity.¹³¹

3.2 *An application to the court by an affected person;*

In terms of section 128(1)¹³² an affected person may be described in relation to a company as,

- (i) A shareholder or creditor of the company, it must be noted that no other comparable legal system gives authority to an individual that holds securities to apply for business rescue proceedings;¹³³
- (ii) Any registered trade union representing employees of the company, and
- (iii) If any of the employees of the company are not represented by a registered trade union, each of those employees or their respective representative.

The authority to initiate proceedings is seen as promoting one of the underlying objectives of business rescue as it offers protection of workers and operates in their best interests, allowing trade unions access to financial statements.¹³⁴ There is however no limit to the amount of

¹²⁹ Loubser 51.

¹³⁰ Loubser 52; This is in terms of sections 22(1)(b) that prohibits the trading of a company in an insolvent state; Section 77(3)(b) that places liability on the director of loss or damage or cost sustained by the company as a direct or indirect consequence of the director having acquiesced in the carrying on of the company's business despite knowing that it was being conducted in a manner prohibited by section 22(1); and Section 214 (1)(c) that places criminal liability on any director who was knowingly party to conduct prohibited by section 22(1).

¹³¹ In terms of the South African Constitution, Section 32 prescribes that everyone has the right to administrative action that is lawful, reasonable and procedurally fair. In this instance a director, like "an affected person" has an interest in the company and should therefore have the *locus standi* to appear before a court of law and make an application as an individual.

¹³² The Companies Act of 2008.

¹³³ Loubser 52. Loubser mentions that, in terms of the English system a company applies in terms of a resolution by the general meeting but individual members are precluded from doing so.

¹³⁴ Loubser 55. Trade unions and employees have in terms section 31, the right to access the company's annual financial statement at any moment Section 31(3), Trade unions must, through the Commission and under conditions as determined by the Commission, be given access to company financial statements for purposes of imitating a business rescue process.

times that such documents can be requested and no penalty for abuse of such a right.¹³⁵ This reveals a serious dilemma, as Loubser points out that these new powers conferred to trade unions can be used as a bargaining tool for higher wages or benefits by disgruntled employees¹³⁶. This must be reviewed as it may pose a grave threat to every employer.

4 Commencement of the rescue proceeding

Chapter 6, as should be with a modern business rescue procedure, makes provision for both voluntary and compulsory initiation of the procedure.¹³⁷ The voluntary route provides an inexpensive alternative to time consuming and expensive court proceedings.¹³⁸

It is important to distinguish when exactly the proceedings commence as the moratorium will commence automatically from the beginning of the process. The implication of this is that as soon as the moratorium commences, all legal proceedings are suspended and the creditors cannot enforce their claims. In the case of the commencement of business rescue proceedings by way of a board resolution, the process is said to have started at the moment the company files with the Companies and Intellectual Property Commission the resolution to place itself under supervision.¹³⁹ In terms of the initiation by order of the court, this process is said to have begun when the affected person applies.¹⁴⁰

5 Stay on legal procedures/moratorium

The moratorium will cause a stay on all legal proceedings, including enforcement actions, against the company, or in relation to any property belonging to the company, or lawfully in its possession.¹⁴¹ It is designed to provide the company with breathing space while the business rescue practitioner attempts to rescue the company by formulating and

¹³⁵ Ibid.

¹³⁶ Ibid.

¹³⁷ Meskin 18.2.

¹³⁸ Ibid.

¹³⁹ Cassim et al 792. Section 129(5) of the Companies Act of 2008.

¹⁴⁰ Ibid, section 128 of the Companies Act of 2008.

¹⁴¹ Section 133 of the Companies Act of 2008.

implementing a business rescue plan.¹⁴² There are however certain exceptions to this prohibition that are:

- a) legal proceedings consented to by the business rescue practitioner, with the leave of the court, as a set-off against any claim made by the company in any legal proceedings, irrespective of whether those proceedings commenced before or after the business rescue proceedings began,
- b) criminal proceedings against the company or any of its directors or officers,
- c) proceedings concerning any property or right over which the company exercises the powers of trustee,
- d) Proceedings by a regulatory authority in the execution of its duties.¹⁴³

6 The duration of the business rescue proceedings

In terms of section 132(1)¹⁴⁴ and 132(2)¹⁴⁵ the business rescue procedure begins through as previously stated a formal application by the creditors, director or court directly. However if the business rescue proceedings have not come to end within three months or such a time as the court has designated, the business practitioner must take it upon himself to prepare reports on the progress of proceedings for each affected person and by mandate make a delivery of the reports to the courts.¹⁴⁶

In terms of section 132(2)(a) to (c)¹⁴⁷, the business rescue proceedings will come to an end when firstly the court sets aside the resolution through the initiation of an order that begins the conversion of the process into a liquidation of the company, or where the practitioner files a notice of the termination of the business rescue proceedings with the Companies Intellectual Property Commission at his own discretion, and finally either where the business rescue plan has been proposed and rejected, and no affected persons have sought to extend the proceedings, or where there has been substantial implementation of the business rescue plan and its objectives have been achieved.¹⁴⁸

¹⁴² Meskin 18.6.

¹⁴³ Harvey 80.

¹⁴⁴ Section 132 of the Companies Act of 2008.

¹⁴⁵ Section 132 of the Companies Act of 2008.

¹⁴⁶ Cassim et al 792.

¹⁴⁷ Section 132 of the Companies Act of 2008.

¹⁴⁸ Cassim et al 792.

7 Appointment and function of the practitioner

There was some debate as to whether the business rescue practitioner should be taken from the existing ranks of insolvency practitioners or whether a whole new profession should be formed.¹⁴⁹

Section 138 of the Companies Act of 2008 explains the appointment and function of a business rescue practitioner. The minister designates an individual with good standing in the profession, who is not subject to an order in terms of section 162(7) of the Companies Act of 2008 and has an independent relationship with the company and would not therefore be compromised in terms of his or her integrity and impartiality.¹⁵⁰ He or she must be a member of a legal, accounting or business management profession accredited by the Commission.¹⁵¹ The Minister prescribes minimum qualifications for a person to practise as a business rescue practitioner, including different minimum qualifications for different categories of companies.¹⁵² The Minister has also imposed standards and procedures to be followed by the Commission in carrying out its licensing functions and powers.¹⁵³

The practitioner has full managerial control of the company in substitution of its board and pre-existing management.¹⁵⁴ He or she may delegate any power he or she maintains to any person who was part of the board or the pre-existing management.¹⁵⁵ The practitioner also maintains a responsibility to develop and implement any business plan that has been adopted in accordance with Part D of this chapter¹⁵⁶ for the duration of the proceedings; the practitioner has the obligation to report back to the court. He or she holds the responsibilities of duties and liabilities of the directors set out in sections 75¹⁵⁷ to 77¹⁵⁸ of the Companies Act of 2008.¹⁵⁹ The *'debtor-in-possession'* approach is being introduced in an attempt to shift from the *'management displacement'* approach in order to curb the unlimited powers the practitioner would have in the latter approach and to circumvent the possibility of the

¹⁴⁹ Meskin 18.14.

¹⁵⁰ Section 138(1) of the Companies Act of 2008.

¹⁵¹ Section 138(1) (a) of the Companies Act of 2008.

¹⁵² Section 138(3) (b) of the Companies Amendment Act of 2011 Government Gazette 20 April 2011. Hereinafter referred to as the Companies Amendment Act of 2011.

¹⁵³ Section 138(3) (a) of the Companies Amendment Act of 2011.

¹⁵⁴ Section 140 (1) (a) of the Companies Act of 2008.

¹⁵⁵ Section 140 (1) (b) of the Companies Act of 2008.

¹⁵⁶ Section 140 (1) (d) (i-ii) of the Companies Act of 2008.

¹⁵⁷ Section 75 of the Companies Act of 2008, the Director's personal financial interest, this includes the disclosure of any financial interest through a notice, the disclosure of any other companies.

¹⁵⁸ Section 77 of the Companies Act of 2008, Liability of directors and prescribed officers, this includes damage incurred whilst acting as in his or her capacity as a director.

¹⁵⁹ The Companies Act of 2008.

management becoming less motivated to work hard under new leadership.¹⁶⁰ Therefore the directors will continue to exercise their functions as directors during the proceedings, subject to the authority of the practitioner, providing information and attending to any business need the practitioner may have.¹⁶¹ The business rescue practitioner in accordance with section 140 of the Companies Act of 2008 has the authority to remove from office any member of the management and to make appointments to the management of the company.¹⁶² There are no clear guidelines that the business rescue practitioner uses in the appointments to management he or she can effect. The Companies Act of 2008 does not prescribe the manner in selection criteria. There needs to be a control mechanism that regulates the method in which appointed persons are selected by the practitioner. This is to curb any threat of abuse of his or her powers by making appointments which he or she may have an interest or benefit in. The directors also have a duty to deliver all books and records to the practitioner relating to the company affairs of which he or she is in possession after the commencement of the proceedings.¹⁶³

The business rescue practitioner may be removed from office by a court order on the request of an affected person on the following grounds;

- Incompetence or failure to perform duties;
- Failure to exercise a proper degree of care in performance of the business rescue practitioner functions;
- Engaging in illegal acts or conduct;
- Where he/she no longer satisfies the qualification requirements;
- Where there is a conflict of interest and he/she cannot act independently;
- Where he/she is incapacitated and is unable to perform their functions in office.¹⁶⁴

¹⁶⁰ Bradstreet “The Leak in Chapter 6 Lifeboat: Inadequate Regulation of Business Rescue Practitioners May adversely Affect Lenders’ Willingness and the Growth of the Economy” 2010 *SA Merc LJ* 22.

¹⁶¹ Rushworth “A Critical Analysis of Business Rescue in the Companies Act of 2008, Part III 2010 *Acta Jurisda* 375, Section 137 (2) (a) of the Companies Act of 2008.

¹⁶² Section 140(1)-(2) of the Companies Act of 2008.

¹⁶³ Rushworth 395. Section 142 (1) of the Companies Act of 2008.

¹⁶⁴ Harvey 83.

8 Administrative requirements of the business rescue practitioner

In terms of the practitioner's qualifications, there had been serious amendments that have recently addressed the shortcomings that have been seen to perpetuate the lack of confidence in these procedures as in the case of judicial management. As stated above Section 138¹⁶⁵ describes how a person may be appointed as the business rescue practitioner if he/she is a member in good standing legal, accounting or business management profession that is accredited by the Commission and has been licensed by the Commission in terms of section 138 (2).¹⁶⁶ Intensifying the qualification criteria will validate the procedure by ensuring qualified; licensed individuals are the only persons are business rescue practitioners. This in time will increase the reputation of the procedure as a more reputable and reliable procedure. However the fundamental success lies in the success rate of the proceedings. Introducing an official system that regulates the registration and admission to the profession of liquidators and business turnaround practitioners will prove extremely beneficial.¹⁶⁷ Formalisation in this manner will harmonise the industry through the upgrading and maintenance of standards in order to ensure that every business that is under the procedure has an equal opportunity in terms of the quality of service to be received from the practitioner.

9 The introduction and application of the business rescue plan

It is the duty of the practitioner to prepare a business rescue plan that will be adopted and implemented. The business plan is broken down into three segments, Part-A, Part-B and Part-C. This is an additional element introduced in the new the Companies Act of 2008. The rationale is to have all the affected people involved to approve the way in which the company will be rescued. The business plan is an important and innovative step for South African businesses that ultimately seeks to avoid liquidation in the appropriate circumstances, whilst involving all relevant parties in the re-organisation of the business.¹⁶⁸

¹⁶⁵The Companies Act of 2008.

¹⁶⁶ Section 138(1) (a)-(b) No. 3 of 2011: Companies Amendment Act of 2011.

¹⁶⁷ Loubser 96.

¹⁶⁸ Leppan and Yeates "Business Rescue" *Without Prejudice* Vol. 10 Issue 11(2010). 17 http://0-search.sabinet.co.za/innopac.up.ac.za/WebZ/images/ejour/jb_prej/jb_prej_v10_n11_a9.pdf?sessionid=01-56324-1329179686&format=F. Date of access 20/01/2011.

9.1 Part A-background¹⁶⁹

This section must contain:

- a) a complete list of the material assets of the company, as well as all the assets that were held as security by creditors when the business rescue proceedings began;¹⁷⁰ this will establish the actual condition of the company financially and determine the point of departure in terms of a recovery plan.
- b) A complete list of the creditors of the company when the business rescue proceedings began, and as a breakdown the creditors ranked in their specific groups as secured, preferent and concurrent creditors.¹⁷¹ This information is needed to compile lists to notify all *interested parties*. Listing will also prove to be very important information as to when payments are made. The compilation of these lists will help in the proving of claims at the time when payments are to be effected.
- c) The probable dividend that would be received by the creditors. Creditors can plan and either from the proposed dividend accept or reject the plan if it is not satisfactory.¹⁷² The proposed dividend will prove to be a paramount issue as it is the return they will receive and will ultimately determine how long the process will take and how much money they will receive as their payment.
- d) A complete list of the holders of the company's issued securities. This allows holders of such securities to take part in the business rescue proceedings.
- e) A statement of the practitioner's fees. The finalisation of the practitioner's fees¹⁷³ will either encourage or de motivate the practitioner. A reasonable market rate price must be set that does not go above his responsibilities, but simultaneously does not leave the practitioner in an unhappy situation desiring more remuneration.
- f) A statement as to whether the plan includes any proposal made informally by a creditor.¹⁷⁴

¹⁶⁹ Section 150 (2) (a) (i-vi) of the Companies Act of 2008.

