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**The Impact of the business rescue proceedings on the rights of
creditors**

by

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Table of contents	Pages
Declaration	i
Abstract	ii
Chapter 1: Background and introduction	
1. General introduction	1
2. Problem statement and research objectives	1
3. Research methodology	2
4. Chapter outline	2
Chapter 2: The creditors' rights during business rescue in South Africa	
1. Introduction	4
2. General participation rights given to creditors	4
3. The right to initiate business rescue proceedings	5
4. The right to vote	9
5. The creditors committee	11
6. The effect of the moratorium on creditors	12
7. Conclusion	16
Chapter 3: The Australian Voluntary Administration	
1. Introduction	18
2. The creditors' rights to commence voluntary administration	20
3. Creditors meetings	21
3.1. The first meeting	22
3.2. The second meeting	23
3.3. Voting rights at the meeting	24
4. The effect of the moratorium	25
5. Conclusion	26

Chapter 4: The Administration order in the United Kingdom

1. Introduction	27
2. The objectives of administration	27
3. The rights of creditors to initiate the administration process	28
4. The creditors voting's rights	30
5. The creditors committee	31
6. The effect of the moratorium	31
7. Conclusion	33
Chapter 5: Conclusion and Recommendation	35
Bibliography	37

Declaration

I declare that this mini-dissertation is my own work, where other people's work has been used (either from printed source, internet source or any other source) this has been properly acknowledged and referenced in accordance with department requirement. It is submitted in the partial fulfilment of the degree Master of Law for (LLM Insolvency Law) course work programme in the Faculty of Law at the University of Pretoria.

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ABSTRACT

The South African Companies Act of 2008 introduced business rescue in Chapter 6 of the Companies Act 71 of 2008. In terms of section 7 (k) of the Companies Act 71 of 2008, business rescue proceedings should provide for the efficient rescue and recovery of financially distressed companies in a manner that balances the rights and interest of all affected persons, *inter alia*, the creditors, employees, and shareholders. This dissertation will focus on the impact of business rescue proceedings on the rights and interests of creditors as one of the affected persons during the proceedings. The dissertation will analyse whether the rights of the creditors are adequately protected and if so, to what extent are they protected. The research paper will further consider the impact of the moratorium on the rights of creditors. Generally, during business rescue proceedings, all legal proceedings against the company are prohibited by the general moratorium and this includes claims by creditors. Last but not least, the business rescue regime in the international jurisdictions such as the United Kingdom and Australia will be explored in comparison with the South African law. The reason behind the choice of the above-mentioned jurisdictions is that they both share commonwealth heritage strategy with South Africa and they have existing business rescue regimes with objects almost similar to the South African regime.

CHAPTER 1

Background and Introduction

1. General introduction

South African Company law has introduced a business rescue regime under Chapter 6 of the Companies Act of 2008.¹ The primary purpose behind the introduction of these business rescue proceedings is to facilitate the rehabilitation or reorganization of a financially distressed company.² The regime aims at rescuing the company and ensuring that the claims and interests of all the stakeholders are protected so that when the company has finally been saved, it can be useful again in the economy of the country.³ The basic philosophy behind business rescue is that it is better for the company which is financially distressed to be rescued rather than being liquidated.⁴ When the company is rescued, the creditors stand to receive better returns.⁵

Prior to the introduction of business rescue proceedings in South Africa, judicial management, which came into operation from as early as 1926, was the preferred option.⁶ Viewed historically, judicial management was introduced to liquidate a financially distressed company in order to provide a quicker and easier method for creditors to receive payments due to them.⁷ Judicial management was provided for in the Old Act.⁸ In *Le Roux Hotel Management (Pty) Ltd v E Rand (Pty) Ltd*,⁹ Josman J referred to judicial management as “a system which has barely worked since its initiation in 1926. Judicial management was, therefore, referred to as an object failure”.¹⁰

2. Problem statement and research objectives.

This dissertation seeks to explore the impact of business rescue proceedings on the rights of creditors and other stakeholders.

¹ Act 71 of 2008.

² Section 128 of the Companies Act 71 of 2008.

³ Cassim Contemporary Company Law (2012) at 861.

⁴ Cassim at 862.

⁵ *Swart v Beagles Run Investment 25 (Pty) Ltd* 2011 (5) SA 422 (GNP).

⁶ Cassim at 862.

⁷ Magardie “Companies in financial distress during business rescue proceedings” (LLM dissertation 2015, University of Pretoria) at 2.

⁸ Section 427 of the 1973 Act.

⁹ 2001 1 All SA 223 (C) at 238.

¹⁰ Magardie at 2, see also Stein C “The new companies Act unlocked” (2011) at 409.

In order to achieve the purpose of this study, the following objectives will form the basis of this dissertation:

- A. The right of creditors to participate in business rescue proceeding;
- B. The rights of creditors as affected persons;
- C. The voting rights of creditors;
- D. The creditors' right to form a creditor's committee; and
- E. The effect of the moratorium on creditors' rights.

3. Research methodology

This research will follow doctrinal research methodology conducted through case law, statutory and journal articles. The database will mostly be used to collect the information and where necessary hard copy secondary sources will be consulted.

4. Chapter outline

4.1. Chapter 1

This chapter is an introductory chapter and will provide a brief background to the study. The chapter will address the problem statement as well as the methodology used to conduct this research.

4.2. Chapter 2

This chapter will explore the rights of creditors including the right to receive better returns, the right to participate, the right to vote, the right to form creditors committee. The chapter will further incorporate the impact of moratorium during business rescue proceedings in South Africa as suggested above.

4.3. Chapter 3

This chapter is a comparative chapter where the position of voluntary administration in Australia relating to the rights and interests of the creditors stated under chapter 2 will be discussed.

4.4. Chapter 4

This chapter is a comparative analysis of voluntary administration in the United Kingdom against the South African business rescue proceedings as enshrined in Chapter 2 of the Companies Act 71 of 2008.

4.5. Chapter 5

This chapter will conclude the findings and contain recommendations.

CHAPTER 2 THE CREDITORS RIGHTS DURING BUSINESS RESCUE IN SOUTH AFRICA

1. INTRODUCTION

The South African Company Law introduced business rescue in the Companies Act.¹¹ The purpose of business rescue in South Africa is to ensure that financially distressed companies are rescued from financial difficulties. Prior to the introduction of business rescue proceedings in South Africa, judicial management, which was initially provided for in Companies Act 24 of 1926, was applied with the aim of saving a financially troubled company from its financial difficulties, provided that there is a possibility or an opportunity that the company may overcome its difficulties under the supervision of the judicial manager.¹²

Business rescue proceedings usually commence either by way of voluntary business rescue proceedings whereby the company itself files a board resolution and furnishes all affected persons with a notice of resolution and its effective date, together with the sworn statement stating the grounds for the proceedings.¹³ Thereafter, a business rescue practitioner has to be appointed.¹⁴ Alternatively, the proceedings may be commenced by way of compulsory business rescue proceedings whereby all the affected persons including creditors may lodge an application with the court seeking the company to be placed under supervision.¹⁵

As indicated above, business rescue proceedings seek to provide for the efficient rescue and recovery of financially distressed companies in a manner that balances the rights and interests of all affected persons.¹⁶ This chapter will focus mainly on the rights of creditors, inter alia, the right to participate as affected persons, the voting rights, the rights to form a creditor's committee and the effect of a moratorium on the creditor's rights during business rescue proceedings in South Africa.

2. General Participation Rights Given to Creditors

¹¹ Act 71 of 2008.

¹² Magardie at 8.

¹³ Section 129 of the Companies Act 71 of 2008.

¹⁴ *Ibid.*

¹⁵ Section 131 of the Companies Act 71 of 2008.

¹⁶ Section 7(k) of the Companies Act 71 of 2008.

Generally, South African law is creditor orientated. However, Chapter 6 of the Companies Act¹⁷ tried to balance the rights of both debtors and creditors.¹⁸ For instance, the insolvency law protects the rights of creditors more than debtor's rights.¹⁹ Therefore, Chapter 6 was introduced to bridge the gap between the rights of creditors and the rights of debtors. Creditors are now given the right to participate during business rescue proceedings and this includes the right to be given a notice regarding the court proceedings, meetings, and information concerning business rescue plan.²⁰ The notification must take place by delivering a copy of the notice and resolution to every affected person;²¹ or displaying a copy of the notice in a conspicuous manner at the registered office of the company and at any workplace where employees of the company are employed,²² or on any website that is maintained by the company and intended to be accessible by affected persons,²³ and if it a listed company, on an electronic system maintained by the relevant exchange for the communication and interchange of information by and among companies listed on that exchange.²⁴ In the case of *Cape Point Vineyards (Pty) Ltd v Pinnacle Point Group Ltd*,²⁵ the Securities Exchange News Service of the JSE Ltd was used to announce a pending application for business rescue, providing notification to creditors to assist them to make an informed decision in line with protecting their interest during a business rescue.

