

**BUSINESS RESCUE AND THE ABUSE THEREOF, WITH COMPROMISE WITH
CREDITORS AS AN ALTERNATIVE**

by

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Annexure F

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1. INTRODUCTION:

The aim of this dissertation is to analyse the formulation and application of business rescue proceedings in South Africa in comparison to the alternative of reaching a compromise with creditors. It aims to highlight the inadequacy of the wording of the Companies Act¹ and how it has created an opportunity for companies or related parties to abuse the business rescue process and for companies to avoid paying its debts.

An investigation is made into the loopholes of the Companies Act and how our courts have interpreted such situations and have formulated precedents which will regulate such situations. Focus is placed on contracts between the company and its creditors, the effect of business rescue on sureties and business rescue proceedings implemented during liquidation proceedings. A comparison will be struck between business rescue proceedings and a compromise with creditors as an alternative and which process is more appropriate for the company as well as its creditors. Lastly a comparison is made between the business rescue process in South Africa and Australia to highlight the inadequacy of the wording of the Companies Act as well as to demonstrate how a similar construct is applied in a different country.

All references to the ‘Companies Act’ or the ‘new Companies Act’ are to that of Act 71 of 2008, unless otherwise stated.

1.1 Operation of Chapter 6 of the Companies Act 71 of 2008:

The current business rescue system was introduced into our law by the enactment of the Companies Act which provides for business rescue procedure in Chapter 6 of the Act. A comparison of the business rescue system in the old Act² shows that the new Companies Act tends to veer away from the ‘credit-orientated’ approach the old Act adopted. The purpose of the system is to provide companies who are in financial distress a process of rehabilitation subject to the company passing the solvency and liquidity test. It further provides that a moratorium be issued to protect the company against claims from creditors or any third parties during the process.

The process can be done voluntarily by the company through an ordinary resolution, or by way of a court order that can be obtained by a shareholder, creditor, trade union or employee through a

¹ Act 71 of 2008

² Act 61 of 1973

formal application to court.³ However where the process is done voluntarily, interested parties may still oppose the process by asking the court to set aside the ordinary resolution.⁴ It is a requirement that the directors believe on reasonable grounds that the company is financially distressed in that the company will not be able to pay its debts as they become due and which will result in insolvency within the next 6 months, but there has to however appear to be a reasonable prospect of rescuing the business.⁵

As soon as the resolution is filed with the CIPC⁶ or a court order is granted, a qualified rescue practitioner is appointed. The practitioner is to oversee the operations of the company and to formulate a plan which aims to maximize the likelihood of the company achieving solvency, or in the alternative to provide a better return to creditors and shareholders should the company be liquidated. Where the plan is accepted by the creditors and where applicable the shareholders, the formal process is terminated, however where the plan is not accepted, the employees, creditors and shareholders may make an offer to other stakeholders who opposed the plan to purchase their interests.

The purpose of the Act and especially chapter 6 thereof is to give effect to the efficient rescue and recovery of financially distressed companies, in a manner which balances the rights and interests of all interested stakeholders⁷.

1.2 Basic application of business rescue principles with regard to recent case law:

Chapter 6 of the new Companies Act provides that a company can be put under business rescue involuntarily when an effected person makes such an application to court. The normal requirements are set out in s131 of the Act. However the matter of *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd*⁸ provided a higher threshold that needs to be met before a court will grant an order that will put a company in business rescue. The court mentioned the requirements of s131:

³ s129 and s131

⁴ s130

⁵ s128(1)(f)

⁶ Companies Intellectual Property Commission

⁷ s7(k) of Act 71 of 2008

⁸ 2012 (2) SA 423 (WCC)

‘In terms of section 131(4) of the new Act, a Court may make an order placing a company under supervision and commencing business rescue proceedings if the Court is satisfied that:

- 19.1. the company is financially distressed;
- 19.2. the company has failed to pay over any amount in terms of an obligation under or in terms of a public regulation, or contract, with respect to employment-related matters; or
- 19.3. it is otherwise just and equitable to do so for financial reasons, and there is a reasonable prospect for rescuing the company, or, it may dismiss the application together with any further necessary and appropriate orders, including an order placing the company under liquidation.’

The court then considered the term ‘reasonable prospect’ and referred back to the operation of the old Act⁹ in terms of s472(1) which uses the term “reasonable probability” instead of “reasonable prospect”. The court stated that:

‘The use of different language in this latter provision indicates that something less is required than that the recovery should be a reasonable probability. Moreover, the mind-set reflected in various cases dealing with judicial management applications in respect of the recovery requirement was that, prima facie, the creditor was entitled to a liquidation order, and that only in exceptional circumstances would a judicial management order be granted. The approach to business rescue in the new Act is the opposite - business rescue is preferred to liquidation.’

The learned judge further stated that even if the court uses its discretion in granting or dismissing the application considering the lower subjective test:

‘...the Court should give due weight to the legislative preference for rescuing ailing companies if such a course is reasonably possible. It would therefore be inappropriate for a Court faced with a business rescue application to maintain the mind-set (from the earlier regime) that a creditor is entitled ex debito justitiae to be paid or to have the company liquidated.’

The latest case regarding business rescue proceedings regarded the status of legal proceedings against the company where the third party initiating such proceedings doesn’t know the company is undergoing business rescue. In *Chetty v Hart*¹⁰ the court regarded the meaning of the term ‘legal

⁹ Act 61 of 1973

¹⁰ [2015] 4 All SA 401 (SCA)

proceedings' and found that it had a broad meaning which included arbitration proceedings. Emphasis was placed on s142(3)(b) of the Act which provides that the company has a duty to inform the business rescue practitioner of all court, arbitration and administrative proceedings the company is involved in. It therefore follows that companies undergoing business rescue proceedings have a duty to inform litigating parties of its status.

Questions that were regarded by the court was whether the failure by the individual to seek and obtain the business rescue practitioner's consent before continuing with the arbitration is fatal to the outcome of the arbitration. And secondly should the arbitration be invalidated due to the lack of consent from the business rescue practitioner? The court stated that the arbitrator derived his jurisdiction to adjudicate over the matter from the arbitration agreement and not the Act. The Act merely placed a moratorium on a third party from instituting action against a company undergoing business rescue, it does however not invalidate the proceedings. Consideration was given to s133 of the Act and it was decided that as the section gives leave to a creditor to approach a court for permission to institute action against a company under business rescue proceedings with or without the permission of the business rescue practitioner¹¹ he would be free to do so for arbitration as well. Further it seems that the operation of s133 of the Act is only for the use of the company and the business rescue practitioner and not third parties or litigants.

The last question considered by the court is whether the company can continue with legal proceedings against an individual or legal entity while being under business rescue, while disallowing its opposing party to continue with its legal proceedings against the company? The court found that as s133 was solely meant for the company and the business rescue practitioner that they could preclude the opposing party from instituting proceedings against it. The opposing party may however still approach the court for leave to continue with its legal proceedings and further in terms of s133(1)(c) and the party may set-off a claim by the company in legal proceedings commenced before and during the moratorium.

¹¹ Section 133(1)(b) of Act 71 of 2008

2. *SHORTCOMINGS AND ABUSE OF CHAPTER 6:*

Chapter 6 of the Act contains several restrictions against third parties including creditors from instituting action against the company, its property, property in its possession during the course of business rescue proceedings, subject to certain exceptions¹². The exceptions are where the business practitioner consents to the proceedings being commenced; the court may grant leave for the proceedings to be commenced; a set-off claim may be exercised where the company institutes legal proceedings; criminal proceedings are instituted against the directors or officers of the company; and proceedings in respect of property rights where the company acts as a trustee. Similarly where someone signed as a surety on behalf of the company or gave a guarantee on behalf of the company, legal proceedings may not be commenced against that person unless the court finds just and equitable cause to do so.