¹⁷⁰ Section 150 (2) (a) (i) of the Companies Act of 2008.

¹⁷¹ Section 150(2) (a) (ii) of the Companies Act of 2008.

¹⁷² Section 150(2) (a) (iii) of the Companies Act of 2008.

¹⁷³ Section 150(2) (a) (v) of the Companies Act of 2008.

¹⁷⁴ Section 150(2) (a) (vi) of the Companies Act of 2008.

9.2 Part B-the proposal¹⁷⁵

This section must contain:

- a) The nature and duration of any proposed debt moratorium.¹⁷⁶ The suspension of all legal and commercial transactions is an extremely important factor as creditors will have to wait to enforce their claims. If the period is too long, creditors will face financial strain. A balance must be struck in rescuing the business and repaying the creditors whilst performing in terms of uncompleted contracts at a reasonable time.
- b) The extent to which the company is to be released from the payment of its debts, and the extent to which any debt is proposed to be converted to equity in the company, or another company.¹⁷⁷ *Equity*, being the share capital of the investors and the residual value of assets after all liabilities have been settled and provided for, is an indication to the creditors and investors of what they might receive if the business plan fails and liquidation is to ensue. This aids in the actual assessment of risk, and in the determination of whether it would be worthwhile actually to proceed with the business plan.
- c) The treatment of contracts and the ongoing role of the company and the treatment of existing agreements.¹⁷⁸ The practitioner has the power conferred on him or her through section 140 of the Companies Act of 2008 in the assumption of full management in substitution of the board. All interested parties must be aware of how this will be handled. The treatment of ongoing contracts and the handling of agreements will give an indication of how business will be conducted and which business relationships will be given in priority and which will not.
- d) The property of the company that is proposed to be available to pay creditors' claims.¹⁷⁹ The disclosure of this will allow the creditors to decide which assets should be available for alienation and which assets will not be alienated. The employees who are now involved in this process in terms of the Act will also have to deliberate on which assets they will need to preserve to enable the business to function successfully as a going concern.

¹⁷⁵ Section 150 (2) (b) (i-vii) of the Companies Act of 2008.

¹⁷⁶ Section 150 (2) (b) (i) of the Companies Act of 2008.

¹⁷⁷ Section 150 (2) (b) (ii) of the Companies Act of 2008.

¹⁷⁸ Section 150 (2) (b) (iii) of the Companies Act of 2008.

¹⁷⁹ Section 150(2) (b) (iv) of the Companies Act of 2008.

- e) The order of preference in which the proceeds of the company will be applied to pay creditors if the proposal is adopted.¹⁸⁰ The order will illustrate who will get how much. It is pivotal that all the creditors reach consensus and are satisfied with the proposal, so as to work together more effectively.
- f) The benefits of adopting the proposal as opposed to the benefits that would be received by creditors if the company were to be placed in liquidation¹⁸¹. As stated above liquidation has been preferred to judicial management, the predecessor of business rescue. There needs to be a clear indication that there is a reasonable chance that the business will indeed become a successful concern once again.
- g) The effect that the business rescue plan will have on the holder of each class of the company's issued securities.¹⁸² Security holders will need to know that their interest in the company is a protected one even through the processing of the business plan. They hold a substantial interest which can affect the procedure. The practitioner will have to ensure that in his/her plan this is effectively catered for.

9.3 Part C-assumptions and conditions¹⁸³

This section must contain:

- a) A statement of the conditions that must be satisfied, if any, for the proposal to (a) come into operation and (b) be fully implemented¹⁸⁴. These will be conditions that are pre determined by the interested parties to ensure all required mandates are thoroughly executed, before, during and after the entire process of business rescue.
- b) The effect, if any, that the plan contemplates on the number of employees, and their terms and conditions of employment¹⁸⁵. In terms of the Act¹⁸⁶ employees now hold a noteworthy role in business rescue and their terms and conditions if not laid out appropriately can affect the approval of the business plan in terms of approval or rejection.

¹⁸⁰ Section 150 (2) (b) (v) of the Companies Act of 2008.

¹⁸¹ Section 150 (2) (b) (vi) of the Companies Act of 2008.

¹⁸² Section 150 (2) (b) (vii) of the Companies Act of 2008.

¹⁸³ Section 150 (2) (c) (i-iv) of the Companies Act of 2008.

¹⁸⁴ Section 150 (2) (c) (i) of the Companies Act of 2008.

¹⁸⁵ Section 150 (2) (c) (ii) of the Companies Act of 2008.

¹⁸⁶ Section 128(1)(a)(ii) of the Companies Act of 2008 “*affected person*” in relation to a company means any registered trade union representing employees of the company; and (iii) if any of the employees of the company are not represented by a registered trade union, each of those employees or their respective representatives.

- c) The circumstances in which the business rescue plan will end.¹⁸⁷ The termination of the business plan is essential to the sustenance of the company. The conditions set can either maintain or send the company back into rehabilitation.
- d) A projected (a) balance sheet for the company and (b) statements of the income and expenses for the ensuing three years, prepared on the assumption that the project is accepted.¹⁸⁸ Projections will help place all interested parties at ease as, the three year period will illustrate the maintenance of assets in the balance sheet and the continuity of a successful concern in the income statements.

The business plan must end with a certificate in which the practitioner must state that the information provided by him was made in all good faith.¹⁸⁹ The business rescue practitioner will then convene with the company's creditors to consider the rescue plan within 10 business days after the publication of that plan.¹⁹⁰ The business rescue practitioner must then explain the plan and purpose of the plan to which and must give objective recommendations about the success of the scheme.¹⁹¹

Once the plan has been approved it becomes binding upon the company and all its creditors and holders of its securities. It is binding irrespective of whether such a person was present at the meeting, voted or even has proven his or her claim against the company.¹⁹² The next step the rescue practitioner must make is to take all the necessary measures and implement the plan, of which, after it has been substantially implemented, he or she must file a notice to the commission.¹⁹³ In the case of *Swart v Beagles*¹⁹⁴ the assessment of the business would have played a pivotal part in building the case of the respondent. Although the businesses plan as seen from above is a powerful tool if used efficiently and effectively, if no prior assessment is conducted of the company, then such a plan will be of no use. In the above case it was later discovered that, the company was hopelessly insolvent and it was seen that the envisaged business plan would not be feasible.¹⁹⁵ Such discoveries could nullify the entire process, and it would therefore be important to establish these findings in the application phase of business rescue procedure.

¹⁸⁷ Section 150 (2) (c) (iii) of the Companies Act of 2008.

¹⁸⁸ Section 150 (2) (c) (iv) of the Companies Act of 2008.

¹⁸⁹ Davis et al (2009) 176.

¹⁹⁰ Section 151(1) of the Companies Act of 2008.

¹⁹¹ Davis et al 177. Section 152(1) (c) of the Companies Act of 2008.

¹⁹² Section 152 (4) (a-c) of the Companies Act of 2008.

¹⁹³ Section 152 (1) (a) of the Companies Act of 2008.

¹⁹⁴ 2011 (5) SA 422(GNP).

¹⁹⁵ *Swart v Beagles Run Investments* 25 2011 (5) SA 422 (GNP).

10 The comparisons between judicial management as seen in the Companies Act 61 of 1973 and the business rescue procedure as seen in the Companies Act 71 of 2008.

In order to understand the full effect that the new business procedures wish to achieve, a comparison should be drawn in order to assess similarities and progressions that the legislature has made. It is important to look at the differences, such as;

The Companies Act of 2008 defines all the key terms at the start of the section on business rescue; the Companies Act of 1973 does not contain any provisions that regulate employee contracts, which qualifications held by the practitioner, and investigations of company affairs.¹⁹⁶ These are some of the differences that will be highlighted.

10.1 The application process

In terms of judicial management, firstly the company must be unable to pay its debts having already arrived at a point at which the business is no longer actually producing enough income to sustain itself. Secondly the company must show that it has not been prevented from becoming a successful concern.¹⁹⁷ Lastly the court must be convinced that the order sought is *just and equitable*.

In business rescue as envisioned in the Companies Act of 2008, an application may be made where there is need to facilitate the rehabilitation of the company that is *financially distressed*.¹⁹⁸ *Financially distressed* as defined by the Act is where it appears to be reasonably unlikely that the company will be able to pay all of its debts as they fall due within the immediately ensuing six months; or it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months.¹⁹⁹ Here the business does not actually have to be in a position where it cannot pay its debts indefinitely, but where it is reasonably likely that it will, implying that it may occur in the future. Companies do not have to be in an extremely dire position, as in the case of judicial management, to have an order granted by the court. This enhances the chances of survival of such companies as they will ultimately be in a better financial position, than those seen in judicial management that are completely unable to pay their debts.

¹⁹⁶ Jooste *The Comparative Guide to the Old and New Companies Act* (2011) 601.

¹⁹⁷ Companies Act of 1973; Section 427 (1) (a-b).

¹⁹⁸ Companies Act 71 of 2008, Section 128(1) (b).

¹⁹⁹ *Ibid*; Section 128 (1) (f).

10.2 Who may apply?

In terms of judicial management, an application can be made by the company, one or more creditors, or a member of the company.²⁰⁰ In contrast the business rescue procedure can be initiated by the courts or any other *affected person*.²⁰¹ An *affected person* as defined in the Act²⁰² means any shareholder or creditor of the company, any registered trade union representing employees of the company and if any of the employees are not duly represented by a trade union, each of those employees and their respective representatives. The addition of employees enables the business when ailing to quickly apply for relief, as the employees of the company have firsthand experience on the dynamics of the company and can save time and money through an early application for the rescuing of the company.

10.3 The business rescue practitioner compared to the judicial manager

In terms of the Companies Act of 2008, the minister may impose reasonable conditions upon a person or association designated by the minister in terms of the Act as regards the execution of their function and prescribe minimum qualifications, such as being a person that is a member in good standing of a legal, accounting or business management profession for the admission of a person to the practice of a business rescue practitioner.²⁰³ By doing so the Minister designates one person or association to regulate the practice of persons as practitioners in terms of the Companies Act of 2008.²⁰⁴ They are to ensure that practitioners possess sufficient human, financial operational resources, adequate administrative procedural skills and have been issued licences to practise.²⁰⁵ This contrasts with judicial management where there is no express provision for the discretion of the Minister in imposing minimum standard qualifications. This saw many people who are not legitimately qualified practising and ultimately proving the process of judicial management to be unsuccessful as shown by the use of liquidators as judicial managers.²⁰⁶ The appointment of a provisional and then a final judicial manager is not cost effective and leads to even more consumption of time and

²⁰⁰ Section 346 of the Companies of 1973, section 103 of the Companies Act of 1973 specifies the description and qualification of a member of a company.

²⁰¹ Section 131 the Companies Act of 2008.

²⁰² The Companies Act of 2008.

²⁰³ Section 138 (1) (a) of the Companies Act of 2008.

²⁰⁴ Ibid.

²⁰⁵ Ibid.

²⁰⁶ Burdette 350.

resources as he or she as the final judicial manager will have briefed about the process from its beginning.

10.4 The effect on the directors and employees

The judicial manager upon appointment would assume the management of the company and recover and come into possession all the assets of the company.²⁰⁷ Secondly all the property was placed in the custody of the judicial manager.²⁰⁸ The judicial manager has discretion and free reign to implement what he or she saw best without input from the board of directors or creditors. This has now been rectified as seen in the new provisions of the Companies Act of 2008. For the duration of the business rescue proceedings, each director must continue to exercise their functions as director, subject to the authority of the practitioner,²⁰⁹ and must attend to requests of the practitioner at all times.²¹⁰ Each director remains bound by the requirements of section 75²¹¹ concerning the personal and financial interests of that person.²¹² The legislator has seen the need for continuity and consistency in having the directors stay on and assist the practitioner in rescuing the company.

10.5 The business rescue plan.

The Companies Act of 2008 prescribes the implementation of a business rescue plan that must be approved by all the *affected people*. This is done in order to engage everyone in the process, creating a more active and involved attitude from all the *affected persons* in seeing the company survive. The plan includes vast amounts of background information from the, all proposals and the assumptions and conditions that the practitioner has recommended.²¹³ This plan must then be approved or rectified to be accepted. The practitioner, unlike the judicial manager, is subject to numerous checks and balances, which prevents him or her from retaining ultimate control over the procedures with just the court oversees him or her.