3. The Right to Initiate Business Rescue Proceedings

The creditors as affected persons have the right to initiate business rescue proceedings and in doing so they can apply to the court at any time to place the company under supervision and commence business rescue.²⁶

The term affected person “ in relation to a company means a shareholder or creditor of the company ,any registered trade union representing employees

¹⁷ Act 71 of 2008.

¹⁸ Sharrock “Hockly’s Insolvency Law”Juta (2012) at 278.

¹⁹ Sharrock at 278.

²⁰ Section 145(1) (a) of the Companies Act 71 of 2008.

²¹ Henochsberg on the Companies Act 71 of 2008, regulation 123 (2) (a) at 507.

²² Henochsberg on the Companies Act 71 of 2008, regulation 123 (2) (b) (i) at 507

²³ Henochsberg on the Companies Act 71 of 2008, regulation 123 (2) (b) (ii) at 507

²⁴ Henochsberg on the Companies Act 71 of 2008, regulation 123 (2) (b) (iii) at 507

²⁵ 2011 (5) SA 600 (WCC).

²⁶ Section 131(1) of the Companies Act 71 of 2008.

of the company , and if any of the employees of the company are not represented by a registered trade union ,each of those employees or their respective representatives”.²⁷

Bradstreet stated that “by allowing creditors to initiate the rescue themselves, the Companies Act 2008 provides an opportunity to take full advantage of the protection that Chapter 6 affords them”.²⁸ The creditors should, amongst other things, prove to the court that the company is financially distressed;²⁹ that the company has failed to meet its obligation to pay the debts payable at the specific time; and that there is a reasonable prospect to restore the company.³⁰

The discretion rests on the court to grant the order placing the company under supervision and commerce business rescue proceeding or to reject the application taking into consideration the grounds mentioned under section 131 (4). In *Southern Palace Investment 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd*,³¹ one of the landmark cases in business rescue proceedings, the court dealt with one of the most crucial requirements of "reasonable prospect" to rescue the company from its financial troubles. Eloff AJ stated that “when looking at the information presented to the court, there was no reason to believe that there was any prospect of the business of the respondent being restored to a success. There was not even a concrete plan available for consideration”.³² Eloff AJ created a checklist or criteria which should be followed before the court can grant application for business rescue.

According to Eloff AJ, the following criteria must be followed in an application for business rescue to prove to the court that a reasonable prospect exists regarding the company’s ability to continue its existence on a solvent basis:

- i. the cause of the failure needs to be addressed;
- ii. a remedy for the failure needs to be offered;
- iii. a reasonable prospect that the remedy advanced will be sustainable.

²⁷ Section 128 (1) (a) of the Companies Act 71 of 2008.

²⁸ Bradstreet “The new business rescue: will creditors sink or swim” 2011 (2) *South African Law Journal* at 352.

²⁹ Section 128 (1) (f) (i) (ii) of the Companies Act 71 of 2008.

³⁰ Section 131(4) of the Companies Act 71 of 2008.

³¹ 2012 (2) SA 423 (WCC).

³² *Southern Palace Investment 265 (Pty) Ltd v Midnight Storm Investments* 2012 (2) SA 423 (WCC) para 23.

The above aspects must be proved based on concrete and objective ascertainable details beyond mere speculation that the remedy is sustainable.³³ These factors have been followed in many cases dealing with the recovery requirements set out in Chapter 6 of the Act. However, Eloff AJ emphasised that each case should be decided on its own merits, taking into consideration the facts before the court.³⁴ It should be noted that the interpretation of a reasonable prospect will differ from one case to another considering the type of method used to initiate an application for business rescue.³⁵ For example, directors on voluntary application, on the one hand, have enough information on the financial details of the company and they can manage to give accurate results on whether there is a reasonable prospect to rescue the company. On the other hand, creditors lack such information and it is very difficult for them to prove the reasonable prospect to rescue the company.³⁶

In the case of *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontien (Kyalami) (Pty) Ltd*,³⁷ Claasen J dealt with the reasonable prospect requirement, also known as the recovery requirement. This was a compulsory business rescue application. Claasen J agreed with the viewpoint made by Eloff AJ in *Southern Palace Investment 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd*.³⁸ The application for business rescue was, therefore, turned down and the liquidation was preferred due to the lack of information before the court to show that there is a reasonable prospect of rescuing the company.³⁹

Another case where the recovery requirement was dealt with is the case of *Koen v Wedgewood Village Golf and Country Estate (Pty) Ltd*,⁴⁰ this was also a compulsory

³³ *Southern Palace Investment 265 (Pty) Ltd v Midnight Storm Investments* 2012 (2) SA 423 (WCC) *supra* note 32.

³⁴ *Southern Palace Investment 265 (Pty) Ltd v Midnight Storm Investments* 2012 (2) SA 423 (WCC) *supra* note 32.

³⁵ Joubert "Reasonable possibility versus reasonable prospect: Did business rescue succeed in creating a better test than judicial management" 2013 76 *THRHR* at 555.

³⁶ Joubert at 555.

³⁷ 2012 3 SA 273 (GSJ).

³⁸ 2012 (2) SA 423 (WCC).

³⁹ *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontien (Kyalami) (Pty) Ltd* 2012 3 SA 273 (GSJ) *supra* note 37.

⁴⁰ 2012 2 SA 378 (WCC).

business rescue application. Binns –Ward J stated that the information needed for the existence of a reasonable prospect will depend on the object of the business rescue.⁴¹

He further stated that “Whatever the object of the proposed business rescue, in order to succeed in the application, the applicant must be able to place before the court a cogent, evidential foundation to support the existence of a reasonable prospect that the desired object can be achieved”.⁴²

Binns –Ward J concurred with Eloff AJ’s requirements of “some concrete and objectively ascertainable details going beyond mere speculation”. He stressed that vague and speculative allegations will not be enough to convince the court that a reasonable prospect exists that the company can be rescued.⁴³ In other words, it is the applicant’s duty to provide enough facts before the court to prove that there is a reasonable prospect to rescue the company. Binns –Ward J pointed out that it is the business rescue practitioner’s duty to indicate whether there is a reasonable prospect that the company will continue to function on a solvent basis after the business rescue plan has been implemented and that the business rescue plan will benefit both the company and the affected person than it would be the case in liquidation.⁴⁴

In the case of *Propspec Investments (Pty) Ltd v Pacific Coast Investments 97 Ltd*,⁴⁵ the creditors made an application for compulsory business rescue and the question before the court was whether there is a reasonable prospect to rescue the company.⁴⁶ The court took a broader approach by looking at the meaning of the phrase “reasonable prospect”.⁴⁷ With regards to the meaning of “reasonable rescue”, Van der Merwe J stated that when rescuing the company one of the following goals should be met:

1. Firstly, if the company can continue doing business on a solvent basis;

⁴¹ *Koen v Wedgewood Village Golf and Country Estate (Pty) Ltd* 2012 2 SA 378 (WCC) *supra* note 40.

⁴² *Koen v Wedgewood Village Golf and Country Estate (Pty) Ltd* 2012 2 SA 378 (WCC) *supra* note 40.

⁴³ *Koen v Wedgewood Village Golf and Country Estate (Pty) Ltd* 2012 2 SA 378 (WCC) *supra* note 40.

⁴⁴ *Koen v Wedgewood Village Golf and Country Estate (Pty) Ltd* 2012 2 SA 378 (WCC) *supra* note 40.

⁴⁵ 2013 1 SA 542 (FB).

⁴⁶ *Propspec Investments (Pty) Ltd v Pacific Coast Investments 97 Ltd* 2013 1 SA 542 (FB) *supra* note 45.

⁴⁷ *Propspec Investments (Pty) Ltd v Pacific Coast Investments 97 Ltd* 2013 1 SA 542 (FB) *supra* note 45.