A business rescue practitioner may cancel or suspend entirely, partially or conditionally any provision of any agreement despite any contrary provisions in the agreement¹³ to which the company is a party at the time of the business rescue, apart from its employment contracts. A party to such an agreement may then only pursue an action against the company in respect of damages¹⁴ and the party cannot claim enforcement in terms of the agreement. This right is subject to the provisions of the Insolvency Act¹⁵ which deals with set-off and netting. Therefore a business rescue practitioner can uphold those provisions of a contract that call on a contractual counterparty to continue supplying goods, and at the same time cancel the reciprocal obligation to pay for the goods supplied. An amendment bill has however been proposed that provides that the practitioner may only suspend, for the duration of the business-rescue proceedings, an obligation of the company, and that a cancellation can take place only upon application to court. The court would have to be satisfied that a cancellation is just and equitable.¹⁶

The Act further provides that companies may dispose of its property in the course of business rescue proceedings if it's done in a *bona fide* transaction at arm's length for the fair value approved

¹² s133

¹³ s136(2)

¹⁴ s136(3)

¹⁵ Act 24 of 1936

¹⁶ (2010) 1 Business Tax and Company Law Quarterly 19 at 21

in advance by the business practitioner or the business rescue plan¹⁷. It is provided that the business rescue practitioner's consent may not be unreasonably withheld.¹⁸

Among the above mentioned problems are numerous other problems the courts have had to decide on due to the inadequacy of the wording of Chapter 6. Among those problems the courts have had to decide on matters concerning the right of a surety during business rescue, the rights of creditors to vote against the business rescue plan and the implications thereof and the effect of cancellation of a lease agreement during business rescue proceedings. These problems will be discussed below.

2.1. *Sureties and property held as security:*

Courts have recently debated the situation of creditor's claims against a surety where the company is under business rescue. The latest decision of the Supreme Court of Appeal in *New Port Finance Company (Pty) Ltd v Nedbank Limited*¹⁹ stated that where the deed of surety is drafted in such a way as to cater for the eventuality of the principle debtor comprising or rearranging its debts with its creditors, then third parties may elect to proceed with action against such sureties regardless of whether the company is under business rescue. This decision confirms that creditor's rights against sureties remain unaffected by business rescue proceedings where the deed of surety specifically provides for such proceedings. However, where the deed does not provide for such proceedings, the earlier judgment of *Tuning Fork (Pty) Ltd t/a Balanced Audio v Greef and another*²⁰ applies which states that where the principle debt is discharged by a compromise with or by the release of the principle debtor, the surety is released unless the deed of suretyship provides otherwise.

Where a company wishes to dispose of any property in which a third party has a security or title interest, the company must obtain the prior consent of the third party before proceeding with the sale, unless the proceeds of the sale will be enough to discharge the company's indebtedness protected by the security or title interest.²¹ The sale proceeds must then be promptly paid to the third party to discharge the debt of the company to such party. The third party's rights should therefore be protected by this arrangement and the company cannot decide to prefer another

¹⁷ s134(1)(a)(ii) and (iii)

¹⁸ s134(2)

¹⁹ 2014 JDR 2547 (SCA)

²⁰ 2014 (4) SA 521 (WCC)

²¹ s134(3)(a) and (b)

creditor by settling its debts with that creditor with the proceeds of the sale. A problem with this provision however arises in the fact that the third party will not be able to call up its security but will have to await the outcome of the business rescue process.

2.2 *Creditor's right to vote against the Business Rescue Plan:*

Creditors are entitled to a notice of all court proceedings, decisions, meetings and other relevant events concerning the business rescue proceedings²². They may vote to amend, approve or reject a business rescue proposal and where the plan is rejected to propose the development of an alternative plan or to offer to acquire the interests of other creditors. The creditors may form a creditors' committee with whom the business rescue practitioner will consult regarding the business rescue plan and proceedings²³.

A problem however comes in where the plan proposed by the business rescue practitioner is rejected and the business practitioner enacts s153(1)(a)(ii) of the Act whereby the company can apply to court to have the decision made to reject the proposal set aside on the basis that the decision was inappropriate. A high threshold of creditors need to approve the business rescue plan²⁴ and if such a vote will affect the shareholders' interests, then 50% of their vote is required. The problem lies with the fact that the word 'inappropriate' is not defined in the Act and its left to the court to determine what constitutes 'inappropriate'. The court however needs to comply with s153(7) and s158 of the Act before it may set aside the creditor's vote against the business rescue plan.

A recent decision of *Senwes Limited v Zellenhen Boerdery CC and Others; Zellehen Boerdery CC v Senwes Ltd*²⁵ where the learned judge Molefe had to determine whether a secured creditor's decision to vote against the adoption of the business rescue plan was deemed to be inappropriate. At paragraph [19] the judge refers to the factors which need to be considered by the court in the subsection of the Act as:

"(a) the interests represented by the person or persons who voted against the proposed business rescue plan;

²² s145(1)(a) to (d)

²³ s145(3)

²⁴ s152(2)

²⁵ [2016] ZAGPPHC 373

- (b) *the provision, if any, made in the proposed business rescue plan with respect to the interest of that person or persons; and*
- (c) *a fair and reasonable estimate of the return to that person or those persons if the company were to be liquidated".¹*

The reasons why the secured creditor, namely Senwes voted against the adoption of the plan was because Senwes was a substantial creditor of the business undergoing business rescue and procured security from the business which included a cession by the business to Senwes of the proceeds of its existing and future crops, mortgage bonds over the business's farms; and members of the business bound themselves as sureties in favour of Senwes for payment of the business's debts.

'Senwes was concerned that in the proposed plan, its security, the proceeds from the crops, was earmarked to be utilized to cover the CC's operating costs. Senwes recorded at the meeting that if an agreement or an arrangement could be arrived at in order to preserve Senwes' security, then Senwes will support the plan. The BRPs were not prepared to accept the suggestion and indicated that the crops are necessary to pay for the expenses of the CC.'²⁶

Counsel on behalf of Senwes referred to s134(3) of the Act which requires that prior consent be obtained by persons having any security over or interest in a property before it may be disposed of during business rescue proceedings and that such persons should be compensated or given security for the value lost. The court agreed and stated:

'I agree with the submissions made by counsel for Senwes that the utilization of Senwes cession security by the BRPs to pay for risky and substantial business expenses clearly flies in the face of the provisions of section 134 (3). In my opinion there is no merit in the BRPs argument that the mere existence of additional security entitled them to dissipate Senwes' cession security. Furthermore, I do not agree with the submission made by the CC's counsel that "property" as referred to in section 134 (3) does not include the harvest of the CC's farming enterprise'.²⁷

²⁶ At [10]

²⁷ At [22]

‘There is nothing in section 134 (3) of the Act that suggests or indicates that a secured creditor can be compelled to surrender his security. It is inconceivable to view a vote against the plan to be inappropriate, if the bona fide belief is that the plan entails a risk for security.’²⁸

‘In my view, the legislature did not intend section 143 (5) to override section 134 (3) of the Act, otherwise section 134 (3) which affords protection to a secured creditor, would be rendered nugatory. It could never have been the intention of the legislature to frustrate a secured creditor by ensnaring the secured creditor in a long business rescue process coupled with the uncertainty and speculation as to whether or not the secured creditor is ultimately going to be paid. If the secured creditor is not prepared to indulge itself in such a risk it can surely not be said that its vote against such an uncertain risky plan is an inappropriate vote.’²⁹

Accordingly the court found that the vote against the business rescue plan was made in good faith, the business was factually insolvent and as such the business was liquidated, however the court did not define the term ‘inappropriate’.

The act does not define the term ‘inappropriate’ in terms of s135(1)(a)(ii) of the Act where creditors vote against the adoption of the business rescue plan. The matter of what may constitute ‘inappropriate’ has been considered in *Advanced Business Technologies & Engineering Company v Aeronautique et Technologies*³⁰ by the honourable Tuchten J. He noted that the term is not defined in the Act and it is unclear what the legislature’s intention is. However a proposed scheme was formulated stating that the court must first determine whether the result of the vote, as at the date of the vote, was inappropriate; If it has not been shown to have been inappropriate, then the relief applied for will not be granted; If however the conclusion is that the result of the vote has indeed been shown to have been inappropriate, then the court must proceed to determine whether it is satisfied that it is reasonable and just to order that the vote be set aside. What will be considered by the court in terms of what constitutes its decision as just and reasonable is not limited to what influenced the voter or voters to vote as they did or what was available on the day the vote was taken.

Unfortunately the judgment did very little to define what constitutes ‘inappropriate’. And it was later discovered that the process proposed by s153(1)(a) of the Act may cause additional costs

²⁸ At [27]

²⁹ At [31]

³⁰ 2012 JDR 0345 (GNP)

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and lead to a business rescue practitioner wasting time on litigation rather than investing time in constructing a new business rescue plan that will suit all of the parties. This matter was pointed out in the judgment of *Nedbank Limited v Bestvest 153 (Proprietary) Limited*³¹ by the honourable Gamble J.