²⁰⁷ Section 430 (a) the Companies Act of 1973.

²⁰⁸ Section 428 (a) the Companies Act of 1973.

²⁰⁹ Section 137 (2) (a) the Companies Act of 2008.

²¹⁰ Section 137 (3) the Companies Act of 2008.

²¹¹ The Companies Act of 2008.

²¹² Meskin 18.13.

²¹³ Section 150 (2) (a-c) the Companies Act of 2008.

11 A critical evaluation of the business rescue procedure contained in the Companies Act of 2008.

11.1 Certain definitions of phrases

Financial distress

The definition of *financial distress* needs to be clarified as it affects the entire basis of the application. An applicant can base the application on the non-payment of a contractual obligation entered into by the company. This makes it difficult to be certain as to whether there has actually been a financially dire situation faced by the company. Loubser believes that there should be a stipulated minimum period or frequency before non-payment constitutes a ground for rescue proceedings, and that at least two payments should be due.²¹⁴

In terms of section 131(4) (a) (iii)²¹⁵ where the court finds it *just and equitable* it may order the procedure to be initiated. The specific phrase *financial reasons* is not clear and does not in which with certainty whether the financial reasoning also correlates to a situation where the company is financially distressed. Loubser believes that widening the definition of *financially distressed* to include circumstances in which a company will be deemed to be financially distressed will in turn clarify the situation allowing for the affected people to receive the appropriate information in order to commence the procedure.²¹⁶

11.2 The failure to comply with procedural requirements

The notice of the appointment must be filed within two working days and every affected person must be furnished with a copy within five business days of the appointment.²¹⁷ If the company fails to do so the resolution lapses and becomes a nullity. There is uncertainty as to whether the word nullity implies that the resolution becomes void or whether the resolution is to be treated as though it never existed. It can further be interpreted as the resolution immediately and automatically becoming of no force and effect as soon as the prescribed

²¹⁴ Loubser “The business rescue proceedings in the Companies Act of 2008: concerns and questions (part 1)” based on: “Some Comparative Aspects of Corporate Rescue in South African Company Law (2010 Thesis SA); Concerns and questions (Part 1)” 2010 *TSAR* 510. In Belgium, the failure to pay such amounts triggered an official investigation and possible business rescue measures, but only after payments had been missed for at least six months: section 7 of the now repealed *Wet betreffende het Gerechtelijk Akkoord* of July 1997.

²¹⁵ The Companies Act of 2008.

²¹⁶ Loubser 2010 *TSAR* 511.

²¹⁷ Section 129 (4) of the Companies Act of 2008.

numbers of business days have lapsed.²¹⁸ The issue is whether the company must apply to the court upon realisation of the error or whether the company must wait for an order declaring the resolution void²¹⁹. Automatic nullification is rather extreme and acts contrary to the entire business rescue process as it makes the administrative process more cumbersome.

In the absence of an expressly prescribed time period, the notice delivered to the affected person must be delivered as soon as it has come to the knowledge of the board that the company is financially distressed.²²⁰ The automatic notification renders it difficult for the board to enter into “pre-packaged” plan before taking the business into formal business rescue proceedings.²²¹

11.3 The failure to adapt a business rescue plan.

Section 129(7)²²² specifies that the board must deliver a written notice to each affected person. The delivery of this notice will affect the company’s credit facilities and consequently the financial instruments held by the company such as overdrafts that will be cancelled.²²³ The company will face an uphill battle in trying to become a successful *going concern* once again. Another hindrance would be the liability the director of a company may face if he or she had voted in favour of a business rescue resolution and it is found, the director will be held personally liable.²²⁴ This will inevitably discourage directors from voting and implementing the business rescue procedures as they will fear personal liability. Eventually very few directors will apply for business rescue and liquidations will be seen as a safer route for both the companies and the directors. Moreover a director who is under the impression that the company is financially distressed but who has been outvoted by the other directors will still be precluded from applying to the court in his own capacity as a director.²²⁵

²¹⁸ Loubser 2010 *TSAR* 501.

²¹⁹ Loubser 2010 *TSAR* 504.

²²⁰ *Ibid.*

²²¹ Loubser 2010 *TSAR* 505; Loubser mentions that pre-packaged plans (or ‘pre-packs’ as they are often referred to) as described by the Turnaround Management Association of Southern Africa as crafting and negotiating a business rescue plan informally, with the intent of placing the company under voluntary business rescue only once that is done (Comments on Chapter 6 of the Companies Bill (B61 – 2008) (2008) 25.

²²² The Companies Act of 2008.

²²³ Loubser 2010 *TSAR* 504.

²²⁴ Loubser 2010 *TSAR* 504, Section 130(5) (c) (ii) of the Companies Act of 2008.

²²⁵ Loubser 2010 *TSAR* 509, The Act recognises the possibility that a director can be an affected person as seen in section 130 (2). A director will often be an affected person by virtue of being a shareholder but can also be an

11.4 Setting aside the resolution

In terms of section 152,²²⁶ until a business plan has formally been approved and adopted any affected person, as seen in the definition of an affected person, can apply to the court to have the resolution set aside on the grounds that there is no reasonable justification for the company to be classified as financially distressed or that it will fail or has failed to comply procedurally with the Companies Act of 2008.²²⁷ The unfettered discretion of the courts in being able to end the business proceedings and simultaneously question the board and business practitioner whilst overturning the board's decision may lead to uncertainty and will not be conducive to a successful rescue.²²⁸ The courts' functions must be limited as they do not have the expertise or experience to make and rebut decisions that a board that has knowledge and the skills to make accurate assessments has.

11.5 The furnishing of security

In terms of most commercial contracts to which there is a duty to provide for the proper performance of duties. South African law has always ensured that either a judicial manager liquidator or even trustee must furnish some form of security in order to ensure that there is a guarantee of the standard of work to be conducted by that specific individual.²²⁹ In terms of the new business rescue procedure, no such security is referred to or mentioned even though the practitioner will be placed in charge of assets and management of the company. This places the practitioner in a position where he or she has no vested interest in the proceedings, and the chances of him or her not performing their allocated duties are significantly higher. The Kings` Code of Corporate Governance recommends that the furnishing of security should be a pre-condition to appointment.²³⁰

employee of the company if a contract of service has been concluded as seen in Cilliers, Benade et al *Corporate Law* (2000) 138.

²²⁶ The Companies Act of 2008.

²²⁷ Loubser 2010 *TSAR* 505, Section 152, Section 130 (1) (a) (I)-(iii) of the Companies Act of 2008.

²²⁸ Loubser 2010 *TSAR* 507.

²²⁹ Loubser 2010 *TSAR* 509, Sections 368, section 375 (1), section 429 (b) (i) and section 431 (4) of the Companies Act of 1973 and sections 18 (1) and 56 (2) of the Insolvency Act 24 of 1936.

²³⁰ Loubser 2010 *TSAR* 509. Loubser refers to the Institute of Directors King Code Of Governance for South Africa 2009 recommendation 2.15.4. in order to illustrate her recommendation.

11.6 Post commencement finance

Post commencement finance refers to funding that is made available to a company after the commencement of the business rescue proceedings, which confers preference on claims in respect of such the post-commencement financing.²³¹

During the business rescue proceedings, reimbursements for expenses or other amounts of money relating to employment contracts become due and payable by the company to an employee as a preferential claim after the remuneration of the business practitioner has been paid.²³² The order of preference limits the manoeuvrability of cash flow going into the company and may even hamper the entire process through forgoing several transactions in order to be in line with what the legislation requires. In terms of section 135(3)(a)(i), after payment of the practitioner's remuneration²³³ and expenses referred to in section 143, and other claims arising out of costs of the business rescue proceedings, all claims contemplated in section 135(1) will be treated equally, but will have preference over all claims contemplated in section 135(2) irrespective of whether or not they are secured. This becomes problematic as it shows that post-commencement employment claims can supersede even those who have security in their claims. This is problematic as it dissolves the function that security has in that it confers a right of preference in claims over preferential and concurrent claims. The intentions of the legislature was clear in that, as seen in the Insolvency Act,²³⁴ there is a need to protect employees as they should not have to atone for the mistakes of the directors and management of the company. Section 364 of the US Bankruptcy Code provides that any credit extended to the company during the re-organisation or rescue process enjoys priority over unsecured claims incurred before the rescue process incentivising post-commencement financiers by providing that preference even if the entire process fails.²³⁵

Although this is of grave concern, section 135, which subordinates creditors' claims, in effect acts in opposition to the function of business rescue which primarily was designed for the survival of the company and the distribution of returns to the creditors who financed the

²³¹ Meskin 18.8.

²³² Section 135(3) of the Companies Act of 2008.

²³³ The Business rescue practitioner is payable as seen in Regulation 128(1)(a)-(c) as follows ;

- (i) R 1250 per hour to a maximum of R15 625 per day (inclusive of VAT) in a small company.
- (ii) R 1500 per hour to a maximum of R18 750 per day (inclusive of VAT) in a medium company.
- (iii) R 2000 per hour to a maximum of R25 000 per day (inclusive of VAT) in a large company.

²³⁴ Salaries or wages of former employees of insolvents have preference immediately after the cost of execution in terms of Section 98A of the Insolvency Act 24 of 1936.

²³⁵ Cassim et al 796.

company.²³⁶ The business rescue provisions of the Companies Act of 2008 do not contain express provisions dealing with the costs incurred by the applicant in the proceedings under section 131 of the Companies Act of 2008.²³⁷

11.7 The effect of the business rescue proceedings on employee contracts

As previously stated employees within the company enjoy a certain level of security and benefit from business rescue procedures. This is seen within section 136 of the Companies Act of 2008, which pertains to the manner in which employee contracts should be handled. The purpose is to regulate the position of the employees and regulate the obligations the company maintains towards them.²³⁸

The latest amendment section inserted by 136(2A)²³⁹ directs the business practitioner how to act in that he or she may not suspend an employment contract but has the power to suspend contracts under section 136(1)²⁴⁰, without application to the court to do so. This amendment was brought in to curb the powers of the practitioner and allow the court to exercise its discretion in a just and reasonable manner as envisioned by the Act. Sub section 2A(c)²⁴¹ goes on to provide that the suspension of a provision relating to security granted by the company for the purposes of a section 134²⁴² disposal of property by the company will have no effect and the provision will remain in application of section 134.²⁴³

11.8 The general powers and duties of the practitioners

The business practitioner has full management in substitution for its board and may thereafter delegate any power or function to a person who was part of the board.²⁴⁴ The practitioner in

²³⁶ Cassim et al 797.

²³⁷ *Cape Point Vineyards v Pinnacle Point Group* 2011 (5) SA 600(WCC).

²³⁸ Meskin 18.9.

²³⁹ The Companies Amendment Act of 2011.

²⁴⁰ The Companies Act of 2008.

²⁴¹ The Companies Amendment Act of 2011.

²⁴² The Companies Act of 2008.

²⁴³ The Companies Act of 2008.

²⁴⁴ Section 140(1) (a)-(b) of the Companies Act of 2008.

terms of his administrative duties must in terms of the recently enacted section 140 (1A)²⁴⁵ as soon possible after appointment inform all relevant regulatory authorities having authority.

11.9 The specific people that can apply for business rescue.

The numerous categories of persons who have the designated power to apply are as Loubser says “too many”. This inclusion seems excessive and is one to which there is no “comparable equivalent in any other system”.²⁴⁶ This could be a cause of confusion as *affected* individuals who do not have the knowledge and skills to actually assess the financial distress of a company may file such an application and in turn waste time and valuable resources. On the other hand there is a benefit to having these inclusions as it provides for the protection of the interests of the workers as they are directly linked to the company.²⁴⁷ Abuse of this procedure can be curbed by providing that the court may order an applicant for business rescue who abuses the procedure, or whose application is found to be malicious, liable to pay damages to the company and any other affected parties.²⁴⁸

11.10 The appointment of a business rescue practitioner

In terms of section 131(5) the court *may* appoint an interim business rescue practitioner. This discretion is somewhat confusing as there can be no actual process without such an officer present. Therefore the provision should make it obligatory for the courts to appoint a business rescue practitioner at the granting of the order.²⁴⁹

11.11 Multiple notifications

Notifications should be limited to instances where the affected people can actually have an influence on the outcome.²⁵⁰ Loubser mentions Finch as he states that the notifications requirements in the administration procedure in England result in expenses as part of the

²⁴⁵ The Companies Amendment Act of 2011.

²⁴⁶ Loubser 2010 *TSAR* 509.

²⁴⁷ Loubser 2010 *TSAR* 510.

²⁴⁸ *Ibid*; Section 347(1A) of the Companies Act of 1973 already provided for such an order in the case of winding up proceedings.

²⁴⁹ The Companies Act of 2008.