2. Secondly if a company's creditors or shareholders will receive the better dividend in terms of business rescue than it would have been the case in liquidation.⁴⁸

Van der Merwe J formulated a new test stating that “a reasonable prospect means no more than a possibility that rests on an objectively reasonable ground or grounds”.⁴⁹ However, he agreed with viewpoints stated by Eloff AJ on the fact that the applicant needs to prove to the court that a reasonable prospect did indeed exist.⁵⁰

However, in cases where the court gives an order to place the company under business rescue proceedings, the court must further make the order appointing a practitioner who has been nominated by the creditors who initiated the proceedings.⁵¹ The practitioner must meet the requirements stipulated under section 138. In other words, he or she must be a member in a good standing legal, accounting or business management profession accredited by the commission and he or she should not have the relationship with the company.⁵² The practitioner must be independent and unbiased in order to comply with the purposes of the Act set out in section 7 and to ensure that business rescue proceedings benefit both parties.

4. The Right to Vote

In addition to the rights conferred on creditors by section 145 (1) of the Act, creditors have the right to amend, approve or reject the business rescue plan.⁵³ The Act provides that a secured or unsecured creditor has a voting interest equal to the value of the amount owed to that creditor by the company.⁵⁴ However the Act does not provide the method or the procedure to determine the amounts. Therefore, amounts will have to be proven to the satisfaction of the business rescue practitioner.⁵⁵ In order for creditors to vote for business rescue plan, the plan must be published within 25

⁴⁸ *Propspec Investments (Pty) Ltd v Pacific Coast Investments 97 Ltd* 2013 1 SA 542 (FB) *supra* note 45.

⁴⁹ *Propspec Investments (Pty) Ltd v Pacific Coast Investments 97 Ltd* 2013 1 SA 542 (FB) *supra* note 45.

⁵⁰ *Propspec Investments (Pty) Ltd v Pacific Coast Investments 97 Ltd* 2013 1 SA 542 (FB) *supra* note 45.

⁵¹ Section 131 (5) of the Companies Act 71 of 2008.

⁵² Section 138 (1) (a) (e) of the Companies Act 71 of 2008.

⁵³ Section 145 (2) (a) of the Companies Act 71 of 2008.

⁵⁴ Section 145 (4) (a) of the Companies Act 71 of 2008.

⁵⁵ Henochsberg on the Companies Act 71 of 2008 at 508.

business days after the appointment of the businesses rescue practitioner. The business rescue practitioner has the duty to convene the meeting so that creditors will have an opportunity to vote for or against business rescue plan. All affected persons must be notified about the meeting at least five days before it takes place.⁵⁶

During the voting process, one of the democratic principles applicable is that the majority vote for business rescue plan binds the company, creditors and shareholders.⁵⁷ The above-mentioned parties are bound by the majority vote irrespective of whether they were present at the meeting or not. The business rescue plan must be approved by 75% of the votes and 50% of those votes must emanate from independent creditors.⁵⁸

In cases where the voters decide to reject the plan, they can also propose to develop an alternative plan or offer to acquire the interests of other creditors.⁵⁹ However, the problem arises in circumstances where the creditors reject the business rescue plan implemented by the practitioner and the practitioner decides to advise the company to apply to the court of law to set aside the decision to reject the plan based on the ground that the decision was inappropriate.⁶⁰

The word inappropriate is not defined in the Act and although the courts have tried to define it, they have not been successful. In *Senwes Limited v Zellenhen Boerdery CC and Others*,⁶¹ the judge had to determine whether the decision taken by secured creditors to vote against adoption of the business rescue plan is deemed to be inappropriate. The court stated that the following factors need to be taken into consideration to determine whether or not the decision was inappropriate:

- i. the interests of the persons who voted against the proposed business rescue plan;
- ii. the provision, if any, made in the proposed business rescue plan with respect to the interests of all affected persons; and

⁵⁶ Le Roux and Duncan “The naked truth: creditor understanding of business rescue: a small business perspective” 2013 *The Southern African Journal of Entrepreneurship and Small Business Management* at 59.

⁵⁷ Le Roux at 59.

⁵⁸ Le Roux at 59.

⁵⁹ Section 145 (2) (b) (i) (ii) of the Companies Act 71 of 2008.

⁶⁰ Section 153 (1) (a) (ii) of the Companies Act 71 of 2008.

⁶¹ 2016 ZAGPPHC 373.

- iii. a fair and reasonable estimate of the returns to those persons if the company were to be liquidated.⁶²

In the case of *Advanced Business Technologies & Engineering Company v Aeronautique et Technologies*,⁶³ the court noted that the term is not defined in the Act and it is unclear what the legislature's intention was. However, the court formulated the factors to be considered in determining the meaning of the word 'inappropriate'. The court stated that firstly the date of the vote should be taken into consideration. If it shows that it was not inappropriate, then the relief applied for will not be granted. But if it shows that it was indeed inappropriate then the court will continue to determine whether it is satisfied that it is reasonable and just to order that the vote is set aside.⁶⁴

5. The Creditor's Committee

Creditors have the right to form a committee to represent their interests as creditors of the company and such committee must act independently and unbiased.⁶⁵ In pursue of its duty to represent the rights of creditors, the committee must consult with the practitioner regarding the business rescue proceedings, but it may not direct or instruct the practitioner.⁶⁶ To qualify as a member of the creditors' committee, a person must be an independent creditor or act under a general power of attorney or must be authorized in writing by an independent creditor to be a member.⁶⁷

While it is clear that the business rescue practitioner, on the one hand, advocates for the best interest of the company, the committee, on the other hand, advocates for the best interests of all affected persons including creditors to ensure that the purpose of the Act set out in section 7(k) of the Act is implemented and the interest of both parties is balanced during the business rescue proceedings.⁶⁸

⁶² Smit "Business rescue and the abuse thereof with the compromise with creditors as an alternative" (LLM dissertation, 2016 University of Pretoria) at 9.

⁶³ 2012 JDR 0345 (GNP).

⁶⁴ Smit at 11.

⁶⁵ Section 149 (1) (c) of the Companies Act 71 of 2008.

⁶⁶ Section 149 (1) (a) of the Companies Act 71 of 2008.

⁶⁷ Section 149 (2) (a) (b) and (c) of the Companies Act 71 of 2008.

⁶⁸ Silangwe "Affected persons in business rescue proceedings: Has a balance been struck" (LLM dissertation 2016 University of Kwa-Zulu Natal) at 14.

6. The Effect of the Moratorium on Creditors

The Companies Act provides for the temporary moratorium to protect the company against any claim in respect of property in its possession during business rescue proceedings.⁶⁹ In other words, during business rescue proceedings, no legal proceedings including enforcement action, against the company or in relation to any property belonging to the company or lawfully in its possession, may be commenced or proceeded.⁷⁰ The main purpose of the moratorium is to give the company a breathing space while the company is still trying to find a solution to solve its financial problems.⁷¹

The moratorium on legal proceedings against the company is regarded as one of the most important pillars for the rehabilitation of the company.⁷² It should be taken into consideration during business rescue proceedings in order to ensure that the company manages to implement the plan to solve its financial difficulties.⁷³ The moratorium seeks to protect the company and ensure that the available resources are used to formulate the plan in order to restore the company rather than being used for litigations against the creditors' claims. Anderson submits that "any corporate rescue system needs a circuit breaker to give the company a breathing space to consider the prospect of rescuing the company".⁷⁴ Delport also stipulates that the "main aim of moratorium is to give the company a breathing space while the business rescue practitioner attempt to implement the business rescue plan in order to rescue the company".⁷⁵

In *Cloete Murray and Another NNO v FirstRand Bank Ltd t/a Westbank*,⁷⁶ the Supreme Court of Appeal acknowledged that "a moratorium on legal proceedings against a company under business rescue is of cardinal importance since it provides the crucial breathing space or a period of respite to enable a company to restructure its affairs, and that moratorium is a cornerstone of all business rescue procedures".⁷⁷

⁶⁹ Section 128 (1) (b) (ii) of the Companies Act 71 of 2008.

⁷⁰ Section 133 (1) of the Companies Act 71 of 2008.

⁷¹ Mmbara "The impact of the business rescue moratorium on creditors" (LLM dissertation 2016 University of Johannesburg) at 3.

⁷² Section 128 as above.

⁷³ Section 133 (1) of the Companies Act 71 of 2008.

⁷⁴ Anderson "viewing the proposed South African business rescue provisions from an Australian perspective" PER 2008 (1) at 18.

⁷⁵ Henochsberg on the Companies Act 71 of 2008 at 482.