The process of setting aside the vote of the creditors may have the result of placing high emphasis on the rights of other parties. Courts need to have consideration to s7(k) of the Act which states that the purpose of the Act is

‘...to provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders’

Before setting aside the vote of the creditors. The term ‘inappropriate’ in terms of section 153(1)(a) therefore remains undefined.

2.3 *The effect of cancelling a Lease Agreement during Business Rescue:*

An interesting predicament comes to light where the creditor is a lessor and concluded a lease agreement with the company undergoing business rescue. Case law suggests that the lessor will be entitled to cancel the lease during the business rescue proceedings.

In the matter of *178 Stamfordhill CC v Velvet Star Entertainment CC*³² the business rescue practitioners advised the Lessors of the property which the business purported to run its business from would be suspended to which the lessors replied and demanded that the leased premises be returned. A letter of cancellation of the lease was then sent which was clearly after the commencement of the business rescue process. The question was therefore posed whether a lessor is entitled to cancel a lease after the business had entered business rescue proceedings. The learned judge agreed with the lessor in stating the following:

‘Mr Kemp submitted that it was competent for the applicant to cancel the lease and seek the ejection of the respondent. The position of the BRPs vis-à-vis the contract is akin to that of a liquidator of a company in liquidation or a trustee in insolvency. On the authority of *Ellerine Brothers (Pty) Ltd v McCarthy Ltd* 2014 (4) SA 22 (SCA) and *Porteous v Strydom* NO 1984 (2) SA 489 (D),

³¹ 2012 (5) SA 497 (WCC)

³² [2015] ZAKZDHC 34

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notwithstanding the establishment of a concursus creditorum, a contract with the respondent can be cancelled. The lease survives the concursus creditorum and the rights and obligations of both parties to the contract remain in existence, and insofar as the obligations of the insolvent in terms of the contract are concerned, the trustee steps into the insolvent's shoes. The trustee is obliged to perform whatever is required of the insolvent in terms of the contract, including unfulfilled past obligations of the insolvent. The contract is neither terminated nor modified nor in any way altered by the insolvency of one of the parties, except in one respect, and that is because of the supervening concursus, the trustee cannot be compelled by the other party to perform the contract. The so-called suspension of the lease cannot amount to anything more than the BRPs' right not to be compelled to perform in terms of the contract. Mr Kemp submitted that this did not permit the BRPs to remain in occupation of the property, for the respondent to continue trading, as it apparently was in February 2015, and not honour its obligation to pay rent. It had to honour its obligations in terms of the contract incurred prior to the business rescue proceedings commencing, and as it had not done so, the applicant was entitled to cancel the contract. I agree with Mr Kemp's submissions in this regard.³³

What the court failed to address was whether 'eviction' constitutes enforcement action in terms of the Companies Act and if not what constitutes 'enforcement action'.

In order for a party to be successfully evicted from a property, court intervention is needed in the form of an eviction order. However it would seem quite clear that a court's intervention to enforce a party's right would constitute an enforcement action.

It would seem from the case law that as the moratorium in terms of the Act specifically prohibits any enforcement action by creditors during business rescue proceedings that eviction would not constitute such an action. That however leaves creditors in the predicament of not knowing whether other actions which require legal intervention would constitute enforcement action in terms of the Act. Common law remedies such as defamation and spoliation are then grey areas in terms of the moratorium. A proper definition of what constitutes 'enforcement action' would be needed in the Act to give clarity on these circumstances.

The aspect of eviction during business rescue proceedings was similarly discussed in the more recent matter of *Kythera Court v Le Rendez-Vous Cafe CC and Another*³⁴ where the judge found that there was sufficient ground to evict the business undergoing business rescue proceedings and

³³ At [27]

³⁴ [2016] ZAGPPHC 172

that it was abusing the business rescue proceedings by unlawfully remaining on the premises and operating its business without making any rental payments or any other charges. The judge accepted that as a lease agreement may be cancelled during business rescue proceedings, it follows that an eviction may similarly be ordered during such proceedings. This cannot be correct in my opinion and the judge still fails to state whether ‘eviction’ which can only be acquired through court order constitutes an enforcement action.

The Judge referred to the leading case of *Cloete Murray & Another NNO v Firstrand Bank Ltd t/a Wesbank 2015 (3) SA 438 (SCA) para [33]* regarding the right of a lessor to cancel a lease agreement whilst the lessee is undergoing business rescue proceedings and that the cancellation of a lease does not constitute “enforcement action” in terms of section 133(1) of the Companies Act. The learned judge stated that the moratorium would not exclude all rights of a creditor against the company undergoing business rescue as that would render the wording of section 136(2) of the Act superfluous. Section 136(2) gives the business rescue practitioner the “right to entirely, partially or conditionally suspend any obligation of the company arising under an extant agreement.” Therefore if section 133(1) already has the effect that rights and obligations are frozen upon the commencement of business rescue, there would have been no need for the legislature to incorporate section 136(2) in the Act. Section 136(2) of the Act provides that:

‘Subject to sections subsection (2A), and despite any provision of an agreement to the contrary, during business rescue proceedings, the practitioner may—

- a) Entirely, partially or conditionally suspend, for the duration of the business rescue proceedings, any obligation of the company that-
 - i) arises under an agreement to which the company was a party at the commencement of the business rescue proceedings; and
 - ii) would otherwise become due during those proceedings; or
- b) apply urgently to a court to entirely, partially or conditionally cancel, on any terms that are just and reasonable in the circumstances, any obligation of the company contemplated in paragraph (a).’

In my respectful opinion the learned judge was incorrect in referring to section 136(2) with regards to lease agreements. The specific section relates to employee contracts and not contracts between the company and its creditors. If a lessor were to be able to cancel a lease contract with a business

undergoing business rescue it would defeat the whole point of business rescue as the business would in all likelihood be unable to conduct business from the premises and would therefore be unable to save its business.

Further the courts fail to distinguish between cancellation of a lease agreement and an application for eviction as two separate actions. Naturally an eviction will follow a cancellation of a lease, but the effect of the one is different to the effect of the other. By cancelling the lease agreement there no longer exist a right to the property or an obligation to pay a rental fee, but when a party is evicted from the property he is no longer able to operate from such a property. The courts as in the case of *Finlayson N.O and Others v Master Movers Cape CC and Others*³⁵ seem to automatically grant an order for eviction as soon as it finds that the lease agreement is validly cancelled without considering whether such eviction would constitute a further enforcement action.

2.4 *Abuse of Process:*

A real risk to creditors is that the company may enter business rescue proceedings even during the liquidation proceedings. In terms of s131(6) of the Act the business or an affected person may apply to court for the business to be placed under business rescue proceedings during the liquidation of that business and that the liquidation proceedings will be stayed pending the outcome of the business rescue application. The applicant in these circumstances will still need to prove the necessary averments in a standard business rescue application and such application will only suspend the liquidation proceedings once it has been issued and served on all the interested parties involved. Liquidators will then not be able to continue with the liquidation proceedings and creditors will have to wait for their claims to be finalized for a longer period. What becomes problematic is the question ‘when does liquidation proceedings commence’?

As mentioned previously, an interested party may apply to commence business rescue proceedings where the company or business is undergoing liquidation proceedings. The business rescue application will result in suspending the liquidation proceeding, however the Act does not provide when business rescue commences and when liquidation proceedings commences.

³⁵ [2016] ZAWCHC 96

Whether it will be stayed only after a final winding-up order has been granted or when an application is made to court to place the company under provisional liquidation.

Satchwell J in *Standard Bank of South Africa Limited v Gas 2 Liquids (Pty) Limited*³⁶ considered the question and it is evident from his judgment that as soon as a provisional liquidator has been appointed which is given effect by a provisional liquidation order, the liquidation process will have commenced and something can be suspended. He continues to state that only once the provisional liquidator has been served with the application for business rescue will he be in a position to suspend his activities, and as such, mere lodging of the application will not suspend liquidation proceedings, service on the provisional liquidator is required.

It seems that abuse of the business rescue proceedings most often take place where the business is undergoing liquidation and an affected person brings a business rescue application in terms of s133 of the Act which will have the effect of staying the liquidation proceedings.