²⁵⁰ Loubser 2010 *TSAR* 515.

intricate procedural burdens which could ultimately lead to creditors selecting alternative procedures.²⁵¹ Section 132(2)²⁵² prescribes that if the proceedings have not been concluded three years after the initial commencement, then compulsory monthly reports specifying updates must be delivered to each affected person. This however will result in substantial administrative burdens, which will only consume time and be expensive.²⁵³ In terms of section 131(8) (b)²⁵⁴ the business rescue order must be notified to each affected person within five business days of the date of the order.

This duty of the notification rests on the distressed company, not the applicant.²⁵⁵ The court then questioned the appropriateness of regulation 124 that requires that the full application must be delivered to affected parties in the above case.²⁵⁶ It was found that in doing so, regulation 124 might well go beyond what may lawfully be prescribed under 131 (2) (b) of the Companies Act of 2008.

11.12 Uncompleted contracts

The wording in section 136 (2)²⁵⁷ as it previously stood suggested that for the duration of the business rescue proceedings the rescue practitioner may cancel or suspend entirely, partially or conditionally any provision of an agreement other than an agreement of employment. This discretion that was previously conferred on the rescue practitioner is to some extent unacceptable as it leaves the practitioner to enforce whatever he or she wishes to enforce and may possibly leave the other contracting party in a detrimental position.²⁵⁸ Through the wording of this section the provisions seem to imply that the business practitioner used to have the power to cancel or suspend a contract that has already been fulfilled. Such actions would be contrary to the standards entrenched in the principles of South African contract law.²⁵⁹ The rescue practitioner should be presented with only two options either to bind himself to the contract, meaning he or she must offer full performance and may therefore

²⁵¹ Loubser 2010 *TSAR* 514. Finch *Corporate Insolvency Law Perspectives and Principles* (2009) 395.

²⁵² The Companies Act of 2008.

²⁵³ Loubser 2010 *TSAR* 698.

²⁵⁴ The Companies Act of 2008.

²⁵⁵ *Cape Point Vineyards v Pinnacle Point Group* 2011 (5) 600(WCC).

²⁵⁶ *Ibid.*

²⁵⁷ The Companies Act of 2008.

²⁵⁸ Loubser "The business rescue proceedings in the Companies Act of 2008: concerns and questions (part 2) 2010 *TSAR* 689.

²⁵⁹ Loubser 2010 *TSAR* 689.

demand the same, or to repudiate the contract, in which a claim for subsequent damages will not enjoy any preference.²⁶⁰ In view of the new amendments, the business rescue practitioner must urgently apply to a court to entirely, partially or conditionally cancel, on any terms that are just and reasonable in the circumstances, any obligation of the company.²⁶¹ The amendments have clearly defined the parameters of the powers the business rescue practitioner holds. This is an attempt to curb as was, prior to these amendments, was the unfettered power of the business rescue practitioner. This section now places powers on him/her to suspend but not to cancel an agreement without leave of the court. The involvement of the court may be costly and time-consuming, but it will uphold the basic principles of administrative justice and give the opposing party the opportunity to present evidence in favour of its case unlike the previous position the outcome was solely based on the discretion of the business rescue practitioner and could only produce a possible claim for damages.²⁶² Any creditor that is affected negatively by the suspension of any transaction has the option of voting against the approval of the business rescue plan.²⁶³

11.13 Investigation of affairs of the company

In terms of section 141(2) (c) (i) the previous position was that if at any time during the business rescue proceedings if the practitioner concluded that there is evidence in the dealings of the company before the business proceedings began of voidable transactions, or when there was failure by a director to perform any material obligation, the practitioner had to direct the management to take the necessary steps to rectify the matter. The previous position placed the business rescue practitioner in a position which he or she must rely on the management of the company and their efforts in order to resolve such a matter. This posed a substantial risk of abuse in that, the same management that made the disposition would have to locate or secure the assets. There are no specific sections in the Companies Act of 2008 that deal with voidable dispositions expressly. The business rescue practitioner is therefore likely to come across some level of difficulty in the execution of his duties and function as he or she would have had to depend on the management and their pace an efficiency to move

²⁶⁰ Loubser 2010 *TSAR* 691, where it has been deemed necessary, the Insolvency Act 24 of 1936 has amended these principles in respect of certain specific types of contracts.

²⁶¹ Section 87 Companies Amendment Act 2011, amendment of section 136 of the Companies Act of 2008 Government Gazette 20 April 2011.

²⁶² Promotion of Administrative Justice Act. The *audi alterem partem rule*- this rule allows for both sides with a dispute or settlement to put forward their cases.

²⁶³ Harvey 81.

forward in any way. The Companies Amendment Act 3 of 2011 however rectified this position and prescribed that the business practitioner must take any necessary steps to rectify the matter and will have the option of thereafter directing the management to take the appropriate steps.²⁶⁴ As with all the other duties the business rescue practitioner holds he or she can effectively locate and secure all properties belonging or connected to the company.

12. Conclusions

Business rescue as a tool for ailing companies is a great improvement in comparison to judicial management. It has been set up to make an effort to involve all the affected parties and through the appropriate planning seeks to ensure that all the affected parties are satisfied with the conditions and actions that will be set and taken. It provides a more transparent system in the planning and implementation of the procedure. Academics have also noted that business rescue policies have a higher likelihood of being successful if they operate in a debtor-friendly system.²⁶⁵ The introduction of this new legislation signifies South Africa is striving towards promoting free enterprise in the interests of the national economy.²⁶⁶ It brings South Africa into line with foreign jurisdictions such as the UK, USA and Australia achieving its purpose in corporate re-cycling of businesses in financial distress with the view of maximising returns for creditors, ensuring there is preservation of employment contracts, the creation of goodwill and the sustenance of the company as a going concern.²⁶⁷

Business rescue in a South African context needs to re-introduce a sense of confidence that was taken away by previous enactments of business rescue procedures. The legislator must thus ensure that there is recognition of these shortcomings and that they are accordingly addressed.²⁶⁸ This is necessary in order to guarantee that legislation that debtor orientated provisions that do not simultaneously undermine the value of creditors in the equilibrium of the marketplace in the totality of its social and financial environment²⁶⁹ are available to the nation. A huge disadvantage to succeeding a procedure such as judicial management is that currently, informal workouts and liquidations still have preference in terms of what

²⁶⁴ Section 92 of the Companies Amendment Act 2011, Amendment of section 141 of the Companies Act of 2008.

²⁶⁵ Bradstreet 2010 *SA Merc LJ* 22, Harmer 'Comparisons of Trends in National Law: The Pacific Rim' 1997 *Brooklyn Journal of International Law* 139 at 147.

²⁶⁶ Bradstreet (2010) *S A Merc LJ* 22, Rajak & Henning 1999 *SA L J* 262, 268.

²⁶⁷ Harvey 85.

²⁶⁸ Loubser 2010 *TSAR* 701.

²⁶⁹ Bradstreet (2010) *SA Merc LJ* 22.

companies will select for themselves in financial distress.²⁷⁰ To change this mentality will take a consolidated effort by the courts, creditors and all affected persons to ensure that the new procedures will be supported and adopted.²⁷¹

On the other hand business rescue has had the benefit of coming after judicial management, in respect of which all experiences and knowledge of the strong points and pitfalls have been uncovered.²⁷² Business rescue has addressed a number of the pitfalls of judicial management and offers a more comprehensive methodology in terms of rescuing companies. The initiation of these new legislative measures has set off process to develop the foundation for more viable and successful rescue procedures that will be relevant in the South African context. There must however be a balance between the rights of the creditor and debtor. This equilibrium must be drawn to ensure a fair process is throughout, enabling both parties to benefit from the procedures.

²⁷⁰ Loubser 380.

²⁷¹ Ibid.

²⁷² Ibid.

Chapter 4:

Some comparative aspects of business rescue mechanisms employed in Australia, the United Kingdom and South Africa

This chapter aims to assess the various business rescue mechanisms employed in Australia and the United Kingdom. Comparing these diverse legislative systems will gauge how far or close the South African corporate rescue policies are in terms of international standards. It will also give the basis for any recommendations that can be made.

Australia and South Africa share a similar Anglo heritage.²⁷³ There may be benefit in comparing both countries as they are similar found in the South African Companies Act of 2008 and Part 5.3A of the Australian Corporations Act of 2001.²⁷⁴ In comparing two countries with an Anglo history, it would be relevant to include the United Kingdom. The United Kingdom serves as the original blue print on which both systems were built. It is for this reason they have become the countries for analysis in this dissertation and not the United States of America or Canada.

1 Australia

Australia does not does not have a separate insolvency statute, but upholds its corporate insolvency policies within the general Corporations Act.²⁷⁵

A large influence on the Australian business rescue regime has come from the United States Chapter 11²⁷⁶ and of its Bankruptcy Code.²⁷⁷ These influences came in the form of corporate theories that promote insolvency law as a social benefit reflecting society`s interests in the

²⁷³ Anderson “Viewing The Proposed South African Business Rescue Provisions From An Australian Perspective” *PER* 2008 (1) 1.

²⁷⁴ *Ibid.*

²⁷⁵ ALRC Hamer report <http://www.alrc.gov.au>. Date of access 12/09/2011.

²⁷⁶ Anderson and Morrison *Corporate Voluntary Administration* (2003) 1.

²⁷⁷ Conway “Chapter 11 of the US Bankruptcy Code” House of Commons Library SN/HA/4798 2010. The Bankruptcy Reform Act 1978 is federal law that governs all insolvency cases. The Bankruptcy Code has two main objectives, that are to provide an honest but financially distressed debtor with a fresh start, and to ensure that his creditors participate equally in any distribution which may be forthcoming from the debtor`s bankrupt estate.

insolvent entity and that community interests are consistently represented.²⁷⁸ This aids in the survival of the company and maintains the standard of living amongst those residing in the community. The second is seeing insolvency from an economic prospective.²⁷⁹ In this instance insolvency provides a means to maximise the methods of collecting debt owed by the creditors.²⁸⁰ On evaluation of both these theories, official management created the opportunity for both aims to be achieved in the form of business rescue used in Australia.

1.1 Official management

The enactment of uniform legislation in the 1960s saw the introduction of official management.²⁸¹ The main features included:

- A temporary moratorium in which legal proceedings could be taken against the company only where there was leave of the court;
- There was a transfer of management functions during that period, appointing an official manager that would attempt to restore the company to a more productive state;
- Unsecured creditors would have to wait for distribution of their money; and
- the decision to place a company under official management was a majority decision that became binding on the minority of creditors.²⁸²

This form of insolvency administration was inserted in the various state based Companies Acts and subsequently adopted in the national scheme legislation being based upon the South African judicial management procedure.²⁸³

Official management can therefore be contrasted with its South African equivalent of judicial management. The Australian Law Reform Commission directed an inquiry into developments in bankruptcy and company law practice, in particular the Cork Report conducted by the United Kingdom Insolvency Law Review Committee.²⁸⁴ The Australian Law Review Committee completed this task and thereafter issued the Harmer Report.

²⁷⁸ Anderson and Morrison 2.

²⁷⁹ Ibid.

²⁸⁰ Ibid.

²⁸¹ Ford *Principles of Company Law* (1982) 550.

²⁸² Ford 550.

²⁸³ Anderson *PER* 2008(1) 3.

²⁸⁴ Anderson and Morrison 6.

The report found that the legislative approach that Australia had maintained to insolvency was conservative and placed very little focus on positively encouraging the possible preservation of the business and employed staff.²⁸⁵ It was also found that a more constructive and practically effective approach to give the company breathing space from its creditors and allow an orderly administration in which the all affected parties could make an informed decision to consider whether or not to wind-up the company or to seek the continuance of the corporate entity, needed to be employed.²⁸⁶ This would come in the form of legislation that would encourage steps at an early stage and create a considerable advantage over the current procedures that was readily available to companies.²⁸⁷ This inevitably led to a proposal that was put forward in order to resolve the deficiencies. However due to the lack of use and success, official management was abolished by the Corporate Reform Act of 1992.²⁸⁸

Judicial management, the South African counterpart to official management had the same characteristics as official management and offered the same method of relief through a moratorium and specialised management of the company to somehow better the chances of the company coming of its that unfavourable position.

Judicial management however faced the same end as official management, as the Companies Act of 2008 introduced a new form of corporate relief in the form of business rescue.

1.2 Administration

The Australian corporate insolvency law is contained within Chapter 5 of the Corporations Act.²⁸⁹ Recent reviews on Chapter 5 in terms of business rescue have focused on:

- *Firstly* employee entitlements-Providing priority assistance for employee entitlements including wages, superannuation contributions by the company, injury compensation through the enhancement of the existing general employee entitlements and redundancy scheme.²⁹⁰ Employees unlike other creditors are unable to avoid the

²⁸⁵ Ibid.

²⁸⁶ Ibid.

²⁸⁷ Anderson and Morrison 7.