⁷⁶ 2015 (3) SA 438 (SCA).

⁷⁷ Silangwe at 11.

The commencement of business rescue proceedings gives effect to a moratorium on legal proceedings. Immediately upon the commencement of the business rescue proceeding, all legal proceedings against the company are automatically stayed. However, the moratorium on legal proceedings is subject to certain exceptions.⁷⁸

Those exceptions are as follows:

- i. the practitioner may consent to such proceedings being commenced or continued,⁷⁹
- ii. the court may give leave on terms if it deems fit;⁸⁰
- iii. 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;⁸¹
- iv. criminal proceedings against the company or any of its directors or officers;⁸²
- v. proceedings concerning any property or rights over which the company exercises the powers of a trustee;⁸³
- vi. proceedings by a regulatory authority in the execution of its duties after written notification to the business rescue practitioner.⁸⁴

The difficulties arise in circumstances where it has to be determined which claims constitute legal proceedings because the term "legal proceedings" is not defined by the Act. In *Chetty v Hart*,⁸⁵ the court was required to interpret section 133(1) of the Companies Act to determine whether arbitration proceedings fall under the general moratorium on legal proceedings against a company under business rescue since the term is not defined under the Act. In this case, the application was brought to arbitration due to the contractual dispute between the parties. However, the application was brought without the consent of the practitioner because she was not aware that the company was under business rescue.⁸⁶ The award was granted on arbitration; however, the applicant was not satisfied with the entirety of the award and therefore

⁷⁸ Section 133 of the Companies Act 71 of 2008.

⁷⁹ Section 133 (1) (a) of the Companies Act 71 of 2008.

⁸⁰ Section 133 (1) (b) of the Companies Act 71 of 2008.

⁸¹ Section 133 (1) (c) of the Companies Act 71 of 2008.

⁸² Section 133 (1) (d) of the Companies Act 71 of 2008.

⁸³ Section 133 (1) (e) of the Companies Act 71 of 2008.

⁸⁴ Section 133 (1) (f) of the Companies Act 71 of 2008

⁸⁵ (20323/14) [2015] ZASCA 112.

⁸⁶ *Chetty v Hart* (20323/14) [2015] ZASCA 112 *supra* note 85.

made another application to the KwaZulu-Natal local division seeking invalidation of the award.

At the time the application was made, the company was no longer under the business rescue but under liquidation and the liquidator (herein referred to the respondent) opposed the application based on the ground that the arbitration proceedings relates to formal proceedings and should be included into legal proceedings set out by section 133 (1).⁸⁷ The matter was taken to the High Court and finally forwarded to the Supreme Court of Appeal to determine whether arbitration proceedings constitute legal proceedings as stipulated by section 133 (1).

The court referred to section 142 (3) (b) of the Act, which obliges directors of a company to assist the business rescue practitioner with any court arbitration or administrative proceedings involving the company. The court questioned the intention of the lawmakers in providing the directors of the company with the power to look at all proceedings including arbitration proceedings but exclude arbitration from the ambit of section 133 (1).⁸⁸

The court considered the purpose of business rescue proceedings and its consequences as stipulated under section 7 (k), one of which 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. The court also referred to section 128 (1) (b) which seeks to provide a breathing space for the company in order to restructure and come up with the solution to their financial problems.⁸⁹

After taking into consideration the above-mentioned sections, the court emphasized the fact that the practitioner has the duty to examine all claims against the company on whether to settle or continue with litigation taking into consideration the impact of such claim. The practitioner must also examine whether the claim will not jeopardize the purpose of the Act. The court held that it is in favour of a broader interpretation of section 133(1) to include proceedings before other tribunals, including arbitral tribunals. The court concluded that arbitration like court proceedings also involves time

⁸⁷ *Chetty v Hart* (20323/14) [2015] ZASCA 112 *supra* note 85.

⁸⁸ *Chetty v Hart* (20323/14) [2015] ZASCA 112 *supra* note 85.

⁸⁹ *Chetty v Hart* (20323/14) [2015] ZASCA 112 *supra* note 85.

and money resources that may hinder the effectiveness of business rescue proceedings.⁹⁰

Furthermore, the interpretation of section 133(1) regarding the term 'legal proceedings' was considered in the case of *LA Sport 4 x 4 Outdoor CC v Broadsword Trading 20 (Pty) Ltd & Others*.⁹¹ The question before the court was whether the cancellation of an agreement while the company is under business rescue falls under the general moratorium on legal proceedings. This emanates from section 133 which prohibits commencement of legal proceedings against the company or property belonging to the company. The court *a quo* stated that the cancellation of an agreement during business rescue constitutes the legal process, which falls under the moratorium in section 133 (1).⁹²

In *Cloete Murray No and Another v FirstRand Bank Ltd*,⁹³ the court was also faced with the question whether the right to cancel the contract with the company while the company is under business rescue proceedings falls under legal proceedings as set out in section 133 (1). To understand the matter between parties, it is very crucial to first briefly discuss the facts of the case. In this case, Cloete Murray (herein referred to appellant) had the agreement and concluded the written master instalment sale agreement (MISA) with FirstRand Bank (herein referred to the respondent). The respondent sold and delivered movable goods to the appellant.⁹⁴ The appellant passed the resolution to place itself under the business rescue and filed the application with the companies and intellectual property commission. Thereafter the respondent furnished the letter to the appellant to cancel the contract after the appellant failed to pay its monthly instalment.⁹⁵ After the resolution was passed, the practitioner was appointed to control the company's affairs in order to make sure that business rescue succeeds. However, business rescue proceedings failed, and the company was placed under liquidation.⁹⁶

⁹⁰ *Chetty v Hart* (20323/14) [2015] ZASCA 112 *supra* note 85.

⁹¹ 2015 ZAGPPHC at 78.

⁹² *LA Sport 4 x 4 Outdoor CC v Broadsword Trading* 2015 ZAGPPHC 78 *supra* note 91.

⁹³ 2010/2014 (2015) ZASCA at 39.

⁹⁴ *Cloete Murray No and Another v FirstRand Bank Ltd* 2010/2014 (2015) ZASCA 39 *supra* note 93.

⁹⁵ *Cloete Murray No and Another v FirstRand Bank Ltd* 2010/2014 (2015) ZASCA 39 *supra* note 93.

⁹⁶ *Cloete Murray No and Another v FirstRand Bank Lt* 2010/2014 (2015) ZASCA 39 *supra* note 93

The liquidator opposed the act of the respondent to cancel the agreement and argued that the cancellation of an agreement is prohibited by section 133(1), which prohibits legal proceedings against the company during the business rescue including enforcement action. The liquidator further argued that the cancellation of an agreement constitutes enforcement action and since it was made without the practitioner's consent, it should be declared invalid. The respondent argued that the agreement was cancelled lawfully, and that the cancellation of an agreement does not constitute an enforcement action as set out in section 133 (1).⁹⁷ The court evaluated section 7 (k) of the Act which provides for the efficient rescue and recovery of financially distressed companies in a manner that balances the rights and interests of relevant stakeholders and concluded that section 133 (1) prohibits legal proceedings against the company during a business rescue.⁹⁸

The court held that the cancellation of an agreement does not constitute an enforcement action as set out in section 133 (1) of the Act. The court further emphasized that a cancellation is a unilateral act of a party to an agreement and if the court accepts the argument made by liquidator it will destroy the principle of the law of contract which provides the unilateral cancellation in the case of a breach of contract.⁹⁹

7. Conclusion

It is evident that the Companies Act provides creditors with sufficient rights to participate in business rescue proceedings and to vote on the business rescue plan during business rescue proceedings taking into consideration their rights as creditors. The South African law protects the rights of creditors more than the rights of debtors. During business rescue proceedings creditors are given enough power to commence business rescue and to reject it if it does not comply with the purpose of the Act. However, creditors lack information to prove to the court that there is a reasonable prospect to rescue the company when they initiate the business rescue, and this limits their right to commence business rescue proceedings set out in Chapter 6.

⁹⁷ *Cloete Murray No and Another v FirstRand Bank Ltd 2010/2014 (2015) ZASCA 39 supra* note 93.

⁹⁸ *Cloete Murray No and Another v FirstRand Bank Ltd 2010/2014 (2015) ZASCA 39 supra* note 93.

⁹⁹ *Cloete Murray No and Another v FirstRand Bank Ltd 2010/2014 (2015) ZASCA 39 supra* note 93.