‘The application must not be an abuse of process and should be brought in good faith and for a proper purpose ie for the “rescue” of the company...and not for an ulterior motive such as to suspend liquidation or for a personal benefit.’³⁷

In the latest judgment³⁸ in the Western Cape High Court Boqwana J presided over and dismissed an application in terms of s131 to place a business in business rescue. The application was made by an affected person but was opposed by ABSA Bank as an intervening party who alleged that the application constituted an abuse of process. The alleged abuse was that the applicant brought the application in an attempt to suspend liquidation proceedings of the company and to enable him to further unlawfully collect rental from the Company’s tenants.

The learned judge considered the purpose of instituting business rescue proceedings whilst the company is undergoing liquidation and referred to other judgments³⁹.

‘The object of the above provision has been articulated in many cases. As Binns-Ward J put it in *Koen & Another v Wedgewood Village Golf & Country Estate (Pty) Ltd and Others* 2012 (2) SA 378 at

³⁶ [2016] ZAGPJHC 38

³⁷ Henochsberg on the Companies Act 71 of 2008, Volume 1 at 464 (12)

³⁸ *Loots v Nongoma Medical Centre CC and Another* [2016] ZAWCHC 76

³⁹ At [26]

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382H-383A: *'[b]usiness rescue is intended to serve that public interest by providing a remedy directed at avoiding the deleterious consequences of liquidations in cases in which there is a reasonable prospect of salvaging the business of a company in financial distress, or of securing a better return to creditors than would probably be achieved in an immediate liquidation.'*

Further reference was made to the judgment of Gamble J in *Blue Star Holdings (Pty) Ltd v West Coast Oyster Growers CC 2013 (6) SA 540 (WCC)* at para 20 where the judge stated:

'a business rescue application might well be used by an obstructive debtor intent on avoiding the obviously inevitable as part of its ongoing strategy to hinder a creditor from pursuing its lawfully permissible goal, and, experience tells one that the business rescue proceedings may then be advanced by the debtor with a degree of tardiness inversely proportional to the alacrity with which it initially approached the court'

The judge found that the applicant had not met the requirements as set out in s133 of the Act and as such the application for business rescue was dismissed. The effect of the abuse amounted to a punitive cost order being granted against the applicant.

In the matter of *Griessel and Another v Lizemore and Others*⁴⁰ the court stated that 'good faith' is required where a company resolves to enter into business rescue proceedings. The learned judge commented as follows:

*'The most obvious is the requirement that there must be a legitimate business purpose in resolving to place the company under business rescue. Moreover a requirement of good faith is implicit in the scheme of Chapter 6 which seeks to balance the interests of affected parties including creditors and employees. The requirement for good faith is expressly mentioned in the context of a director who may be liable for costs under section 130(5) (c) if the directors resolution placing the company under business rescue is set aside and he fails to satisfy the court that he acted in good faith when claiming that the company was financially distressed. It is also mentioned in the case of a director who seeks to set aside a resolution he had supported under section 129 which placed the company under business rescue.'*⁴¹

⁴⁰ [2015] ZAGPJHC 189; [2015] 4 All SA 433 (GJ)

⁴¹ At [83]

‘In my view bad faith will be demonstrated if, for instance, the intention of the directors in passing a section 129(1) resolution is found to be an abuse. This would be considered in conjunction with other factors such as the attitude of major creditors, whether the company has assets, whether there are other sources of funding and, depending on the circumstances of the case, whether there was an intention to implement a business plan that meets the avowed objectives of the Act and a reasonable prospect of the plan being implemented.

The corollary is that a company should not be placed under business rescue as a litigating strategy or to prevent or discourage a creditor from enforcing a claim to the full extent. This brings into focus the intention of the party seeking business rescue and whether that person genuinely seeks to attain the objectives of Chapter 6. Good faith, or rather the lack of it, is therefore an essential element in determining what is just and equitable under section 130(5) (a) (ii).⁴²

In regarding the above the court set aside a resolution commencing business rescue as it found that the only active director of the board resolved to place the company under business rescue proceedings to suit his own personal needs, despite the fact that he was aware that the shareholders were raising substantial funding to cover the company’s debt and increase turnover and creditors were happy to assist the company financially. As a result the director who was cited in his own personal capacity along with the business rescue practitioner were held responsible for the cost of the application as the court found that the company itself should not be held responsible for the costs.

In the matter of *Absa Bank Limited v Caine N.O. and Another, In Re; Absa Bank Limited v Caine N.O. and Another*⁴³ the court was faced with numerous complaints and instances of abuse committed by the business rescue practitioner of the company. ABSA applied for the business rescue proceedings to be set aside or be declared void on the basis that the provisions of the Act were not being followed. From the facts of the case it was pretty clear that the appointed business rescue practitioners did not adhere to any of the prescribed time limits in publishing a business rescue plan or arranging creditors’ meetings. The business rescue practitioner further disposed of immovable property without publishing a business rescue plan or discussing it with the creditors and after the initial business rescue plan was not approved by the majority creditors, he amended

⁴² At [84]

⁴³ [2014] ZAFSHC 46

the business rescue plan without following proper procedure. ABSA argued that the proper procedure that should have been followed is that business rescue should have been terminated. The court regarded the relevant case law and statute keeping section 7 in mind, which provides for the provide for the efficient rescue and recovery of financially distressed companies in a manner that balances the rights and interests of relevant stakeholders. It first regarded the position where a company enters business rescue by way of resolution in terms of section 129 of the Act and reiterated the importance of the time limits prescribed for in terms of the Act.

‘It is apparent from s 129 that a company resolving to begin with business rescue proceedings is statutory obliged to comply with certain strict time limits pertaining to the publishing of the notice of the resolution and the appointment of the business rescue practitioner. S 129(5) clearly indicates that should a company fail to comply with any of the provisions of ss (3) or (4), its resolution to begin business rescue proceedings and place the company under supervision lapses and is a nullity.’⁴⁴

The court then considered the operation of section 130 of the Act whereby a party can apply to set aside the business rescue proceedings in comparison to the operation of section 129. Reference was made to the earlier mentioned case of *Advanced Technologies and Engineering Company (Pty) Ltd (in Business Rescue) v Aeronautique et Technologies Embárquees Sas and Others (GNP)* and how the learned judge did not regard the anomalies between the operation of section 129 and 130.

‘There appears to be an anomaly if ss 129(5)(a), which provides for an immediate lapsing and a nullity of the resolution in the event of non-compliance, and s 130(5) which provides for the setting aside of the company’s resolution in certain circumstances are considered. Surely, there is no reason to provide a court with a discretion to set aside a resolution which had automatically lapsed or which is a nullity. This is just one of several anomalies found in the Act and I refer in this regard to the discussion in Henochsberg on the Companies Act 71 of 2008, Vol 1, p 450-461. Fabricius J did not at all consider the effect of ss 130(5) read with ss 130(1)(a)(iii) in *Advanced Technologies supra* as he preferred to rely on the plain and unambiguous wording of ss 129(3) and (4).’⁴⁵

⁴⁴ At [21]

⁴⁵ At [25]

A further anomaly is that ss 130(1)(a) provides an affected person seeking to approach the court to set aside a resolution only three grounds on which to base the application, but in contrast, ss 130 (5)(a) empowers the court hearing an application to set aside the resolution not only on one of those three grounds, but to rely on an additional ground, to wit if it is considered just and equitable. Clearly, ex facie ss 130(1)(a) an applicant is not entitled to base his application on the just and equitable ground, but contrary thereto, the court may invoke this ground to set aside the resolution. This might be a drafting error. In my view an applicant should be entitled to rely on the just and equitable principle as an additional ground to the three grounds listed in ss 130(1)(a). The legislature should make an appropriate amendment to avoid uncertainty.⁴⁶

In a particular case, namely *Absa Bank Ltd v Newcity Group (Pty) Ltd, Cohen v Newcity Group (Pty) Ltd and Another*⁴⁷ it was even stated by the applicant that the sole purpose of the business rescue application is to suspend the winding up of the business and if the final winding up of the business is not granted, the application for business rescue will be withdrawn.⁴⁸ What had transpired in this matter was that the applicant had applied for business rescue on a previous occasion which was withdrawn, then when liquidation proceedings were pending, a further application for business rescue was made. The court commented as follows on the intention of instituting such an application:

‘There is considerable evidence, from which to draw, to argue that it is not a genuine application. The frank admissions by Cohen himself that the first application was a ruse and that the second application is conditional, and upon a discharge of the provisional order, it would be withdrawn, probably suffice to establish the feigned character of the invocation of the device of business rescue. Moreover, the institution, on the eve of the return day, of the second application, as with the timing of the withdrawal of the first business rescue application, on the eve of round one, affords corroboration for such an inference.’⁴⁹

The court however still considered the proposal set forward by the applicants and found that it was not without merit and that if it should be followed the only outstanding creditor will be paid within

⁴⁶ At [26]

⁴⁷ [2012] ZAGPJHC 144; [2013] 3 All SA 146 (GSJ)

⁴⁸ at [18]

⁴⁹ at [22]

months. But that is not the only factor to be considered. What bothered the court was the question why the business was adamant that a liquidator should not be appointed to look into the affairs of the business. The scepticism of the court was bolstered by the fact that the applicant had time and again made material non-disclosures. The court decided that on the basis that a viable business rescue proposal was put before it which would result in the business being rescued it would grant the business one last chance to effect such a plan, but a proviso was added that the bank could approach the court at any time on the same papers if it was found that the business rescue plan was not being implemented or followed.⁵⁰

In some instances the application to commence business rescue proceedings during liquidation proceedings are made where the business is not even solvent, regardless of the requirement of the business being ‘financially distressed’. The court in *Sulzer Pumps (South Africa) (Pty) Ltd v O & M Engineering CC*⁵¹ found that the business was not able to commence business rescue as the under oath of the deponent on behalf of the business they admitted to having no creditors and that the business was in such financial distress it was virtually insolvent.⁵² The court referred to the judgments of *Merchant West Working Capital Solutions (Pty) Ltd v Advanced technologies and Engineering Company Ltd*⁵³ and *Redpath Mining South Africa (Pty) Ltd v Marsden NO and Others*⁵⁴ in stating that insolvent business cannot be placed into business rescue. The court further commented on the application to commence business rescue proceedings whilst liquidation proceedings were underway:

‘A business rescue application must be brought at the first available opportunity and must not be brought as a knee-jerk reaction to the application for liquidation; in casu the facts clearly indicate that this is in fact what is happening. The opposition of the liquidation is tainted with dishonesty and the court cannot come to the mercy of the applicant condoning such dishonesty.’⁵⁵

It was further pointed out by the court that the party was acting *mala fide* in that it filed a resolution to commence business rescue proceedings after liquidation proceedings had commenced. Such

⁵⁰ at [35]

⁵¹ [2015] ZAGPPHC 59

⁵² at [22] and [23]

⁵³ [2013] ZAGPJHC 109

⁵⁴ [2013] ZAGPJHC 148

⁵⁵ at [24]

resolution is not possible as a party needs to apply to court to suspend liquidation proceedings and to commence business rescue proceedings.

“The introduction of business rescue in chapter 6 of the Act places a duty on a court to balance the sanctity of entities with the interests of creditors. Business rescue proceedings attempt to keep a company alive by diverting serious consequences for its members, creditors and employees. In South Africa retaining jobs is most certainly a priority. A court thus has a duty to judicially favour business rescue to liquidation. This must be the backdrop to liquidation proceedings versus business rescue proceedings. This being said, no court can allow business rescue proceedings to be utilized as an abuse of the court process. The court also has a duty to ensure that the entry into business rescue was not feigned. This is so because the Act does not shun liquidation proceedings within the business rescue provisions. Express provision for this is to be found in section 129 which reads as follows:

(1) “Subject to subsection (2) (a) the board of a company may resolve that the company voluntarily begin business rescue proceedings...

(2) A resolution contemplated in subsection (1)-

(a) may not be adopted if liquidation proceedings have been initiated by or against the company; and

(b) has no force and effect until it has been filed. ”

Henochsberg on the Companies Act, Vol 1, p458 states that “The reason for this is to prevent the board from thwarting an application to liquidate the company by adopting a business rescue resolution.”

I can without hesitation find that the business rescue application was launched at this late stage with the sole purpose to thwart the application to liquidate it. I can make this finding without the necessity of entering into the merits of the business rescue which of course I do not have before me. The reasons for this finding follow.⁵⁶

Apart from the actual application for business rescue proceedings being an abuse of process, the actual process and procedures of business rescue may also be used to abuse the process, regardless of the fact whether the business had a proper ground to commence business rescue proceedings or not. In the earlier mentioned matter of *Absa Bank Limited v Caine N.O. and Another, In Re; Absa Bank Limited v Caine N.O. and Another* it was clear that one of the abuses constituted by business rescue practitioners is the non-compliance with the time periods and rules as set out by the Act. The court stated that the purpose of business rescue proceedings was to facilitate a swift

⁵⁶ at [28]

rehabilitation of the business and that such a process should adhere to strict time periods as per section 132 of the Act.⁵⁷

Reference was made to the case of *DH Brothers Industries (Pty) Ltd v Gribnitz NO and Others*⁵⁸ that stated that even though the Act does not provide for consequences for non-compliance with the time periods within which to publish the business rescue plan, the judge found at [32] of his judgment that:

‘It is my view, on a conspectus of the structure of business rescue proceedings, that a meeting must be convened and a vote taken in order for it to be said that a majority of creditors 'allowed' an extension of time. This was not done. No extension was therefore allowed by creditors as envisaged in s 150(5)(b). This means that the business rescue proceedings came to an end after the 25-day period elapsed. If this is not the case, this application can and should bring them to an end by setting aside the resolution on the just-and-equitable ground.’

The court therefore stated that strict compliance should be met with the time periods provided for in the Act, otherwise the proceedings may be set aside by the court.

A further abuse by the business rescue practitioner is to fail to terminate the business rescue proceedings when he should. In the ABSA matter as cited above the court regarded the position where a business rescue plan has been rejected by the creditors. Section 153(7) of the Act provides that where a plan has been rejected an affected party may apply to court to set the proceedings aside, and section 153(5) provides that where a plan has been rejected and the business rescue practitioner has not received the required vote to revise the plan or the vote against the plan is not set aside, the business rescue practitioner must terminate the business rescue proceedings. The court made the following statement:

‘If no person takes any action contemplated in ss 153(1) the business rescue practitioner must promptly file a notice of termination of the business rescue proceedings as is apparent from the provisions of ss 153(5). It is uncertain whether the business rescue proceedings lapse automatically if the practitioner fails to take the required action, but it has to be considered whether an affected person has locus standi

⁵⁷ at [29]

⁵⁸ 2014 (1) SA 103 (KZP)

to approach the court in such case to obtain a declaratory order that the proceedings have terminated. Although the Act is silent in this respect logic dictates that a court may grant appropriate relief if approached by an affected person in circumstances where the business rescue practitioner fails to comply with his statutory duties. If there is no further hope that the business rescue may succeed, affected persons should be allowed as soon as reasonably possible to pursue their common law and/or contractual rights against the company.⁵⁹

On finding that there was a substantial lack of compliance with time periods the court found⁶⁰ that even though the business rescue proceedings should have lapsed due to the non-compliance, it was better to issue a declaratory order as there was just and equitable ground in terms of section 130(5) to set aside the business rescue proceedings.

3. SECTION 155 COMPROMISE WITH CREDITORS:

3.1 *The aim of compromise with creditors and the wording of section 155 of the Companies Act 71 of 2008:*

A compromise or arrangement in terms of the section⁶¹ is not defined in terms of the Act, but its meaning should be construed from the operation of the old Act⁶² together with the objectives of the current Act to achieve a similar purpose to that of 'business rescue'. A 'compromise' in terms of the old Act referred to an agreement to settle a dispute over rights or to modify rights not in dispute where difficulty exists with enforcement thereof. Traditionally it is an agreement between the company and its creditors, but it could also constitute an agreement between the company and its members. The new Act however does not allow for the company to compromise with its members in terms of s155, but rather has a separate provision for it in terms of s114.

In terms of the Act the company may only affect a compromise with its creditors if it is not undergoing business rescue proceedings⁶³. The option to compromise can therefore not be used in conjunction with business rescue proceedings but rather as an alternative.