²⁸⁸ Anderson and Morrison 5.

²⁸⁹ Morrison and Anderson "The Australian Insolvency Regime Revisited: A Précis of The Next Leap Forward" 2006 *International Insolvency Review Volume 15* 129. www.intersciencewiley.com date of access 19/08/2011.

²⁹⁰ Ibid.

possibility of insolvency which such would be extremely detrimental to their entire economic environment.²⁹¹

- *Secondly* misconduct and creditor protection measures-another major concern that has been reviewed and was addressed, is the deterring of company officers, misconduct by removing the limitation on investigations of companies with few or no assets.²⁹² This provides a public benefit of pursuing those who abuse the company, encouraging both accountability and transparency.
- *Thirdly the* regulation of practitioners-in terms of their independence and remuneration in order to ensure the furtherance of their skills and promote independence to prevent companies from appointing friendly administrators that do not operate at arm's length.²⁹³

All three points focus on the essential foundations for business rescue. The protection of the employees ensures the sustenance of the employee's livelihood and therefore overall standard of the community. The monitoring of misconduct provides a sense of accountability that creates confidence in businesses in that abuse and negligence will be caught out and prevented. The regulation of the practitioner will ensure that every company has equally the best chance of receiving the assistance needed in order to be a successful concern once again. The revision signifies the importance placed the business rescue and the need for this regime of corporate assistance to be successful.

Section 435A²⁹⁴ is seen to supports the above objects in the maximisation the chances of the company's continuance or existence and if that is not possible, then the provision of a better result than that of immediately winding-up the company.²⁹⁵

1.3 Appointment of the administrator

The process of administration is set off by the appointment of the administrator.²⁹⁶The appointment of an administrator can be made by the board if it is of the opinion that the

²⁹¹ Ibid.

²⁹² Ibid.

²⁹³ The Australian Government Treasury, Insolvency Reform Package Release (2005) 6.

²⁹⁴ Corporations Act 50 of 2001 volume 2 section 435A.

²⁹⁵ Corporations Act 50 of 2001 volume 2 section 435A.

²⁹⁶ Corporations Act 50 of 2001 volume 2 section 435C. This appointment is however made under section 436A where a company may appoint an administrator if the board is of the opinion that it is in the best interests of the

company is insolvent or is likely to become insolvent at some future time.²⁹⁷ A liquidator has the same powers as directors of the board in this regard and can appoint an administrator for the same reasons as given above. He or she may even appoint themselves as an administrator under section 436B (1).²⁹⁸ A *charegee* who is entitled to enforce a charge on the whole or substantially the entire company property may also appoint an administrator through written application to the court.²⁹⁹

1.4 The effects of the appointment of an administrator

The administrator then assumes control of the company`s affairs and acts as an agents performing and exercising his powers in such a capacity.³⁰⁰ His or her role is one where he or she is expected to:

- have control of the company assets and affairs;
- carry out the business and manage the affairs of the company;
- terminate or dispose of all or part of that business; and
- Perform any function that the company or any of its officers could perform.³⁰¹

Under Australian provision in the *Patricks* case, the High Court made it clear that the administrator must execute his functions as he or she may deem fit even to the extent that he or she may breach industrial legislation, moreover the court was not ready to make an order retaining employees whilst the voluntary administration order was in motion.³⁰² The business rescue practitioner is not as seen in the South African position an officer of the court, therefore creating the perception that they are in a more independent position.³⁰³

company or the company will become insolvent; Section 426B the liquidator may appoint an administrator and finally 436C a *chargee* may appoint an administrator.

²⁹⁷ Corporations Act 50 of 2001 volume 2 section 436A.

²⁹⁸ Corporations Act 50 of 2001 volume 2 section 436B.

²⁹⁹ Corporations Act 50 of 2001 volume 2 section 436C.

³⁰⁰ Corporations Act 50 of 2001 volume 2 section 437B.

³⁰¹ Corporations Act 50 of 2001 volume 2 section 437A.

³⁰² *Patrick Stevedores Operations (No2) v Maritime Union of Australia* 195 CLR 1.

³⁰³ Anderson *PER* 2008(1) 17.

1.5 Personal liability and indemnity

Administrators may act as company agents, but cannot contract out of their personal capacity therefore remaining personally liable for the debts incurred in the execution of their duties in terms of performance, function, services, goods bought, and taxation remittance provisions.³⁰⁴ They have seven days within which to decide whether or not to continue to use of property based on an agreement that was made prior to the administration.³⁰⁵

This, unlike official management and liquidations, creates an assurance that under administration debts will be paid.³⁰⁶ Assurance of this nature will create confidence in suppliers that they will receive performance for what they have supplied. Although the manager assumes it personally, he or she must ensure that there are sufficient free assets to satisfy the statutory indemnity before continuing the company business, this is where his/her protection lies.³⁰⁷

1.7 The moratorium

As with all other business rescue procedures, the moratorium is designed to give the company breathing space binding even owners or lessors of property to its conditions.

The Harmer report recommended the moratorium on the basis of promoting an orderly dealing with the company's affairs.³⁰⁸

There are however exceptions to the application of the moratorium in the Australian system. These are the exceptions in respect of which the specific persons mentioned will not be bound by the moratorium:

- A holder of a charge over the whole or a substantial amount of the assets of the company acts before or during the decision period and enforces the charge in relation to all property of the company subject to the charge,³⁰⁹

³⁰⁴ Anderson and Morrison 19.

³⁰⁵ Ibid; Corporations Act 50 of 2001 volume 2 section 443A that deals with the General debts incurred in the furtherance of the business rescue procedure.

³⁰⁶ Ibid.

³⁰⁷ Colin and Morrison 20.

³⁰⁸ ALRC Harmer Report www.alrc.gov.au/inquiries/title/alrc6&36&45/index.htm. Date of access 11/11/2011.

³⁰⁹ Corporations Act 50 of 2001 volume 2 section 441A.

- A secured creditor holding a charge has entered into possession or assumed control of the property of the company or has entered into an agreement to sell such property or made arrangements for such property to be offered for sale by public auction or has exercised any other power in relation to such property,³¹⁰
- A secured creditor who holds a charge over perishable property or an owner of such property where the company is under administration,³¹¹
- Owners or lessors of property used, occupied by or in the possession of the company who have enforced a right to take possession of the property prior to administrator`s appointment.³¹²

As seen in judicial management and business rescue within the South African context there are no exceptions to the moratorium. It is recommended that South African legislators assess whether such provisions are necessary in South African business rescue. Certain assets are sensitive due to the fact that they can either perish or lose value as time passes. Therefore a company that maintains these assets may ultimately save an asset that could perish or diminish substantially in value. It is consequently submitted that there should be an assessment as to whether such provisions can affect positive results in South Africa. A moratorium is a tool that should be used with caution as companies can use business rescue as a means of avoiding obligations and responsibility that they are bound to. The court`s involvement needs to be a balancing act focusing on the prevention of abuse of the system whilst functioning efficiently and expeditiously saving costs and time.³¹³

1.7 Termination of the administration process

The administration process will come to an end, if the events in either section 435C (2) or 435C (3) occur after the administration process has began.³¹⁴ Section 435C (2) describes the normal outcome of the administration of a company where a deed of a company arrangement is executed by both the company and the deed`s administrator or alternatively the company`s

³¹⁰ Corporations Act 50 of 2001 volume 2 section 441B.

³¹¹ Corporations Act 50 of 2001 volume 2 section 441C.

³¹² Corporations Act 50 of 2001 volume 2 section 441F.

³¹³ Colin and Morrison 20.

³¹⁴ Corporations Act 50 of 2001 volume 2 section 435C.

creditors resolve under paragraph 439 C (b) that the administration should end. In terms of section 435 C (3) the administration of a company may also end due to the court orders under section 447A, or the convening period coming to an end.³¹⁵

2 The United Kingdom

The Cork Committee which produced the Insolvency Law and Practice reports³¹⁶ held that United Kingdom³¹⁷ maintained few satisfactory methods of rescuing companies in financial difficulties and moreover recommended that there should be new methods of corporate rescue initiated that would assist in the creation of alternatives to liquidations. This alternative came in the form of a procedure called administration.³¹⁸

2.1 Administration

Administration was however seen and criticised for being cumbersome, expensive and unsuitable for small to medium sized companies.³¹⁹ A white paper in July 2001 was published setting out the need for reform and the Enterprise Act 2002 substantially replaced a number of provisions within the Insolvency Act of 1986.³²⁰

The most successful petitions for administration are brought in the pursuance of attempting to sustain the survival of the company and to preserve the business as a *going concern*, where it is proven that it would be more advantageous to realise the company's assets than it would be to effect a order winding-up the company.³²¹

The court may not grant an administration order:

³¹⁵ Corporations Act 50 of 2001 volume 2 section 439 A (5) (a)- the convening period if the administration begins on a day that is in December, or is less than 28 days before Good Friday – the period of 28 days beginning on that day; or otherwise the period of 21 days beginning on the day when the administration begins.

³¹⁶ Grier *UK Company Law* (1998) 623, *Report of the Review Committee on Insolvency Law and Practice 1982, Cmnd 8558. Hereinafter referred to as the Cork Report*

³¹⁷ Hereinafter referred to as the UK.

³¹⁸ Grier 623.

³¹⁹ Parry and Rebecca *Administrative Receivership and Administration: An Overview of Recent Developments from Selected Countries* (2004) 146.

³²⁰ Loubser 166.

³²¹ Grier 624.

- if the company is already in liquidation;³²²
- if the company is an insurance company or a money-lending institution,³²³
- where a receiver is in place;
 - I. The floating charge-holder.³²⁴

Administration is available only by means of an administrative order granted by the courts through a petition from a suitable petitioner.³²⁵ The Court under the United Kingdom Insolvency Act of 1986 Chapter 45 Part II IA 1986 section 8 could make an administrative order,

- If it is satisfied that a company is or likely will become unable to pay its debts within the meaning given in section 123³²⁶. The inability to pay debts as described in section 123 must contain the financial position of the company in which the applicant specifies to their best knowledge the assets and liabilities of the company and any other information the applicant may deem to be necessary for the court in making the decision.³²⁷ Section 123(1)³²⁸ unlike the Companies Act of 1973 and the Companies Act of 2008 sets out guidelines as to what exactly the phrase *inability to pay debts* means. This enables an applicant to know whether there are in the appropriate position to make the application, rendering the application a lot less prone to dismissal if the parameters are adhered to. The balance sheet deficiency test can also be applied to assess whether or not the company is in a position to apply.³²⁹ This is an important feature that allows an application for an administration order to be presented while the

³²² Grier 624; The United Kingdom Insolvency Act 1986 Chapter 45 Part II IA 1986 section 8(4).

³²³ Ibid, The United Kingdom Insolvency Act 1986 Chapter 45 Part II IA 1986 section 8(4) (b).

³²⁴ Ibid, The United Kingdom Insolvency Act 1986 Chapter 45 Part II IA 1986 section 9 (3); A floating charge which is rather like a mortgage that gives the charge holder on liquidation a prior right to the proceeds of the sale of the secured assets of the company. It is an equitable charge over present and future assets belonging to a charger, and the assets in question may change in the course of the business as they are bought and sold, added to, replaced or altered. Floating charges strike a balance between the lender's need for security and the borrower's need to continue trading with the charged assets, which generate enough funds to repay the lender.

³²⁵ The United Kingdom Insolvency Act 1986 Chapter 45 Part II section 9. An application to the court for an administration order shall be by petition presented either by the company or the directors, or by a creditor or creditors (including any contingent or prospective creditor or creditors), or by any of those parties, together or separately.

³²⁶ Section 123 of Insolvency Act 1986 Chapter 45.

³²⁷ Loubser 177, Rule 2.4 (2) (a) to (c) of the Insolvency Rules. The required affidavit is replaced by a witness statement once the Draft Insolvency (Amendment) Rules 2010.

³²⁸ Section 123 of Insolvency Act 1986 Chapter 45.

³²⁹ Section 123(2) of the Insolvency Act 1986, Fletcher *Insolvency* (2002) 660 and Goode and Roy *Principles Corporate Insolvency Law* (2005) 88,101-109.

company is still able to pay its debts as they may become due and payable, but before the assets will be exhausted.³³⁰

- If it considers that the making of the order would be likely to achieve one or more of the purposes specified in the Act.³³¹ These goals are:
 - (i) The rescuing of the company as a going concern. This is the first and main objective of administration that an administrator must pursue.³³² This is in contrast to judicial management as administration seeks to rescue the business and corporate entity as a whole and not only a viable or prospectively successful part of its business.³³³
 - (ii) Obtaining a better result for the creditors. If the administrator is of the opinion that the first objective is unlikely to be attained, he may perform his functions with the second objective fully in mind and pursue achieving a better result for the creditors if liquidation could not produce a better result.³³⁴ In terms of judicial management the courts would refuse to issue a provisional judicial management order to enable a judicial manager to later establish if the company could in the future become successfully rescued.³³⁵ Allowing the administrator the opportunity to make the best of the situation is practical as not every company that attempts business rescue will succeed in total rescue. The option of then selling the business at the best market price possible betters the return for creditors and will in the end create the chance for the debtor to be discharged.
 - (iii) The distribution to secured or preferential creditors. This objective is pursued only where the previous objectives cannot be reached and the interests of the creditors will not be jeopardised.³³⁶ The administrator in this instance is placed

³³⁰ Loubser 178.