As discussed above, a lot of cases rejected the application made by affected persons due to lack of information to prove a "reasonable prospect" to rescue the company. The creditors are also given the right to formulate committee which will represent their best interest during business rescue proceedings. However, their rights are limited by section 133 (1) which prohibit claims against the company while the company is under business rescue. The limitation is subject to exception since the claims may commence if the practitioner or the court give consent.

CHAPTER 3 The Australian Voluntary Administration

1. Introduction

The Australian voluntary administration will be discussed in this chapter taking into consideration the rights of creditors during voluntary administration. Voluntary administration is the corporate rescue mechanism used in Australia¹⁰⁰ to rescue companies that are financially distressed. Prior to voluntary administration, Australian companies relied on schemes of arrangement and Official management to rescue businesses which were financially distressed.¹⁰¹ Both procedures were replaced by voluntary administration which is now found in Part 5.3A of Corporation Act 2001.¹⁰²

Schemes of arrangement were said to be time-consuming and expensive for financially distressed companies.¹⁰³ Official management, on the other hand, had a low rate of success.¹⁰⁴ Official management was on the same footing with South African judicial management procedure. During official management, company creditors had the power to place the company under the supervision of an insolvency practitioner for a period of three years.¹⁰⁵ In other words, the creditors were supposed to pass a resolution to activate official management.¹⁰⁶ The main purpose of the procedure was to pay all the company's debts in full within a predetermined time.¹⁰⁷ Other formal schemes dealing with financially distressed companies were receivership and liquidation.¹⁰⁸

In 1988, the Australian Law Reform Commission saw a need to reform the corporate rescue system in Australia and the commission was conducted after which the *Harmer*

¹⁰⁰ Harris "The effect of voluntary administration on business restructuring" (2014) *Australian Insolvency Law* at 1.

¹⁰¹ Sellars "Corporate voluntary administration in Australia" (2001) *Australian Insolvency Law* at 1.

¹⁰² Sellars at 1.

¹⁰³ Regulatory Guide 60: Schemes of arrangement, 2011, *Australian Securities and Investments Commission* at 11.

¹⁰⁴ Sellars at 1.

¹⁰⁵ Anderson at 4.

¹⁰⁶ Mamphey "Legislating business rescue in South Africa: A critical evaluation" (LLM dissertation 2008 University of Fort Hare), at 39.

¹⁰⁷ Mamphey at 39.

¹⁰⁸ Sellars at 1.

*Report*¹⁰⁹ was released.¹¹⁰ One of the reasons for reform of the corporate rescue system in Australia was due to the fact that the previous procedures for rescuing financially distressed companies were too conservative and focused too much on rescuing the business rather than saving the company.¹¹¹

The *Harmer Report Commission* stated that “a constructive approach to corporate insolvency requires the preservation, if practical and possible, of the property and businesses of the company in the brief period before creditors are in a position to make an informed decision. This assists in an orderly and beneficial administration whether creditors decide to wind the company or accept compromise. Administration affairs of an insolvent person is the centre of insolvency law whether, in the case of an insolvent company, that law offers the prospect of a winding up or continuation of the corporate business. This approach is almost identical to the international trend on rescuing corporate business”.¹¹²

As mentioned above, Australian law reform made changes in the corporate rescue system in Australia taking into consideration the recommendations made on the Harmer Report. Voluntary administration was incorporated in the corporate law reform and adopted in the Act of 2001.¹¹³ The procedure is set out in Part 5.3A as follows:

The objective of Part 5.3A is to allow the “business property and affairs of an insolvent company to be administered in such a way that maximises the chances of the company or as much as possible of its business continuing in existence or, 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”.¹¹⁴

Voluntary administration provides for a flexible and inexpensive procedure for the company in order to rescue it from its financial difficulty.¹¹⁵ During administration, the company is given the breathing space so that the directors and people involved in the

¹⁰⁹ ALRC Harmer report <http://www/alrc.gov.au> (accessed on August 2018).

¹¹⁰ Yee Carrie and Wai Yan “An analysis of the corporate rescue objectives: Voluntary Administration in Australia, Administration order in the United Kingdom, provisional supervision in Hong Kong (Honours degree project 2010 Hong Kong Baptist University) at 8.

¹¹¹ Jianrong Fu and Tomasic “The Australian Voluntary Administration rescue procedure” (2012) *The Twenty-First Century Commercial Law Forum* at 8.

¹¹² Sellars at 1.

¹¹³ Corporation Act of 2001.

¹¹⁴ Section 435A of the Corporation Act 2001.

¹¹⁵ Sellars at 2.

administration can be able to come up with a plan on how to rescue the company.¹¹⁶ This is in line with one of the important factors provided under Chapter 6 of South African Companies Act 2008.¹¹⁷ The company is further given an opportunity to make compromises or arrangements with its creditors and continue to trade even though it has failed to repay its debts.¹¹⁸ One of the important purposes of voluntary administration is to save both the company and its business, and when the administration is successful, the company will be set out in a deed of company arrangement which has the effect of binding both the company and its creditors. However, in cases where the procedure fails, liquidation is often considered.¹¹⁹ The voluntary administration procedure requires the participation of both directors and creditors.

2. The creditor's right to commence voluntary administration

Voluntary administration commences when the administrator is appointed.¹²⁰ Only three parties can make an application for the appointment of the administrator; firstly, the board of directors can appoint the administrator by way of a resolution provided that the board is of the opinion that the company is insolvent or about to become insolvent.¹²¹ Secondly, by a liquidator or provisional liquidator if he or she thinks that the company is insolvent or about to become so.¹²² Finally, by a secured creditor who has a charge over the whole or substantially the whole of the company's property if the secured creditor is entitled to enforce the charge.¹²³

The right to appoint an administrator is only given to the above-mentioned parties and the court is not allowed to make an order concerning the appointment of an administrator which is in contrast with the South African rescue regime.¹²⁴ The voluntary administration procedure tries, by all means, to reduce cost by denying the courts' involvement during the rescue procedure. It is unreasonable to add

¹¹⁶ Anderson at 123.

¹¹⁷ Section 133 (1) of the Companies Act 71 of 2008.

¹¹⁸ Sellars at 2.

¹¹⁹ Harris at 3.

¹²⁰ Section 435C (1) Corporation Act 2001.

¹²¹ Section 436A of the Corporation Act 2001.

¹²² Section 436B of the Corporation Act 2001.

¹²³ Section 436C of the Corporation Act 2001.

¹²⁴ Anderson at 113.

unnecessary costs to a company which is already in financial difficulty.¹²⁵ However, the court may intervene where the procedure is being abused.¹²⁶ For example, in *Aloridge Pty Ltd v Christianos*,¹²⁷ Burchett J found that the appointment of the administrator had been made, not in the interests of the company or its creditors, but to wrest control of the company's affairs from the provisional liquidator in the hope that the administrator will favour Christianos. Therefore, an order was made under s.447A to terminate the administration.

It should be noted that when appointing the administrator, the parties (directors and liquidators) must be able to show that the company is insolvent or about to be insolvent, while secured creditors have to show an entitlement to enforce the charge.¹²⁸ However, only the board of directors will be able to give an accurate decision on whether the company is insolvent or not due to the fact that they have access to the company's financial affairs. The Australian law provides only secured creditors with the opportunity to make an appointment of an administrator, in other words, an ordinary creditor cannot effect an appointment of an administrator.¹²⁹

The appointment of an administrator has certain consequences. The administrator takes over the control of the business, property and financial affairs of the company.¹³⁰ He or she must investigate the financial position of the company and the directors must assist the administrator by handing over the financial books of the company.¹³¹ The administrator is regarded as the company agent and he or she must, after the investigation, provide the recommendation for the company's future and those recommendations must be presented before the creditors at the first meeting convened by the administrator.¹³²

3. Creditors' meetings

¹²⁵ Anderson at 113.

¹²⁶ Section 447A of Corporation Act 2001.

¹²⁷ *Aloridge Pty Ltd v Christianos* 1994 13 ACSR 99.

¹²⁸ Kaulungombe "Business rescue for Zambia: suggestions for legislative reform" (LLM dissertation 2012 University of Cape Town) at 22.

¹²⁹ Anderson at 113.

¹³⁰ Section 437A of the Corporation Act 2001.

¹³¹ Mamphey at 49.

¹³² Section 436E of the Corporation Act 2001.