⁵⁹ At [36]

⁶⁰ at [56]

⁶¹ s155 of Act 71 of 2008

⁶² Companies Act 61 of 1973

⁶³ s155(1)

3.2 *The process of affecting a compromise with creditors:*

A compromise with creditors only becomes effective once it has been granted by the court. An application therefore needs to be made in terms of s155 of the Act to court containing a number of averments and the application need to be served on all interested parties before it will be heard. Before approaching a court the company will approach its creditors with an offer of compromise. It will compile a proposal that will be sent to the creditors or a class of creditors and a meeting will be arranged to discuss the proposal. The notice of the proposal will have to be sent in the prescribed form to every creditor with a known address or whose address can be reasonably obtained as well as the commission.⁶⁴

The proposal has specific requirements that need to be met and has to contain all the facts that will enable the creditors to make an informed decision. It will be divided into three parts namely; the background, the proposals and lastly the assumptions and conditions. Accompanying the proposal should be a certificate signed by a director or authorized offices stating that the factual information provided appears to be accurate, complete and updated and that the projections made are made in good faith and on the basis of the facts and assumptions as provided.⁶⁵

Once the complete proposal has been sent to the creditors, a meeting will be held to discuss the proposal and a vote will be taken for the adoption thereof. In order for the proposal to be adopted by the creditors there needs to be a majority vote in favour of adopting the proposal consisting of at least 75% of the voting creditors.⁶⁶

As soon as the proposal is adopted by the creditors in that majority voted in its favour, the company needs to apply to court to have the proposal approved.⁶⁷ The court will consider whether it is just and equitable to approve such a proposal after having regard to the number of creditors who were present at the meeting and who voted in favour of the proposal and in the case where the company was in liquidation proceedings, the Master's report.⁶⁸

Interestingly the Act does not provide how the application must come to the attention of the affected parties. Rule 6(2) of the Uniform Rules of Court needs to be considered in that it states

⁶⁴ s155(2)

⁶⁵ s155(5)

⁶⁶ s155(6)

⁶⁷ s155(7)(a)

⁶⁸ s155(7)(b)

that every person who may have an interest in the application needs to be cited and informed of such an application. It therefore begs the question whether the application needs to be served on all the creditors or only the parties who were present at the meeting and how such service should be affected. In the matter of *Geldenhuis and Others v Orthotouch Limited and Others; In re: Highveld Syndication Investors v Orthotouch Limited*⁶⁹ the learned judge regarded the requirements of service and made an order that an application needs to be served on all parties who voted on the proposal through email, sms or registered mail and further that a publication of the proposal shall be made in a newspaper to inform investors of the proposal.

S155(7)(a) of the Act states that the company ‘may’ apply to court to have the compromise sanctioned. However s155(8)(c) provides that only once the compromise has been made an order of court will it be binding on the creditors and that such an order needs to be filed with the CIPC. It is therefore clear that the compromise needs to be made an order of court before it would have any real legal effect.

3.3. *Liability of the sureties during a compromise:*

The rights of a surety differ where a compromise is struck in comparison to where the company is undergoing business rescue. Unlike during business rescue proceedings, the surety is in no way protected by a moratorium or the wording of the deed of surety and he will be liable for the debts of the company in terms of section 155(9) of the Act.

In the matter of *Ex Parte Voysey Bond Property Investments Ltd*⁷⁰ the court referred to the operation of a compromise in terms of section 311(3) of the Old Act which reads identical to the provisions of section 155(9) of the new Act and stated the following:

‘Section 311 (3) of the Companies Act 61 of 1973 does no more than prevent a compromise (or arrangement) from automatically terminating the liability of a surety for the company's debts; it does not prevent either of the parties to the compromise (or arrangement) from agreeing to release such surety or the Court from approving a scheme providing for such release.’⁷¹

⁶⁹ [2016] ZAGPJHC 162

⁷⁰ 1978 (2) SA 134 (D) at

⁷¹ At 134

Therefore in the court's view the only way a surety would be protected from its liability is if the compromise itself provides that he may be released. This was confirmed in the judgment of *Friedman v Bond Clothing Manufacturers (Pty) Ltd*⁷², where the judge stated the following

'To some degree a compromise must, in almost every case, affect the extent of the liability of a surety. In a compromise the creditor of the company usually accepts a lesser sum in discharge of the debt of the company to him. Obviously the proviso does not have effect to preserve the amount of the surety's liability as it was prior to the compromise. 'Liability' must be read as meaning the obligation to pay whatever may be owing under the guarantee. But the obligation to pay, which is preserved, may be an obligation to pay at all, or an obligation to pay a particular person. I can see no reason at all to limit the effect of the proviso to the first case. Both the liability to pay at all, or the liability to pay a particular person, could at common law be affected by a compromise; the former where the company's debt is discharged, the latter where it is ceded. The intention of the Legislature I think was to do away with the effects of a compromise in the suretyship under the common law, in whatever way it might operate. Liability could be 'affected' not only where the surety is released but also where he becomes liable to another. The proviso enacts that it is not to be affected.

I consider that the liability of the appellant to the respondent was preserved, despite the cession of the principal debt, by the proviso to sec. 103 (2).'

3.4 *Creditor's rights to vote against the compromise:*

Unlike in business rescue proceedings the Act does not specifically provide what the creditor's rights are where they have voted against the compromise and it has been accepted and it does not provide what the company may do where the creditors have voted against the compromise.

Where a creditor has voted against a compromise which has been accepted by 75% of the creditor's he will not be left without remedies. As mentioned earlier the creditor will need to receive notice of when application will be made to court to sanction the compromise and he may oppose such an application. He will similarly be able to use any other remedies afforded to him in terms of the Companies Act or the common law.

In the instance where the creditors have rejected the proposed compromise, the company is not afforded the same right in terms of the section to approach the court to set aside the vote. The

⁷² 1965 (1) SA 673 (T) 680 C-F

company is however in a position to amend the compromise and try to re-negotiate a better compromise that will suit the majority of the creditors.

3.5 *Cancellation of a lease agreement during the compromise:*

The compromise has the effect of a contract and will be binding on the company as well as all the relevant creditors. Therefore if the compromise is concluded with a lessor being one of the creditors affected, he will be bound by such a compromise, but the compromise will not remove his right to cancel the lease agreement. Similarly if the lease agreement has been varied due to the compromise and the company does not perform in terms of the compromise, the lessor will still be entitled to cancellation of the lease agreement and his remedies that flow from such cancellation.

A creditor's rights in terms of a contract with the company remain intact and the creditor will be able to cancel any such contract where the company has not performed in terms of the contract. However if the contract has been varied by the compromise the creditor will not be able to cancel the agreement where the company has performed in terms of the compromise instead of the original contract.

It follows that the position in terms of cancellation of a lease agreement and the consequent eviction of the company under business rescue proceedings will be the same where the company has concluded a compromise.

3.6 *Other comparison of the outcomes of business rescue proceedings and a Section 155 compromise with creditors:*

The first practical difference between business rescue and a compromise is the costs of the procedure. An unfortunate side effect of business rescue is that it is a costly affair. The business rescue practitioner's fee along with the administration costs of administering the business rescue may as well result in the company becoming insolvent regardless of the fact that there was a hope of rehabilitation. Therefore business rescue may not be a viable option for small companies or companies with a small asset base. However the cost of reaching a compromise with creditors is greatly reduced and becomes an appealing option to both creditors and the company.

A further factor which may make a compromise with creditors a more appealing option is that it is a quicker process to that of business rescue. During the business rescue proceedings it takes time to appoint the business rescue practitioner, to have the first creditor's meeting and then for

the business rescue plan to be presented and voted upon. During a compromise with creditors only one meeting needs to be held to gain the approval of the creditors after which the compromise may be made an order of court. Creditors will not need to wait too long before their claims are realized in terms of the compromise.

When a company decides to conclude a compromise with its creditors, the creditors are involved from the outset as opposed to business rescue proceedings where they are only notified thereof after the resolution was passed or a court application was made. The creditors in effect have an agreement with the company as to how it will settle its debts and the agreement is only effected once it has been made a court order.

A company may only enter business rescue proceedings when it is financially distressed but with a hope of being rescued, a company will not be allowed to enter business rescue proceedings where it will be found that it is in a position to adequately pay its debts or where it is completely insolvent with no hope of being saved. A company may however strike a compromise with its creditors in any financial state⁷³, regardless of whether it is financially distressed or whether it is adequately able to pay its debts.