³³¹ Insolvency Act 1986 Chapter 45 Part II section 8 (3).

³³² Loubser 181.

³³³ Ibid.

³³⁴ Goode and Roy 327.

³³⁵ Loubser 183, *Kotze vTulryt Bpk en Andere* 1977 (3) SA 118 (T).

³³⁶ Bailey and Groves *Corporate Insolvency* (2007) 345.

under stringent regulation as he or she will have to clarify why he or she believes that the other objectives cannot be achieved.³³⁷

2.2 Procedure to commence administration

The process is initiated by either the company or the directors. The actual appointment of an administrator signifies the official commencement of administration process.³³⁸ The rules regarding who may apply are very specific. When an application is made by the company or by the directors, the affidavit must be drafted by one of the directors or the secretary of the company.³³⁹ However if the application is made by the creditors, they must authorise one of the above persons to make the affidavit on their behalf.³⁴⁰

The courts however rely heavily on the evidence supplied by the prospective administrator and his or her statements should contain enough information to show why other options such as liquidation are not appropriate and how the administrative process is to be dealt with.³⁴¹ In order to discourage improper applications and abuse of the system, an application may not be withdrawn without consent from the court.³⁴²

In terms of the notification procedure, there is a detailed and very specific list of persons to whom the notice must be given, this however does not include the general body of creditors or the employees of the company, but is limited to the company and the applicant or prospective administrator.³⁴³ The reason for this is that such notifications may have an extremely detrimental effect on the company's ability to operate as a business and may have cause irreparable damage to the goodwill and stability of the business entity.³⁴⁴ The Companies Act of 2008 does not however apply the same rule, which shields damage to a company caused by notifications. The only shortcoming of this feature is that it may result in an uninformed creditor making an application for the winding-up of the company after an

³³⁷ Loubser 184.

³³⁸ Loubser 185.

³³⁹ Rule 2.2(2) of the Insolvency Rules.

³⁴⁰ Rule 2.2(3) of the Insolvency Rules.

³⁴¹ Bailey and Groves 357.

³⁴² Loubser 189.

³⁴³ Loubser 189; Paragraph 12(2) of Schedule B1 to the Insolvency Act 1986 and Rule 2.6 of the Insolvency Rules.

³⁴⁴ Loubser 189.

application for administration has been lodged.³⁴⁵ The courts within the United Kingdom will primarily hear the application for administration and evaluate the actual chances of success.³⁴⁶ In exceptional cases the courts have granted administration orders in situations where there have been no prior notifications.³⁴⁷ In terms of the South African judiciary, the guidelines outlining the exact method that the courts use in determining the chances of success are not expressly stated.

2.3 The qualifications of the administrator

In exercising his or her functions the administrator of the company acts as the company agent.³⁴⁸

The strictly regulated system of appointment and supervision of insolvency practitioners is an important feature of the system in the United Kingdom, which is largely responsible for the majority of its success.³⁴⁹ The Cork Report recommended that there should be a minimum standard professional qualification as well as a control structure to ensure a high standard of competence and integrity to prevent abuse.³⁵⁰ Acting without the required qualifications is an offence which may be sanctioned by imprisonment and the imposition of a fine.³⁵¹

In terms of section 390(2) of the Insolvency Act 1986 an individual can be authorised to practise as an administrator by one of two ways.³⁵²

Firstly, through the administrator becoming a member of recognised professional body. Without being a member in such a body practise will be prohibited.³⁵³ In terms of section 391(2)³⁵⁴ a professional body will be recognised if it regulates the practice of a profession and maintains rules for securing that some of its members as are permitted by or under the law to act as practitioners are fit and proper persons meeting the acceptable educational and practical experience requisites. The Secretary of State does not maintain direct control over

³⁴⁵ The Cork Report.

³⁴⁶ Bailey and Groves 351.

³⁴⁷ Parry and Rebecca 34-35.

³⁴⁸ Paragraph 69 of Schedule B1 to the Insolvency Act 1986.

³⁴⁹ Loubser 197.

³⁵⁰ Pennington and Roberts *Corporate Insolvency Law* (1997) 4.

³⁵¹ Section 389(1) of the Insolvency Act 1986 Chapter 45.

³⁵² *Ibid.*

³⁵³ Section 390(2) of the Insolvency Act 1986.

³⁵⁴ Insolvency Act 1986.

these professional bodies and can merely exercise its authority through the revocation of an administrator's recognition for non-compliance of their standards and regulations.³⁵⁵

Secondly, is through the authorisation by the Secretary of State which is described in section 392³⁵⁶ as a competent authority. This alternative is available for those insolvency practitioners who are not members of a recognised professional body.³⁵⁷ The authorisation period is granted only for a period of one year and thereafter must be annually renewed.³⁵⁸ In the pursuit of the maintenance of the standards, all prospective insolvency practitioners are mandated to pass a centrally standardised examination set by the Joint Insolvency Examining Board³⁵⁹ and possess the necessary prescribed minimum number of worked cases or alternatively insolvency work hours.³⁶⁰ These regulations create uniformity in the quality of service that is provided to companies and gives each company an equal chance of rescue. Judicial management has maintained no such standard, practice or form of filtering qualified person for the position of judicial manager.

2.4 The functions and powers of the administrator

The administrator is deemed to be company's agent³⁶¹ and anyone dealing with him in good faith for value need not be concerned whether or not administrator is acting beyond the power that he or she has given.³⁶² Preceding the appointment of the administrator he or she must take control of all the assets including those that are distributed throughout the globe.³⁶³

³⁵⁵ Sealy and Milman *Annotated Guide to the Insolvency Legislation* (2004) 428.

³⁵⁶ Insolvency Act 1986.

³⁵⁷ Sealy and Milman 429.

³⁵⁸ Section 393(3).

³⁵⁹ Finch *Corporate Insolvency Law: Perspective and Principles* (2009) 334.

³⁶⁰ Insolvency Practitioners Regulations 2009/3081 reg. 7(1)-(6). The practitioner must have held a minimum of 30 cases in the preceding ten years and 2000 hours of insolvency work.

³⁶¹ Insolvency Act 1986 Chapter 45 Part II section 14 (5).

³⁶² Insolvency Act 1986 Chapter 45 Part II section 14 (6).

³⁶³ Grier 628.

2.5 The administrator's remuneration and his or her liabilities in the case of the remuneration

The administrator's fees and expenses are paid out of the property under his control and in priority to any other sum that may be due to any secured creditors.³⁶⁴

2.6 The moratorium

The moratorium now commences only once the company is in administration and although the definition of the word connotes an allowance or breathing space for the company, it does not like the South African system postpone the payment of debt, but only protects the company from the creditors and other parties alike from enforcing several legal rights.³⁶⁵

There is an interim moratorium that protects the company before the appointment of the administrator and directly after the application has been lodged.³⁶⁶

The interim moratorium will however come into full effect against claims and other legal actions only upon the notice of intention to appoint administrator.³⁶⁷ This will see the interim moratorium take full effect and protection of the company commence.

Directors, however, before an administration order is granted or rejected, may still exercise their powers which include the disposing of property through alienation, leasing mortgaging and the access to company accounts.³⁶⁸ When the management powers of the directors are thus effectively suspended for the duration of the administration, they are however still required to carry out their statutory duties.³⁶⁹ By contrast judicial management and business rescue in terms of the Companies Act of 2008 relieve the directors of all their powers and office placing management under the full control of the judicial manager and the business rescue practitioner. This would deter any inappropriate actions or agreements that could be concluded by a director during the fragile time that the company would be experiencing.³⁷⁰

³⁶⁴ Insolvency Act 1986 Chapter 45 Part II section 19 (4).

³⁶⁵ Lightman and Moss et al *The Law of Administrators and Receivers of Companies* (2007)40.

³⁶⁶ Loubser 193, In terms of par 27(1) of the Schedule B1 to the Insolvency Act 1986.

³⁶⁷ Sealy and Milman 517,528.

³⁶⁸ Pennington361-362.

³⁶⁹ Bailey and Groves 393 and Fletcher 549.

³⁷⁰ Loubser 194.

The final moratorium is automatic and wide in its application for the duration of the administration, but is however not absolute as both the administrator and the court have the discretion to allow specific legal processes against the company to be instituted or continued.³⁷¹

2.7 The rescue plan

The administrator is mandatorily obligated to prepare a rescue plan which he or she must submit personally, but he or she is not however obliged to consult or negotiate with creditors in terms of that specific plan.³⁷² There are however mechanisms to ensure that the administrator fulfils his or her functions according to approved proposal through the challenging his or her conduct in the courts.³⁷³ By contrast in terms of section 150(1)³⁷⁴ the business rescue practitioner must consult with all affected persons.³⁷⁵

Consultation with the creditors will ultimately lead to a smoother processing of the plan, as all objections and clarifications can be made to ensure that the majority of the affected persons, namely the creditors, are happy with the proposals and structuring of the plan. However the process of negotiating and ensuring that all affected parties are content may be long and cumbersome. The rescue plan must contain the statement of how the company has been managed and financed since the administrator appointment and how it will continue to be managed and financed.³⁷⁶

In terms of the Companies Act of 2008, the business rescue plan does not require a deposition on the past, present or future financing of the company explaining how it had previously been or would in turn be managed.³⁷⁷ As seen from the *Swart v Beagles Run Investments 25*³⁷⁸ case, an assessment of the past financial position of the company would prove to be beneficial as it would give an indication of how the business was run and if indeed there is any real chance of it being rescued. It was found in the above case that the financial history of

³⁷¹ Loubser 195.

³⁷² Goode and Roy 382.

³⁷³ Loubser 212, this in terms of pars 74 and 75 of schedule B1 of the Insolvency Act 1986.

³⁷⁴ Act 71 of 2008.

³⁷⁵ As defined by the Companies Act 2008.

³⁷⁶ Loubser 208, Rule 2.33(2) (o) of the Insolvency Rules.

³⁷⁷ Loubser 208.

³⁷⁸ 2011 (5) SA 422(GNP).

the company showed that recovery would be almost close to impossible therefore causing such an application to be refused by the courts.

2.8 Termination of the administration procedure

Termination of the administrator's term of service and consequently the administration process are automatically terminated one year after the appointment of the administrator became effective.³⁷⁹ He or she may apply for an extension of up to six months with the consent of all the secured creditors.³⁸⁰ The reason why this procedure is seen to lapse automatically after a year is that it is seen as a temporary course of action that should grant the company support, while the essentials for the actual rescue strategies are laid out, rather than being the rescue measure itself.³⁸¹ The administration process may also come to an end through an order of the court or through the filing of a notice.

³⁷⁹ Loubser 212, Paragraph 76(1) of Schedule B1 to the Insolvency Act 1986.

³⁸⁰ *Ibid.*

³⁸¹ Keay and Walton *Insolvency Law: Corporate and Personal* (2003) 95.

3 An evaluation of the main differences between the Australian and United Kingdom's business rescue procedures

- In the United Kingdom an administration order is initiated by a court application containing evidence on affidavit and reports from the accountant, by which the court must be satisfied that one or more of the purposes for making the order will be achieved. The cost of initiating such an order is therefore high and it may take some time to be implemented.³⁸²
- In terms of the United Kingdom regime, any creditor has the power and ability to apply for an administration order. This is however not the case in the Australian system.³⁸³
- In order to vote in creditor meetings as a secured creditor in the United Kingdom, he or she must forfeit his or her security whereas in the Australian system, no such process or order is required for secured creditors to participate in or vote at creditor meetings.³⁸⁴
- Holders of a charge in the United Kingdom and Australia may both veto the administration order; however it is only in Australia that after the process has been initiated, the creditor will still have the opportunity to enforce his or her security for ten business days after commencement. The same can however not be said in terms of the United Kingdom where secured creditor is automatically bound the administration as soon as it commences.³⁸⁵
- Third party guarantees remain enforceable under the insolvency regime in the United Kingdom where as in contrast with the Australian system, such guarantees are not enforceable without leave of the court where the guarantor is a director or natural person.³⁸⁶

³⁸² Colin and Morrison 366.

³⁸³ Ibid.

³⁸⁴ Ibid.

³⁸⁵ Ibid.

³⁸⁶ Ibid.