Voluntary administration allows all involved parties to participate in the administration procedure and this includes creditors.¹³³ The creditors are given an opportunity to decide whether to liquidate or adopt a rescue plan.¹³⁴ The administrator has the duty to investigate and give creditors information regarding the future and financial position of the company and that should be in the best interest of the company's creditors.¹³⁵ This is done in the first and second meetings of the creditors convened by the administrator.¹³⁶ The meetings assist the creditors to make a well-informed decision in protecting their interests.

3.1 The first meeting

The administrator must, in pursuance of his or her duties, convene the first meeting for creditors within five business days of appointment.¹³⁷ However, the time-frame for the first meeting has been amended to eight business days due to criticisms.¹³⁸ For example, Sellars stated that "the time frame for the first meeting is very short, it occurs five days after the appointment and many creditors may not have the opportunity to assess the merits of the appointee in that time".¹³⁹ QBE Insurance Group Limited also expressed the view that "the time for the first meeting of creditors is too short considering the distance that has to be travelled by other creditors to attend the meeting".¹⁴⁰ Lucas¹⁴¹, on the other hand, stated that "the voluntary administration process was designed to be a fast process of reviewing a company's position, however, the timeframes as set out in the Act now are extremely tight and are often difficult to archive. There is no doubt that a fundamental objective of voluntary administration provisions is the speed, it is my view that voluntary administration

¹³³ Parliamentary joint committee on corporations and financial service, (2004) at 93.

¹³⁴ Parliamentary joint committee on corporations and financial service, (2004) at 93.

¹³⁵ Section 438A of the Corporation Act 2001.

¹³⁶ Murray & Harris "Keay's Insolvency Personal and Corporate law and practice", 2014 pyrmont NSW Thomson Reuters (professional) Australia limited 3 (<https://nla.gov.au/nla.cat-vn6381206>, accessed on 29 October 2018)

¹³⁷ Section 436E (2) of the Corporation Act 2001.

¹³⁸ Anderson at 119.

¹³⁹ Parliamentary joint committee on corporations and financial service, (2004) at 94.

¹⁴⁰ Parliamentary joint committee on corporations and financial service, (2004) at 95.

¹⁴¹ Parliamentary joint committee on corporations and financial service, (2004) at 95

regime should be altered to realise the commercial reality that time constraints are too tight'.¹⁴²

The main purpose of the first meeting during voluntary administration is to give creditors an opportunity to remove the administrator and appoint someone else in his or her place if the creditors vote to do so and to appoint a creditor's committee which will work hand in hand with the administrator during the administration process.¹⁴³ It should be noted that the committee cannot direct the administrator on what to do but rather require the administrator to report to the committee regarding the progress of administration.¹⁴⁴ It can be argued that the committee represents the best interest of creditors similar to creditor's committee set out in Chapter 6 of South African Companies Act 2008.¹⁴⁵

3.2. The second meeting

The administrator must, after investigating the financial affairs of the company, convene a second meeting for creditors usual within 28 business days or within 30 days if the Easter and Christmas intervene the commencement of administration.¹⁴⁶ The timeframe can be extended if one of the parties involved in the administration applies to the court for extension especially an administrator or the creditors.¹⁴⁷ However, the law does not specify the grounds to be taken into consideration by the court in granting the extension. The second meeting is one of the most important meetings whereby the creditors are given an opportunity to decide the future of the company.¹⁴⁸

Before the second meeting, the administrator has the duty to furnish all the company's creditors with the notice of the meeting and the notice must be accompanied by the details of any arrangement made with the creditors.¹⁴⁹ The administrator must also provide creditors with opinions as to whether it would be in the interest of the

¹⁴² Parliamentary joint committee on corporations and financial service, (2004) at 95.

¹⁴³ Section 436E (4) of the Corporation Act 2001.

¹⁴⁴ sellars at 5.

¹⁴⁵ Section 145 (3) of the Companies Act 71 of 2008.

¹⁴⁶ Section 439A (5) of the Corporation Act 2001.

¹⁴⁷ Section 439A (6) of the Corporation Act 2001.

¹⁴⁸ Parliamentary joint committee on corporations and financial service, (2004) at 98.

¹⁴⁹ Parliamentary joint committee on corporations and financial service, (2004) at 98.

company's creditors to execute a deed of company arrangement, whether it would be in the interest company's creditors to end administration and whether it would be in the interests of the company's creditors for the company to be wound up.¹⁵⁰

Taking into consideration the information given to creditors at the second meeting by the administrator, creditors have the right to come up with a resolution on one of the following:

- i. that the company executes a deed of company arrangement;
- ii. that the administration should end or that the company is wound up.¹⁵¹

One can argue that the best interest of creditors is of paramount importance and any opinion which prejudices the creditors' best interests will be set aside by the court.

3.3. Voting right at the meeting

As already indicated, the creditors must pass a resolution at the end of the meeting and such resolution must be in their best interest. The resolution is reached by voting and the law provides creditors with the right to vote under Part 5.6 of the *Corporation Regulation*.¹⁵² In order for a creditor to have voting rights, he or she must lodge his or her claim with the voluntary administrator.¹⁵³ The administrator is given the power to preside over the voting proceedings at the meeting. The resolution is determined by voices unless the poll is demanded to determine the vote either by creditors, a chair who is usually an administrator or anyone with a proxy of 10% voting rights.¹⁵⁴ In cases where the poll is granted, the majority rule will be applicable to determine the resolution. Therefore the majority of creditors voting in favour of the motion and the value of the debts owed to those voting in favour must be more than half the total debts owed to all creditors who vote.¹⁵⁵ However, in cases where the votes are 50/50 the

¹⁵⁰ Section 439A (4) of the Corporation Act 2001.

¹⁵¹ Section 439C of the Corporation Act 2001.

¹⁵² Corporation Regulation 2001.

¹⁵³ Australian securities and investment commission (2018) at 6.

¹⁵⁴ Parliamentary joint committee on corporations and financial service, (2004) at 104.

¹⁵⁵ Corporation Regulation 5.6.21 (2).

administrator may get a casting vote,¹⁵⁶ which may be set aside by the court if the creditor is not satisfied by the exercise of casting vote.¹⁵⁷

4. The effect of the moratorium

The appointment of the administrator has the effect to trigger moratorium prohibiting any action against the company. In other words, the court proceedings in relation to company property or against the company cannot proceed or be commenced unless the administrator gives consent or the court order is granted.¹⁵⁸ The main reason for providing a moratorium during administration is to give an administrator and creditors a chance to prepare an adequate solution to rescue the company.¹⁵⁹ Amongst other things, the moratorium prevents the company from being wound up,¹⁶⁰ owners or lessors are prevented from recovering property that is in the possession of the company,¹⁶¹ all the proceedings are stayed against the company,¹⁶² and it prevents attempts to enforce the court judgment.¹⁶³ Anderson states that “in any corporate rescue system there needs to be a circuit breaker that provides a breathing space while a consideration is given to the prospect of saving the company”.¹⁶⁴

The moratorium limits the rights of unsecured creditors since they cannot begin, continue or enforce their claims against the company without the administrator’s consent or the court’s permission, owners are also restricted to recover their property leased by the company.¹⁶⁵ On the other hand, the secured creditors cannot enforce their rights although they have a special position to enforce their rights under certain circumstances.¹⁶⁶ For example, the secured creditors who have the charge over the whole or substantially the whole assets of the company.¹⁶⁷

¹⁵⁶ Corporation Regulation 5.6.21 (4).

¹⁵⁷ Sellars at 6.

¹⁵⁸ Section 440D (1) of the Corporation Act 2001.

¹⁵⁹ Kaulungombe at 33.

¹⁶⁰ Section 440A of the Corporation Act 2001.

¹⁶¹ Section 44B of the Corporation Act 2001.

¹⁶² Section 440D of the Corporation Act 2001.

¹⁶³ Section 440F of the Corporation Act 2001.

¹⁶⁴ Anderson at 122.

¹⁶⁵ Australian Securities and Investment Commission (2018) at 4.

¹⁶⁶ Section 440B of the Corporation Act 2001.

¹⁶⁷ Section 441A of the Corporation Act 2001.