It is possible to effect a compromise with creditors during the business rescue proceedings before resolving the business rescue proceedings into liquidation proceedings. In the *Geldenhuyts v Orthotouch* matter the affected and relevant class of creditors of Orthotouch Ltd met with a representative of Orthotouch and sanctioned the agreement in terms of s155(2) of the Act. Application was made to court and the agreement was made a court order and therefore binding against all creditors of Orthotouch.

4. BUSINESS RESCUE APPLICATION IN AUSTRALIA:

4.1 *Process of Voluntary Administration:*

The Australian equivalent to Business rescue is termed as 'voluntary administration' and is administered by Part 5.3 A of the Corporations Law⁷⁴.

The objective of the process is:

⁷³ s155(1)

⁷⁴ Corporations Act 2001

‘to provide for the business, property and affairs of an insolvent company to be administered in a way that:

- (a) maximises the chances of the company, or as much as possible of its business, continuing in existence; or
- (b) if it is not possible for the company or its business to continue in existence--results in a better return for the company's creditors and members than would result from an immediate winding up of the company.’⁷⁵

The process to be followed is that a ‘company administrator’ is appointed to the company to assess the company’s financial future, by investigating the financial position of the company and deciding on the appropriate course of action. He will generally be appointed by a majority creditor of the company. At the end of the investigation there are two possibilities, either a deed of ‘company arrangement’ is agreed upon or the company gets liquidated.

The administrator is given a period of 21 days before a meeting with creditors must be held to discuss the future of the company. If the meeting is not held within the 21 days or it is not extended to a limited 60 days after the first day the meeting was held the administrator will lose his control and the administration will come to an end.

The point of the meeting and the administration is for the creditors together with the administrator to reach an arrangement termed a ‘deed of company arrangement’ as to how the business of the company will be conducted in future. If the deed is not put into action within 21 days after it was agreed upon, the company will be liquidated.

When the administrator is appointed he is given broad powers to control the business, its property and affairs. He may perform any function and exercise any power that a director or officer of the company may perform.

Once the deed of arrangement has been adopted within the allocated time period the administration ends and the administrator is relieved of his duties. The terms of the deed will then govern the business and the deed will bind the creditors. Interestingly the secured creditors of the company will not necessarily be bound by the arrangement unless it specifically agrees to being bound. The secured creditor may however not enforce his interest against the company during the administration period without the consent of the administrator or by leave of the court.

⁷⁵ s345A of the Corporations Act 2001

There are conflicting views on whether voluntary administration is a helpful tool. The Jones Day Commentary states that:

‘Voluntary administration has in turn triggered the destruction of companies’ enterprise value as core creditors and suppliers have terminated their contracts in reliance on ipso facto clauses that apply when companies experience an “insolvency event”. All too often, those companies have eventually ended up being liquidated, and employees and other unsecured creditors have faced significant losses.’⁷⁶

On the other hand M. Pretorius and W. Rosslyn-Smith state in their article⁷⁷ that “*Despite its ‘creditor-friendly’ disposition, the number of companies entering the scheme that are rescued is increasing.*”

According to Jones Day due to the poor performance of voluntary administration, the Australian Government released a proposals paper entitled, “Improving Bankruptcy and Insolvency Laws” (“Proposals Paper”), on 29 April 2016. It is uncertain how this proposal will shape the future for voluntary administration as it mainly deals with entities that are already bankrupt.

The Australian judicial system experiences a similar problem to that of South Africa in that it finds that entities abuse the voluntary administration process for their own gain. Abuse of the voluntary administration system becomes attractive to debtors as it results in the creditors’ collection rights against the debtor being suspended by a moratorium and it stays winding-up procedures. Directors of the company see the potential of using voluntary administration as a proverbial scapegoat or to use it to hide behind the administrator to escape liability in liquidation investigations. As the directors of the company lose legal control of the company during the administration process it creates defences for insolvent trading, it stays proceedings of enforcement of personal guarantees against a directors and it enables them to avoid personal liability for unpaid tax.

It seems that the abuse stems from the implementation of the insolvency test in that debtors who are not actually experiencing threat of insolvency are applying for voluntary administration

⁷⁶ Jones Day “Corporate and Business Rescue in Australia: Insolvency Law Reform Process Continues as Government Releases Proposals Paper” (2016) May *Jones Day Commentary* 1

⁷⁷ Pretorius M and Rosslyn-Smith W “Expectations of a business rescue plan: international directives for Chapter 6 implementation” (2014) 18 *Southern African Business Review* Volume 108

to avoid debts. Initially a company had to be, in the director's opinion, insolvent or likely to become insolvent. During July 2004, the Joint Committee on Corporations and Financial Services recommended that the criteria be changed to allow debtors who 'may become insolvent' to apply for voluntary administration. However this led to some debates and the potential abuse was likely to ensue.⁷⁸

The Corporations and Markets Advisory Committee ('CAMAC') decided to consider the system used in the United States namely the "good faith test" found in Chapter 11 of their Bankruptcy Code to solve the threshold problem created by the insolvency test. The 'good faith test' considers factors such as a debtor's subjective motives and ability to reorganize together with insolvency. The idea to adopt the test in Australia was however rejected by the Committee.

It is the opinion of Eow⁷⁹ that:

'...unknown to many, the Australian courts have been more willing to experiment with an embedded good faith test to control access to the voluntary administration system. This 'voluntary administration good faith test' focuses more narrowly on the directors' purpose in reorganising.'

4.2 General comparison to the system in South Africa:

The first and probably most striking difference between business rescue and voluntary administration is the amount of judicial interference. In business rescue proceedings, the court has the power upon application by any interested party to intervene in the matter. The basic ideas and operations of the two systems are the same in that an outside party is appointed to take control of the company, during which time a general moratorium will be implemented preventing creditors from enforcing any claims against the company and finally a business plan or deed of arrangement is proposed whereby the company will conduct itself.

Voluntary administration is generally commenced by the board of directors resolving to appoint an administrator⁸⁰, however an administrator may also be appointed by a liquidator⁸¹ if he is satisfied that the company meets the required threshold. A secured creditor who has a charge

⁷⁸ Eow, Intan "The Door to Reorganisation: Strategic Behaviour or Abuse of Voluntary Administration?" (2006) 30(2) Melbourne University Law Review 300

⁷⁹ Intan Eow, author of "The Door to Reorganisation: Strategic Behaviour or Abuse of Voluntary Administration?"

⁸⁰ s436A(1)

⁸¹ s436B(1)

over the whole or substantially the whole of the company's property may similarly cause an administrator to be appointed, if the secured creditor is entitled to enforce the charge⁸². During business rescue proceedings the board of directors may similarly commence business rescue proceedings by way of resolution, however the Companies Act provides that any effected person may approach a court to place the business under business rescue, which in effect widens the pool of potential parties who may place the company under business rescue in comparison to that in voluntary administration. The exact point when voluntary administration commences is when the administrator is appointed. Business rescue proceedings however commences once the resolution by the directors or shareholders has been lodged with the CIPC or when an interested party applies to court for an order placing the company under business rescue.

Both procedures provide for an appointment of a 'practitioner' or 'administrator' to investigate and supervise the business of the company and then to formulate a proposed plan that needs to be proposed to the creditors. However there is a clear difference in the control of the creditors at such a meeting. During voluntary administration the creditors may at this first meeting decide to substitute the administrator, however during business rescue proceedings the creditors do not have such a power at the first meeting and the intention of the first meeting is merely for the business rescue practitioner to inform the creditors that there is a reasonable prospect of rescuing the business. In both procedures creditor committees may be formed at the first meeting.

At the second meeting the creditors during a voluntary administration will vote to either adopt the 'Deed of Arrangement' which is effectively the business plan, to wind-up the company or to allow the company to continue as it had before. The administrator does not make the decision. At the second meeting of creditors or interested parties during business rescue proceedings, the parties present are called upon to vote on the plan. If majority of 50% rejects the plan the business rescue practitioner may propose to revise the plan. This may result in the procedure being prolonged unnecessarily.