4 A critical evaluation on the differences between the Australian, South African and the United Kingdom business rescue regimes

4.1 The initiation/commencement of the business Rescue Process

Australia: The administration of a company begins when an administrator of the company is appointed.³⁸⁷ The administrative process is initiated either through the company, the liquidator, or the *chargee* initiating the procedure. The basis or test for the commencement of the procedure is where firstly the *chargee* has a charge that has become enforceable, implying that there is an outstanding amount owing, creating the assumption that the company has become unable to service its obligations. The reasoning behind this approach of allowing the above party to initiate the process is in recognition of the fact that court based systems as adopted in jurisdictions such as the United States of America, experience delays and costly litigation which result in smaller dividend for the creditors.³⁸⁸ The liquidator and the company use the same test and base their application on the probability that the company is or likely to become insolvent and unable to service its obligations.

South Africa: The business rescue proceedings begin either when the company files resolution to place itself under supervision, or a person applies to the court for an order placing the company under supervision, or during the course of liquidation proceedings, or proceedings to enforce a security interest, a court makes an order placing the company under supervision as highlighted in the previous chapter.³⁸⁹ The basis or test is somewhat different from the Australian one in that, the company need not likely be or become insolvent but is either financially distressed, or has failed to pay its obligations or where it is just and reasonable for financial reasons for the order granted.³⁹⁰

The United Kingdom: The administration process is said to have commenced at the appointment of the administrator.³⁹¹ An administrator may be appointed by either order of the court, or by the holder of a floating charge, or by the company or its directors.³⁹² The inability to pay debts must exist where there is a belief that the company is or will become unable to service its obligations.³⁹³ An affidavit that contains a statement of the financial position of the

³⁸⁷ Corporations Act 50 of 2001 volume 2 section 435 C.

³⁸⁸ Anderson 2008 *PER* 9.

³⁸⁹ Section 132(1) (a)-(c) of the Companies Act 71 of 2008.

³⁹⁰ Section 129(1) of the Companies Act 71 of 2008.

³⁹¹ Paragraph 1(2) (b) of Schedule B1 to the Insolvency Act 1986.

³⁹² Paragraph 2 of Schedule B1 to the Insolvency Act 1986.

³⁹³ Paragraphs 11 (a) and 27 (2) (a) of the Schedule B1 to the Insolvency Act 1986.

company must accompany this application.³⁹⁴ The United Kingdom also makes use of the balance-sheet deficiency test, where the company's assets are compared to its liabilities.³⁹⁵ The court must be satisfied that that such an administration order will achieve its purpose.³⁹⁶ This is to rescue the company and maintain it as a going concern,³⁹⁷ creating the opportunity for creditors to receive better results placing their interests first³⁹⁸ and finally for the distribution of money to secured and preferential creditors where the administrator can assess that the prior requirements cannot be achieved.³⁹⁹

The United Kingdom's use of the balance sheet test is extremely useful. It is a tool the South African provisions could adopt in enhancing the levels to which a company is analysed before the business rescue process is initiated. The South African system gives wide access to the initiation of process through allowing *affected persons*, which include employees to, such a process. This, however, as mentioned in the previous chapter, creates the opportunity for abuse. The question has to be asked is whether the South African provisions have gone too far in trying to improve employee rights, within the business rescue process, or will this become an international trend that other countries are yet to follow? The case of *Swart v Beagles*⁴⁰⁰ was an illustration of the an application that was a complete negation of the rights of creditors as the respondent had been extremely reckless and in which the application itself was seen as an abuse of process in order to exempt the company from the payment of its debts.⁴⁰¹

4.2 The moratorium

Australia: The Australian business rescue provision contains certain exceptions within its application excluding particular individuals from being bound by the moratorium. The exempt parties are:

- A secured creditor holding a charge other than a charge on the whole of the company,

³⁹⁴ *Ibid.* The financial position includes past present and future conditions the company is under and will experience.

³⁹⁵ Loubser 178.

³⁹⁶ Paragraph 3 of schedule B1 to the Insolvency Act 1986.

³⁹⁷ Paragraph 3(1) (a) of schedule B1 to the Insolvency Act 1986.

³⁹⁸ Paragraph 3 (1) (b) of schedule B1 to the Insolvency Act 1986.

³⁹⁹ Paragraph 3 (4) of schedule B1 to the Insolvency Act 1986.

⁴⁰⁰ 2011 (5) SA 422 (GNP).

⁴⁰¹ *Ibid.*

- A secured creditor who holds a charge over perishable property,
- Owners or lessors of property used, occupied by or in possession of the company.⁴⁰²

In terms of the powers conferred on the administrator as regards for moratorium, he or she may not dispose of the any such property without the written consent of the owner, in the ordinary course of business, and without the leave of the court. However these exceptions may operate to the purpose the moratorium. Allowing the above exceptions may prove problematic for companies that deal either primarily in perishable goods and even companies that are leasing high priced premises. The intended leverage that moratorium aims to provide will find itself becoming ineffective and inapplicable in many cases.

South Africa: In contrast to the South African system where the only exceptions are: criminal proceedings against the company, proceedings concerning entities over which the company exercises the powers of a trustee, and set-off transactions against the any claim made by the company in any legal proceedings. These exceptions do not take away the breathing space the moratorium was intended to provide which still sustaining a form a protection that will enable the company to initiate and maintain the business rescue procedures.

The United Kingdom: The United Kingdom unlike Australia and South Africa maintains an interim and final moratorium. The interim moratorium comes into full effect upon the notice of intention to appoint an administrator.⁴⁰³ The interim moratorium applies where an administration application has been made and the application has not yet been granted or dismissed, or the application has been granted but the administration order has not yet taken effect.⁴⁰⁴ The moratorium comes creates an absolute moratorium upon the winding-up of the company in administration.⁴⁰⁵ The moratorium automatically applies for the duration of the administration proceedings.⁴⁰⁶

Once again the United kingdom`s provisions are clear and protect the company systematically through the entire process ensuring maximum security for company. The Australian provisions focus heavily on creditor rights placing the moratorium in the position

⁴⁰² Corporations Act 50 of 2001 volume 2 section 441(A),(B),(C),(F).

⁴⁰³ Paragraph 27(1) of schedule B1 to the Insolvency Act 1986.

⁴⁰⁴ Paragraph 44(1)(a)-(b) of Schedule B1 to the Insolvency Act 1986.

⁴⁰⁵ Paragraph 42 of Schedule B1 to the Insolvency Act 1986.

⁴⁰⁶ Loubser 195.

where it may fall short of achieving its desired purpose. The South African provisions are not as succinct as the United Kingdom's but offer better protection for the debtor company.

4.3 Post-commencement finance

Australia: The administrator's right to indemnity out of the company's property for remuneration and personal liability for debts have priority over all the company's unsecured debts.⁴⁰⁷ Debts and claims must be paid in priority to all other unsecured debts, and claims, starting with expenses properly incurred by a relevant authority in preserving, realising or getting in property of the company, or in carrying on the company's business.

South Africa: Employee wages and salaries have a preferential claim after the remuneration of the business rescue practitioner has been paid out.⁴⁰⁸ The South African Companies Act 71 of 2008 purports to protect the employees in the ailing company. This may have an adverse effect to those who would wish to finance the company, in terms of loans, goods or services provided. Although their claims may be substantial, they will not confer any preference or priority before the employee's claims.

The United Kingdom: Preferential debts rank equally among themselves after the expenses of the administration and shall be paid in full, unless the assets are insufficient to meet them, in which case they shall be distributed in equal proportion.⁴⁰⁹ A payment may not be made by way of distribution under this paragraph to a creditor who is neither secured nor preferential unless the court gives permission.⁴¹⁰

The Australian prospective is more attractive to creditors and financiers alike as it provides assurances, guarantees the creditor of a return and places a preference in the claim through the administrator being personally liable for the expenses he or she incurs in the ordinary course of business. Creditors are assured of payment. The South African position however places the rights of the employees at the top of the objectives. This preferential treatment is in the furtherance of the objectives of business rescue as seen in the general treatment of employees in the Companies Act 71 of 2008. This may prove to be extremely detrimental to

⁴⁰⁷ Anderson and Morrison 21.

⁴⁰⁸ Section 135 (3) of the Companies Act 71 of 2008.

⁴⁰⁹ Paragraph 65(1) and (2) of Schedule B1 to the Insolvency Act 1986; Section 175 shall apply in relation to a distribution under this paragraph as it applies in relation to the winding-up of a company.

⁴¹⁰ Paragraph 65 (3) of Schedule B1 to the Insolvency Act 1986.

the company as creditors may be hesitant to provide finance in a situation where there is high risk, as the same creditors may not receive payment of the capital they put into the company.

4.4 The qualifications and appointment of the administrator and business rescue practitioner

Australia: The administrator must not consent to be appointed, and must not act as an administrator of a company, if that person is not a registered liquidator.⁴¹¹ This would denote that the administrator is a natural person.⁴¹² The administrative process can include more than one administrator through the appointment of joint administrators to perform their duties.⁴¹³ The administrator however has more of an incentive to see to it that the administration has a successful outcome as he or she acts as an agent of the company becoming personally liable for the debts of the company incurred in the performance of his or her function and powers, in respect of services rendered, goods bought and property used or hired.⁴¹⁴ This will create a reasonable assurance to the creditors guaranteeing and providing certainty of a return.⁴¹⁵

South Africa: In terms of the Companies Act 71 of 2008, a business rescue practitioner must be an individual that is a member of good standing of a legal, accounting or business management profession.⁴¹⁶ In order to ensure that practitioners possess sufficient human financial resources and adequate procedural skills, all practitioners are to be issued with licences in order to practise.⁴¹⁷ This will ensure that every company will receive a qualified business rescue practitioner that will improve its chances of becoming a successful concern. The business practitioner does not have to furnish any form of security. The board of the company in which the practitioner will be working, should furnish security for the value of the assets.⁴¹⁸ This, as is seen from an Australian perspective, will give creditors a form of assurance.

The United Kingdom: The United Kingdom maintains a very strict regulatory system that is seen to qualify administrators to the highest standards as between all three countries. An

⁴¹¹ Corporations Act 50 of 2001 volume 2 section 448 B.

⁴¹² Bradstreet "Exploring the Possibility of a Composite Business Rescue Practitioner" *De Rebus* (2010) 48.

⁴¹³ Corporations Act 50 of 2001 volume 2 section 451 B.

⁴¹⁴ Anderson and Morrison 19.

⁴¹⁵ *Ibid.*

⁴¹⁶ Section 138 (1) (a) of the Companies Act of 2008.

⁴¹⁷ Section 138 (1) (2) (a)-(c) of the Companies Act of 2008.

⁴¹⁸ Bradstreet 2010 *De Rebus* 48.

administrator that acts without the required qualifications commits an offence and may face either imprisonment or a fine and in some cases both forms of punishment can be sanctioned.⁴¹⁹ Every administrator must be a member to a recognised professional body that regulates and ensures that all the administrators have the necessary background educational and experience to perform their jobs effectively.⁴²⁰ Those who do not form part of a recognised professional body must be authorised to practise by the secretary of state.⁴²¹ The standards of all the administrators are kept level through the mandatory examinations set by the joint Insolvency Examining Board.⁴²²

. The United Kingdom has set a high standard that South Africa could learn from. The centralised testing model to which that practitioners are subjected to, allows regulators to know that the relevant skills and knowledge are present in each and every business rescue practitioner. This creates uniformity and allows for companies to maintain an expectation of all practitioners that they will have the necessary expertise to deal with whatever may come their way. This is pivotal in creating a confidence and reliance on the procedure. South Africa would greatly benefit from this as business rescue would require as much goodwill as possible, displacing the lack of confidence in judicial management created in most companies due to its lack of efficiency and success in terms of business rescue.

4.5 Debtor in possession

Australia: The administrator will act as the company's agent when performing his functions and exercising his or her powers.⁴²³ For the time that the company is under administration, all other officers of the company must not purport to perform or exercise a function or power as an officer or provisional liquidator of the company.⁴²⁴ Without express written approval all officers are automatically suspended.⁴²⁵ The rationale behind this is that the same management that led the company into the present financial situation should not be to maintain influence or control over the company.⁴²⁶

⁴¹⁹ Section 389 (1) of the Insolvency Act 1986.

⁴²⁰ Section 391(2) of the insolvency Act 1986.

⁴²¹ Loubser 198.

⁴²² Finch 336.

⁴²³ Corporations Act 50 of 2001 volume 2 section 437 B.

⁴²⁴ Corporations Act 50 of 2001 volume 2 section 437 C.

⁴²⁵ Anderson and Morrison 12.

⁴²⁶ Ibid.

South Africa: In terms of the Companies Act 71 of 2008, for the time of the proceedings, the directors must continue to exercise their powers as directors subject to the authority of the practitioner.⁴²⁷ This is seen as “debtor in possession.”⁴²⁸ The practitioner will have full control of the company, and have the management available for consultation and guidance. This would be of advantage to the administrator as he or she will not have to spend time and resources in becoming familiar with the company and the dynamics of how things are run.