However, there are exceptions to the moratorium, one of which is whereby the secured creditor has a charge over the whole or substantially the assets of the company.¹⁶⁸ The term “charge” is not defined in the Act, therefore the court in the case of *Osborne computer Corporation Pty Ltd v Airroad Distribution Pty Ltd*,¹⁶⁹ held that the term “charge” did not include a lien or pledge. These were regarded as possessory security only and hence being different in nature to a charge which implied a right even without possession.¹⁷⁰ Furthermore, creditors or owners who enforce their rights before administration begins may be given an opportunity to proceed with their enforcement, and also creditors who enforce their rights in relation to the perishable property are allowed to continue with their enforcement.¹⁷¹

5. Conclusion

Australian law provides creditors with sufficient rights to be involved during the voluntary administration procedure taking into consideration their best interests. They are given the rights to appoint the administrator, however it should be noted that only secured creditors have the rights to appoint administrator meaning that an ordinary creditor may not affect the appointment. The creditors are also given the right to appoint new administrator and to form a creditor’s committee on the first meeting, the committee advocates for creditors’ best interests. However, as mentioned above, the committee cannot direct the administrator but it may require the administrator to report on the progress of the administration. The creditors’ rights are of paramount importance and the creditors have the power to decide the fate of the company since they are given an opportunity to reject or adopt the recommendation made by the administrator in relation to the company’s future. As much as creditors are given the right to participate and make decisions during administration, the moratorium which operates immediately upon the appointment of the administrator, prohibits creditors to institute their claims against the company, however, such moratorium is subject to exceptions.

¹⁶⁸ Section 441B9 (1) of the Corporation Act 2001.

¹⁶⁹ *Osborne computer Corporation Pty Ltd v Airroad Distribution Pty Ltd* 1995 17 ACSR 614.

¹⁷⁰ Anderson at 123.

¹⁷¹ Sellars at 5.

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CHAPTER 4 the Administration Order in the United Kingdom

1. Introduction

The law in the United Kingdom has different kinds of procedures to rescue the companies which are facing the financial difficulties.¹⁷² The procedures are; administration, administration receivership, company voluntary arrangement and scheme of arrangement.¹⁷³ It should be noted that all these procedures are found in one consolidated legislation called the *Insolvency Act*.¹⁷⁴ However, this chapter will only focus on the administration procedure taking into consideration the rights of creditors during the administration process.

Prior to the introduction of the administration process, the United Kingdom's corporate rescue system under administrative receivership gave creditors more powers to be in control when the company is under financial distress.¹⁷⁵ During the application of administrative receivership, creditors had more powers due to the fact that the holder of a floating charge over an asset was given the power to appoint a receiver to serve in his or her own interest by acquiring the assets or selling the assets of the company.¹⁷⁶ However, the system was reformed with the influence of the Cork Committee Report¹⁷⁷ which believes in the system that benefits both creditors and the community at large in order to save jobs.¹⁷⁸ Administration procedure is found in the Insolvency Act 1986 of the United Kingdom and it was later implemented by the Enterprise Act 2002.¹⁷⁹

2. The objectives of Administration

¹⁷² Pretorius and Rosslyn- Smith "expectation of business rescue: international directives for chapter 6 implementation" 2014 *Southern African Business Review* at 116.

¹⁷³ Pretorius and Rosslyn-smith at 116.

¹⁷⁴ Insolvency Act 1986.

¹⁷⁵ Omar and Gant "corporate rescue in the United Kingdom Past, present and future reforms" 2016 at 2.

¹⁷⁶ Omar and Gant at 2.

¹⁷⁷ Cork report, 1982, Insolvency law and practice report of the review committee, (CMND 8558).

¹⁷⁸ Omar and Gant at 3.

¹⁷⁹ Part 10 of the Enterprise Act 2002.

Simply defined, an administration is a corporate rescue mechanism for companies which are facing financial difficulties in the United Kingdom.¹⁸⁰ The procedure is described as a method which ensures the survival of the company as a going concern with the effect of prohibiting the claims for debts (moratorium),¹⁸¹ which will be discussed below. Since its implementation, it has received too much support because most creditors and companies prefer to use it. The administration aims at "rescuing the company as going concern, ensures that the company creditors receive better returns than they would if the company goes to liquidation or realise property in order to make a distribution to one or more preferential creditors".¹⁸²

The above-mentioned objectives must be met in every application for the administration order. In *Doitable Ltd v Lexi holdings PIC*,¹⁸³ the application for administration order by the Doitable Company which owned the land was denied. This was due to the lack of evidence to show that the above-mentioned objectives will be met.¹⁸⁴ Nevertheless, the applicant for the company submitted before the court that the administration order could rescue the company as going concern and the company has sufficient assets to be realized and the surplus would be enough for a member. The applicant further submitted that appointing an independent professional to take control of the company's assets and prohibiting the receiver to pursue other actions could assist in rescuing the company. However, the creditors opposed the application on grounds that the administration process was an abuse by the applicant to prevent the creditor from enforcing its security. Appropriately, the court refused to grant the administration order and favoured liquidation.¹⁸⁵

3. The rights of creditors to initiate the Administration process

The administration order is commenced in two ways namely: (i) court application; and (ii) out of court resolution.¹⁸⁶ In the court application, the general creditors may apply

¹⁸⁰ Mamphey "Legislating business rescue in South Africa: A critical evaluation" (LLM dissertation University of Fort Hare 2014) at 62.

¹⁸¹ Comparison of chapter 11 of the United States bankruptcy code and the system of administration in the United Kingdom.

¹⁸² Paragraph 3 (1) (a) (b) (c) of Enterprise Act 2002.

¹⁸³ 2005 EWHC 1804 (ch).

¹⁸⁴ Section 3(a) (b) (c).

¹⁸⁵ *Doitable Ltd v Lexi holdings PIC* 2005 EWHC 1804 (ch) *supra* note 183.

¹⁸⁶ Schedule B1 Paragraph 14 & 11 of the Insolvency Act 1986.

to a court to place the company under administration order. The applicants must submit to the court that the "the company is or likely to become insolvent and it is reasonably likely that the company can be rescued as going concern,¹⁸⁷ or if it cannot be rescued the applicants must further show that the process could result in better returns for creditors than it would in winding up the company or the assets of the company could be realized in order to make a distribution for secured and preferential creditors".¹⁸⁸ The application must be accompanied by the statement made by the administrator confirming that the purposes of the Act will be achieved.¹⁸⁹

It should be noted that in order for the court to grant the administration order giving effect to the appointment of the administrator, the petitioner must ensure that he or she established that indeed the company is unable to pay its debts or it is unlikely to do so. In addition, the petitioner must show that the administration order will indeed achieve the purposes of administration in terms of the Act. In other words, reasonable prospects to achieve the purpose of the Act must be established. In the case of *Auto management services Ltd v Oracle fleet UK Ltd*,¹⁹⁰ the court emphasised that the term reasonable prospect and the purpose for administration should be met.¹⁹¹

In order to test whether the company is unable to pay its debts, two tests are considered namely: cash flow and balance sheet. In the cash flow test, the question is whether the debtor company is able to pay debts as it carries on business.¹⁹² The balance sheet test looks at the extent to which a company's liabilities exceed its assets resulting in an inability to discharge debts.¹⁹³ In the case of *Re Colt Telecom Group PIC*,¹⁹⁴ the court, after making its observations, stated that "both cash flow and balance sheet insolvency must be proven to the satisfaction of the court. The court further observed that it was for the petitioner to prove the allegations made in the petition for administration".¹⁹⁵

¹⁸⁷ Schedules B1 paragraph 11 (b) of the Insolvency Act 1986.

¹⁸⁸ Schedule B1 paragraph 8 (1) of the Insolvency Act 1986.

¹⁸⁹ Mamphey at 62.

¹⁹⁰ 2008 B.C.C 761.

¹⁹¹ *Auto management services Ltd v Oracle fleet UK Ltd* 2008 B.C.C 761 *supra* note 190.

¹⁹² Schedule B1 at para 111(c) of Insolvency Act 1986.

¹⁹³ Section 123 of Insolvency Act 1986.

¹⁹⁴ 2002 EWHC (ch).

¹⁹⁵ *Re Colt Telecom Group PIC* 2002 EWHC (ch) *supra* note 194.

On the other hand, the procedure can be commenced by way of out of court resolution whereby secured creditors with "qualifying floating charge", directors or company itself may pass the resolution for an administration order.¹⁹⁶ The same requirements stated above should be met for the company to be placed under administration order.¹⁹⁷

On both procedures, after parties prove that the administration would achieve the purpose of administration, a qualified administrator should be appointed to take over the control of the company's property, affairs and business as a whole.¹⁹⁸ The administrator must be an independent person who takes control of the company with the intention of rescuing the financial difficulties of the company.¹⁹⁹ He or she must act in the best interest of both the creditors and the company.²⁰⁰

4. The creditor's voting rights

One of the duties and powers given to the administrator is the duty to prepare the proposal for the administration process, indicating on how he or she intended to achieve the administration and such proposal must be approved by the creditors by way of voting.²⁰¹ The creditors exercise their right to vote in the meeting convened by the administrator within ten weeks of his appointment.²⁰² In essence, the main purpose of the meeting is to decide the future of the company and such responsibility is given to creditors since their best interests are of paramount importance during the administration process.