At the first meeting during business rescue proceedings, employees may also be present and an employee committee may be formed. No such provision exists for voluntary administration and it seems that the Australian legislation has not included the employees in the process at all.⁸³

⁸² s436C(1)

⁸³ Anderson C "Viewing the proposed South African business rescue provisions from an Australian perspective" (2008) 1 Potchefstroom Electronic Law Journal 1

Anderson in his journal article '*Viewing the proposed South African business rescue provisions from an Australian perspective*' points out that during the investigation by the administrator of the business affairs of the company, the directors of the company are called upon to assist the administrator. The aim of the assistance is to consider whether the company shouldn't be wound-up in the interest of the creditors and then to make that transition as cost-effective as possible. During business rescue proceedings, the directors are similarly called upon to assist the business rescue practitioner with his investigation, but the aim thereof is rather to assist with the business rescue plan and the implementation thereof.

A very important distinction between the two systems is the duration and effect of the moratorium. During voluntary administration everyone is precluded from enforcing their rights against the company, except for a secured creditor having a charge over the whole or substantially the whole of the assets of the company. The moratorium commences when the administrator is appointed but ceases once the second meeting of creditors has been held and a plan has been adopted. During business rescue proceedings all persons are precluded from instituting claims against the business and may only do so with leave of the court. The moratorium commences when the resolution has been filed with the CIPC and ceases once the business rescue plan has been complied with and a notice to such effect has been filed, or the business has been placed in liquidation.

The last significant difference between the two systems is the control of and culpability which is attached to the administrator in terms of statute. In terms of the Corporations Act⁸⁴ the administrator is rendered liable for general debts, payments for property used or occupied by, or in the possession of, the company and certain taxation liabilities subject to certain conditions as set out by the Act. The administrator can only be held liable in terms of the Act. The Act⁸⁵ further provides for indemnification of the administrator under certain circumstances and how such indemnification may be preferred over other creditor's rights. The company or any other person is therefore enabled to hold the administrator liable for his actions in terms of the Act albeit it is limited. The Companies Act of 2008 does not provide for such liability or indemnity for the business rescue practitioner leaving parties with no relief where business rescue practitioners act recklessly or negligently. The only relief available is that the business rescue practitioner may be

⁸⁴ s443A to s443C

⁸⁵ s443D to s443E

replaced, but that will not result in the company recovering anything from the damage that was already incurred. This does however not preclude parties from relying on their common law *delictual* rights to claim for damages.

4.3 *The rights of surety holders:*

According to Austin RP and Ramsay IM⁸⁶a holder of a security right who has started enforcing such a right before the administration process, may continue to do so during the administration process. However during the administration other holders of security rights may not enforce their rights against the company unless they have the permission of the administrator or the leave of court.

S440B of the Act imposes restrictions on, rather than prohibits a third party from exercising his rights in relation to the property of a company undergoing administration. Where a party has a security interest over the whole or substantially the whole of the company's property there is substantially no point in preventing such a person from exercising their rights in relation to the property as the holder of such a security could appoint a receiver over all the property who in turn could conduct and orderly administration. In terms of s441A the security holder has a "decision period" within which he can enforce his right subject to the security interest. If the holder of the security chooses not to enforce his right in the "decision period" which is ten days, he is barred from doing so until the administration has been concluded.

The court may limit a secured party's exercise of his rights of security in terms of s441D(2) where the property encumbered by a security interest is essential to the company's business. This may only occur where the court is satisfied that the secured creditor's interest can be adequately protected otherwise. The administrator could offer the secured party security over other assets.

An administrator is prohibited from disposing of property over which security is held by a third party unless it is in the ordinary business of the company, with the written consent of the owner or with the court's leave in terms of s442C.

The Australian legislature is clear in regards to the rights of security holders where the company is being administered and it is very clear to the holders of these rights what relief they are entitled to. This aspect should be considered by the South African Legislature in drafting the

⁸⁶ Austin RP & Ramsay IM *Ford's Principles of Corporations Law* 15ed (2013) 1668 - 1670

Companies Act as it would alleviate the courts from having to create the law under these circumstances.

4.4 *Rights of creditors to vote against administration:*

The administrator will have a meeting with the creditors where he will give his recommendation as to whether they should execute a Deed of Company Arrangement. The process will only continue if the creditors resolve that the company should execute the Deed. The creditors will be able to terminate the deed by way of a resolution under s445F.

Unlike in South Africa, the Act does not provide for a situation where creditors have voted against the Deed of Arrangement and whether the administrator can apply to set aside their vote. This is a construct that is unique to South Africa.

4.5 *The cancellation of a lease during the administration:*

Similar to the security holder who instituted action before the administration process, a lessor will be able to continue with his legal proceedings against the company in relation to the lease if the legal action was instituted before the commencement of the administration. The court may however order that the property may not be taken where it is clear that the property may be needed during administration. S441H provides for this order but states that the court needs to be satisfied that the lessor's rights are adequately protected. Where the lessor fails to act before the administration he will be prohibited in terms of s440B(3) from taking possession of the property unless he has the consent of the administrator or the leave of court.

In the matter of *Re Java 452 Pty Ltd (admin apptd) v Stout*⁸⁷ the court considered the position where a lessor cancelled the lease after the administration process commenced and stated that the court had to balance the respective interests of the lessor and the creditors. In this case the creditor's meeting was imminent and the court stated that as such it was within the best interest of everyone that the status quo be maintained. Further the court stated that even if the administration was unsuccessful it could still result in a better return for creditors and as such the property should be utilised for such a purpose. The administrator is not allowed to sell the leased premises except

⁸⁷ (1999) 32 ACSR 507

if it is in the ordinary course of its business, it is with the written consent of the owner or lessor, or if it is with the leave of the court in terms of s442C.

The position in regards to a lease agreement in Australia therefore drastically differs from the situation in South Africa. The Australian legislature has considered the rights of the creditors and the purpose of the administration and has given deeper thought to the process as a whole and the effect a cancellation of the lease and the return of the property will have on the success of the administration. South African courts should similarly have greater regard for the purpose of business rescue and the fact that it will only be for three months. If such regard is had, then it may result in more companies being successfully rescued or a greater return for creditors.

5. CONCLUSION:

From the above discussions it is quite evident that the current statutory structure for business rescue as set out in the new Companies Act leaves a lot to be desired. The ambiguities of the text as well as the many loopholes have left the courts in the laborious position to create law to regulate situations which are not provided for in the Companies Act.

The obvious problem with this situation is that parties are able take advantage of the defective procedure before they are changed by case law. The precedents created by our courts do not remain as stable as statute and may result in conflicting judgments on the same issues. Without statute to guide the courts, the courts are left to their own logic to determine what the legal position will be and how parties will be governed, which is not the purpose of a court. The inevitable effect of the defective wording and structure of Chapter 6 of the Companies Act is that the Creditors, Shareholders and Employees of a company undergoing business rescue are at the risk of suffering harm without preventative measures or proper relief being provided to them in terms of the Act. As stated before, parties are not precluded from using the common law to claim for any damage that they may suffer, but it leaves them to have to identify which party is at fault, the company or the debt rescue practitioner, and proving that such party can in fact be held liable. Legislators will have to effect amendments to the Companies Act to address these ambiguities and loopholes to ensure that parties do not abuse the process and to give courts better guidance as how to address disputes arising from business rescue proceedings.

A compromise with creditors has its appeal as an alternative to business rescue proceedings. Not only is it a more time and cost effective approach, it leaves the business to decide what to do

with its creditors. There is no third party intervention involved. The process as worded by the Act leaves less to be desired and does not contain as many loopholes and ambiguities. The process has however not been applied as often as business rescue proceedings since the adoption of the Companies Act of 2008 which remains a mystery.

A comparison between the business rescue system and the voluntary administration system shows many similarities. This can be expected as both processes had the UK and United States systems in mind while they were being developed. But it is quite clear that the Corporations Act of 2001 provides clarity on all matters and leaves little room for the judicial intervention in the interpretation of the Act. However, even though the Corporations Act has fewer loopholes, the voluntary administration system is also used as an abuse of process. The courts in Australia have however taken more cognisance of the results of voluntary administration and the aim thereof when considering whether third parties can institute claims against the company or exercise their rights in regards to property that is used by the company. The result is that companies are rather granted the opportunity to utilise the asset in order for the administration process to be successful or for a better return to be given to creditors than to give the property back to a third party. It is submitted that if South African courts took this approach then the business rescue procedure would become more effective and successful, bearing in mind that the whole business rescue process should only endure for a period of three months.

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