The United Kingdom: The directors and management are not automatically removed from office and maintain their powers as organs if the company subject to restrictions on their powers.⁴²⁹ The management powers of the directors in terms of their ordinary powers are suspended, but they are however not precluded from their statutory duties such as, filing annual returns and the convening of the annual general meeting.⁴³⁰ The level of uncertainty of directors and management powers compounded with the ever-present risk of personal liability may influence directors to postpone the commencement of the administrative process.⁴³¹ The continuance of the statutory duties that they maintain may help in reducing the responsibilities of the administrator and in turn allow him or her to focus on the recovery of the business.

There are two sides to this aspect of business rescue. The first would be that, allowing the a company`s directors to maintain influence would allow for a smoother and more efficient rescue, as the practitioner would have the guidance and presence of the management under his or her control to effect whatever changes he or she may deem to be just. The other would be that the directors that placed the company in such a position should no longer retain any such influence on the company. The first perspective would be the better option as the practitioner will maintain full control and work together with directors that he or she will leave in charge after he or she has completed the task. This has good long term effects in that it allows the management to see where there mistakes were made and prevent them from taking the same pitfalls again.

⁴²⁷ Section 137 (2) (a) the Companies Act of 2008.

⁴²⁸ This is when the management of the company are not suspended, but remain in the management of the company assisted the business rescue practitioner in their operations.

⁴²⁹ Paragraph 64(1) of Schedule B1 to the Insolvency Act 1986.

⁴²⁹ Loubser 195.

⁴³⁰ Bailey and Groves 393.

⁴³¹ Loubser 221.

4.6 Uncompleted contracts

Australia: In terms of prior agreements, where the company has entered into an agreement prior to the administrative order, the administrator has seven days within which to decide whether or not to continue to use, occupy or possess the property. Unless the administrator gives prior notice to the owner or lessor of the property within seven days after the administration commences, the administrator will become personally liable for the subsequent amounts due under the agreement.⁴³² In terms of section 443 B⁴³³ the administrator is not personally liable to the owner of trading stock supplied to the company prior to the administration of the company.⁴³⁴ The owners of such stock must attempt to negotiate a satisfactory arrangement with the administrator in relation to the proceeds of sale or seek the leave of the court to repossess the stock.⁴³⁵

South Africa: In view of the latest amendments to the Companies Act, the business rescue practitioner must urgently apply to a court to entirely, partially or conditionally cancel, on any terms that are just and reasonable in the circumstances, any obligation of the company. He does not become personally liable as the Australian administrator does. This may serve as a hindrance as business practitioners will be deterred by the fact that they will incur personal liability through the ordinary running of the company.

The United Kingdom: In terms of a charged property and floating charges, the administrator of a company may dispose of or take action relating to property which is subject to a floating charge as if it were not subject to the charge.⁴³⁶ The holder shall therefore have the same priority in respect of acquired property as he or she had in respect of the property disposed of. The court may by order enable the administrator of a company to dispose of property which is subject to some form of security (other than a floating charge) as if it were not subject to the security.⁴³⁷ The court may also by order enable the administrator of a company to dispose of goods which are in the possession of the company under hire-purchase agreement as if all the rights of the owner under the agreement were vested in the company.⁴³⁸

⁴³² Anderson and Morrison 21.

⁴³³ Corporations Act 50 of 2001 volume 2 section 443 B.

⁴³⁴ Corporations Act 50 of 2001 volume 2 section 443 B.

⁴³⁵ Anderson and Morrison 21.

⁴³⁶ Paragraph 70(1) of Schedule B1 to the Insolvency Act 1986.

⁴³⁷ Paragraph 71 of Schedule B1 to the Insolvency Act 1986.

⁴³⁸ Paragraph 72 of Schedule B1 to the Insolvency Act 1986.

The South African position mandates the business practitioner to go through the courts. This circumvents any possible form of abuse and limits his or her powers in terms of uncompleted contracts. The courts in this situation do have necessary skill and expertise to deal with the legal parameters of the law of contract. However the courts' involvement would mean that there will be money used and time spent in adjudicating such matters. The Australian position would prove to be more cost and time effective. This is so due to the time lapse that automatically comes into effect after seven days preceding the commencement of the administrative order.

4.7 Voidable dispositions

Australia: An unfair preference is an unfair preference given by a company to a creditor of the company if and only if and the creditor and the company are party to a transaction that results in creditor receiving more than the creditor would receive from the company in respect of the debt if the transaction were set aside and the creditor were to prove the debt in a winding-up of the company.⁴³⁹ Section 588FE (2)-(6)⁴⁴⁰ gives an exposition of the different specific transactions that could be categorised as voidable transactions. On application, if the court is satisfied that a transaction of the company is voidable because of section 588 FE, the court may direct that individual to pay the value of the transaction, make an order transferring property back so as to reverse the voidable transaction, or make an order for the payment of an amount that would reasonably represent the benefit that was given, or the court may void the agreement from the date it was concluded or vary such an agreement in the way that the court may deem just and equitable.⁴⁴¹

South Africa: As regards voidable transactions, or the failure by the company or any director to perform any material obligation relating to the company, the practitioner must take any necessary steps to rectify the matter.⁴⁴²

The Companies Act 71 of 2008 does not give the same detailed description as the Australian provision does of what and how voidable transactions can be identified.

⁴³⁹ Corporations Act 50 of 2001 volume 2 section 588 FE.

⁴⁴⁰ Corporations Act 50 of 2001 volume 2 section 588FE (2)-(6).

⁴⁴¹ Corporations Act 50 of 2001 volume 2 section 588FF (1) (a)-(j).

⁴⁴² Section 141 No. 3 of 2011: Companies Amendment Act, 2011.

The United Kingdom: Where an individual carries out transactions that defraud creditors, the court may if satisfied make an order to restore the position to what it would have been if the transaction had not been entered into and to protect the interests of persons who are victims of the transaction.⁴⁴³

The Australian position is thorough in its treatment of how and what voidable disposition are. The South African position could be improved by the adoption of a similar provision as seen in Australian system. A full description of what forms a voidable disposition will make interpretation easier for practitioners.

4.8 Duration of Proceedings

Australia: The administration of a company will come to an end upon the occurrence of the specified circumstances that may occur in section 435C (3).⁴⁴⁴ Subject to the discretion of the court, an administration order could last up to a period of four months.⁴⁴⁵

South Africa: In South Africa if the company`s business rescue proceedings have not ended within three months after the start of those proceedings, or such longer time as the court may allow, on application by the practitioner, in which he or she must prepare a report on the progress of the business rescue proceedings and give an update at the end of each subsequent month until the proceedings have come to an end. He or she must deliver the reports and the updates to each affected person, court and the Commission.⁴⁴⁶

The United Kingdom: The administration process commences on the appointment of the administrator. It can therefore be assumed that the process will concurrently for the same duration of the administrator`s tenure. The appointment of an administrator shall cease to have effect at the end of the period of one year beginning from the date on which it takes effect.⁴⁴⁷ The administrator`s term of office may be extended through an application of the administrator by the court for a specified time, but not for a period exceeding six months.⁴⁴⁸

⁴⁴³ Section 423(2) of the Insolvency Act 1986.

⁴⁴⁴ Anderson and Morrison 11.

⁴⁴⁵ Ibid.

⁴⁴⁶ Section 132(3) of the Companies Act 71 of 2008.

⁴⁴⁷ Paragraph 76(1) of Schedule B1 to the Insolvency Act 1986.

⁴⁴⁸ Paragraph 76(2)(a) –(b) of Schedule B1 to the Insolvency Act 1986.

The reason for this short period in which the administration is prescribed, is due to the fact that, the procedure is not seen as an end itself but a facilitative procedure to give the company some protection while a rescue strategy can be formulated.⁴⁴⁹

The duration of the proceedings is a decisive element in the planning of the entire process. A balance needs to be struck between providing enough time for the practitioner and business rescue proceedings to come into full effect and not giving too much time to the entire process so as to incur further costs in the rescue process. The South African position strikes a balance between both these points and ensures that the process is not dragged out.

4.9 Discharge

Australia: In Australia the extent of release of company debts is that a deed of company arrangement releases the company from a debt only in so far as the deed provides for the release and the creditor concerned is bound by the deed.

South Africa: In terms of the South African regime, if the business rescue plan has been approved and implemented, a creditor is precluded from enforcing any debt owed by the company immediately before the beginning of the business rescue process, except to the extent provided for in the business rescue plan.⁴⁵⁰ A creditor who has acceded to the discharge of the whole or part of a debt owing to that creditor will lose the right to enforce the relevant debt or any part of it.

The United Kingdom: Discharge of the administration order occurs where the administration ends or where the court makes an order under schedule B1 providing for the appointment of the administrator of a company to cease to have effect.⁴⁵¹ It is at this point the court discharges the administration order.⁴⁵²

It is unclear from all three pieces of legislation where the position will be if the business rescue plan does not work out.

⁴⁴⁹ Loubser 213.

⁴⁵⁰ Section 154 of the Companies Act 71 of 2008.

⁴⁵¹ Paragraph 85(1) (a)-(b) of Schedule B1 to the Insolvency Act 1986.

⁴⁵² Paragraph 85(2) of Schedule B1 to the Insolvency Act 1986.

5 Conclusions

The Australian business rescue system has undergone had the same developments as experienced in South Africa. It has adopted what may be seen as a more reliable and effective regime in terms of business rescue. It however faces the same problem that South Africa faces in that administration needs to establish itself as being a reliable and sustainable mode of business rescue.

The initial introduction of administration in the United Kingdom was accompanied by scepticism as they drew similarities as it was seen as a related rehabilitative procedure that was ineffective and not trusted.⁴⁵³ The amendments effected by the Enterprise Act 2002 have removed certain shortcomings ultimately helping administration in its attempt to become successful as a procedure.⁴⁵⁴

The power of the directors to appoint an administrator directly, without the involvement of the courts, has resulted in the administrative process becoming more user-friendly and efficient for rescuing companies.⁴⁵⁵ The introduction of a less formal procedure for the company and its directors to commence administration is therefore of particular importance to the South African legal regime as it has the intended result of encouraging directors to act as early as possible to avoid as much damage as possible.⁴⁵⁶

The automatic, interim and final moratorium in terms of administration allows automatic protection throughout the entire process, whereas in terms of judicial management an order can be executed without the moratorium being approved, which ultimately poses a real threat to the success of the procedure in terms of legal action being taken against the company.

South African business rescue can take the strengths of both Australia and the United Kingdom, incorporating them into a complete system that would function to the benefit of South African companies.

⁴⁵³ Sealy and Milman 40.

⁴⁵⁴ Loubser 216.

⁴⁵⁵ Loubser 217 and Finch 393; She mentions how statistics indicate that the out of court procedures for the appointment of an administrator was an immediate success after the Enterprise Act 2002 came into effect.

⁴⁵⁶ Parry 172.

Chapter 5:

Conclusion

1 Concluding remarks

Judicial management was the primary form of business rescue in South Africa. The only other alternative was the liquidation of a company. Judicial management had the function of helping a company in financial distress to recover and become a successful concern once again. The procedure was a good stepping stone for business rescue, as it helped build a foundation for business rescue in the Companies Act of 2008. It was however costly, and time consuming due to the court being heavily involved in most of the process.

On evaluating judicial management there were several shortcomings that were discovered. These shortcomings as mentioned in the previous chapter played a pivotal role in the failure of judicial management. Judicial management, created a platform for business rescue in the Companies Act of 2008 by showing what would work and what would not work for a business in such circumstances.

The new Companies Act of 2008 introduced a more structured approach that gave a complete layout of the background, proposals and assumptions in the form of a business rescue plan. Business rescue in terms of the Companies Act of 2008 brought about the introduction of a business rescue practitioner, who had to maintain formal qualifications in order to practice. Contrasting business rescue from the new Act and judicial management highlighted the improvements that have been made to the Companies Act of 2008. The bettering of employee rights through the preference of claims and the access to initiate the process is but one of the many new additions to the Act.

On evaluating business rescue in terms of the Companies Act of 2008, it was seen that there were several shortcomings. A majority of these shortcomings have been addressed through the introduction of the Companies Amendment Act of 2011. Business rescue is a significant improvement from judicial management.

The comparative study on Australia, the United Kingdom and South Africa was necessary to assess whether South Africa has kept up with other international standards in terms of

business rescue. Both procedures in Australia and the United Kingdom have several similarities to the South Africa system of business rescue.

On evaluating the three countries, South Africa has kept up with the majority of the provisions maintained by Australia and the United Kingdom. However there are certain provisions in these countries that would benefit South Africa if implemented, such as the centralised testing for administrators in the United Kingdom. The testing may be costly but will ensure that all business practitioners would be equally competent and capable of performing their duties.

South Africa business rescue has grown from its predecessor judicial management. If implemented successfully business rescue will become a viable option that ailing companies will be willing to take in order to seek recovery for their companies.

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