It should be noted that the administrator is not obliged to hold or convene the meeting if he or she can manage to state on the proposal that the "the purpose of the administration can be achieved, which includes the sufficient property for the payments of creditors to be paid in full or company have insufficient property in order

¹⁹⁶ Schedule B1 paragraph 14, 22 (1), 22 (2) of the Insolvency Act 1986.

¹⁹⁷ Schedule B1 paragraph 11 of the Insolvency Act 1986.

¹⁹⁸ Schedule B1 paragraph 64 (1) of the Insolvency Act 1986.

¹⁹⁹ Schedule B1 paragraph 4 of the Insolvency Act 1986.

²⁰⁰ Schedule B1 paragraph 3(2) of the Insolvency Act 1986.

²⁰¹ Pretorius and Rosslyn-Smith at 118.

²⁰² Slaughter and May "Common issues in corporate recovery and insolvency in England and Wales"2011 *The Act Borrower's Guide* 7.

to make distribution to the unsecured creditors”.²⁰³ However, creditors who have 10% of the total bets of the company may request the meeting to be held.²⁰⁴

In the proposal, the administrator must provide sufficient information including the history of the company, its current financial position, and future plans in order for creditors to make a well-informed decision on whether to reject or accept the proposal.²⁰⁵ The proposal must be furnished to all affected creditors and the members of the company. The administrator must further file the proposal with the registrar of companies.

The creditors may accept or reject the proposal with modification and the modification must be approved by the administrator.²⁰⁶ The voting rights are subject to majority rules where the decision of the majority value on the proposal is binding.²⁰⁷ In circumstances where the proposal is accepted with modification, the administrator will be obliged to execute the company’s affairs based on that proposal.²⁰⁸ However, if the proposal is rejected, the court may intervene and discharge the administrator or make an order it deems fit for the administration purposes.²⁰⁹

5. The creditor's committee

During the meeting, the creditors have the right to appoint a committee which will advocate for their best interests and the committee should consist of at least three creditors.²¹⁰ The main function of the committee is to receive reports from the

²⁰³ Schedule B1 paragraph 52 (2) of the Insolvency Act 1986.

²⁰⁴ Schedule B1 paragraph 52 (2) of the Insolvency Act 1986.

²⁰⁵ Pretorius & Rosslyn-smith at 118.

²⁰⁶ Comparison of chapter 11 of the United States bankruptcy code and the system of administration in the United Kingdom at 15.

²⁰⁷ Comparison of chapter 11 of the United States bankruptcy code and the system of administration in the United Kingdom at 15.

²⁰⁸ Comparison of chapter 11 of the United States bankruptcy code and the system of administration in the United Kingdom at 15.

²⁰⁹ Comparison of chapter 11 of the United States bankruptcy code and the system of administration in the United Kingdom at 15.

²¹⁰ www.r3.org.uk “Administration a guide for unsecured creditors” association of business recovery professionals, accessed on 12 September 2018 at 6.

administrator on the progress of administration.²¹¹ The committee also has the right to hold its meeting periodically.

6. The effect of the moratorium

The appointment of an administrator triggers the moratorium which protects the company from any claim by creditors with the aim of giving the company a breathing space.²¹² Administration provides for two types of moratoriums namely: the interim and final moratorium.²¹³ The interim moratorium comes into effect immediately when there is intention to appoint an administrator,²¹⁴ while the final (automatic) moratorium, on the other hand, automatically comes into effect after the appointment of the administrator.²¹⁵ Both moratoriums have the same function to protect the debtors of the company against any legal processes by creditors and other stakeholders during the administration process. However, the interim operates before to appointment of the administrator, while the final moratorium operates after the appointment of the administrator.²¹⁶

The moratorium provision provides that "no legal processes to enforce security over the company's property, repossess goods under a hire purchase agreement, exercise a landlord's right of forfeiture and any legal process against the company or its property while the company is in administration".²¹⁷ In *Hudson and Others v Gambling Commission (Re Frankie Golder Green) Ltd and others*,²¹⁸ the court dealt with one of the legal processes that are prohibited during the administration process. In this case, the gambling commission was insisted on the review of the license of the company before the appointment of the administrator.²¹⁹ However, the administrator contested the review and argued that if the review is allowed and the license is withdrawn, it would affect the company's ability to trade lawfully. The commission, on the other

²¹¹ www.r3.org.uk "Administration a guide for unsecured creditors" association of business recovery professionals, (accessed on 12 September 2018) at 6.

²¹² Anderson at 111.

²¹³ *Chapter 7 International Scenario on a Law of Insolvency* at 223.

²¹⁴ Schedule B1 of the Insolvency Act 1986.

²¹⁵ Schedule B1 paragraph 43 of the Insolvency Act 1986.

²¹⁶ Mamphey at 70.

²¹⁷ Schedule B1 Paragraph 43 of the Insolvency Act 1986.

²¹⁸ 2010 ALL ER (D) 59.

²¹⁹ *Hudson and Others V Gambling Commission (Re Frankie Golder Green) Ltd and others* 2010 ALL ER (D) 59 *supra* note 218.

hand, argued that review is not prohibited as a legal process in terms of paragraph 43 of the *Insolvency Act*.²²⁰

However, the court, after taking all the interests of the parties into consideration, held that the review will stay and the company will be allowed to continue with the contract of sale in order to be rescued and save jobs of its employees.²²¹

It should be noted that the moratorium is not absolute since the administrator or the court have the power to allow the legal process to continue during the administration process.²²² The secured creditors have the right to apply to a court to lift the stayed process in certain circumstances. For example, where the company had not adequately protected the property interests of the creditors during the period of moratorium or where the debtor company does not have equity over the property and the property is not required for rehabilitation of the company.²²³

In the case *Re Atlantic Computer System Plc*,²²⁴ the court dealt with the application by the secured creditors to exercise their proprietary rights (including security rights). It was stated that one of the principles to decide on whether to grant the leave or not is to balance all the rights of creditors whether secured or unsecured, taking into consideration the administration purposes.²²⁵ Therefore, the leave should be granted if the lessor or secured creditor will suffer a loss if the leave is refused.²²⁶

7. Conclusion

The United Kingdom's *Insolvency Act* provides creditors with sufficient rights to participate during the administration process. The creditors have the right to appoint an administrator to commence administration process. However, secured creditors who hold a floating charge have too much power compared to ordinary creditors. The

²²⁰ *Hudson and Others V Gambling Commission (Re Frankie Golder Green) Ltd and others* 2010 ALL ER (D) 59 *supra* note 218.

²²¹ *Hudson and Others V Gambling Commission (Re Frankie Golder Green) Ltd and Others* 2010 ALL ER (D) 59 *supra* note 218.

²²² Buba "The balancing of creditor interests in business rescue provision of the Companies Act 2008" (PhD dissertation University of Cape Town 2017) at 149.

²²³ Buba at 149.

²²⁴ 1990 BCC 859.

²²⁵ *Re Atlantic Computer System Plc* 1990 BCC 859 *supra* note 224.

²²⁶ *Re Atlantic Computer System Plc* 1990 BCC 859 *supra* note 224.

secured creditors can appoint the administrator by way of out of court procedure by passing the resolution, while the ordinary creditors, on the other hand, may appoint the administrator by way of court application. The creditors also have the right to vote to decide the future of the company. The creditors' interests are of paramount importance in corporate rescue system globally since the future of the company is in their hands to decide on whether to approve or reject the proposal to rescue the company. The creditors also have the right to elect the committee which will represent their rights during administration. However, it should be noted that their rights are limited since the administration process has the moratorium which prohibits any legal actions against the company when the company is under the administration process.

CHAPTER 5: Conclusion and Recommendation

The aim of this dissertation was to examine the newly established rescue mechanism under Chapter 6 of the South African Companies Act 71 of 2008, taking into consideration the rights of creditors and using the business rescue mechanisms from other jurisdictions as comparative reference points. Business rescue replaced judicial management and one of its main purposes is to rescue the companies which are facing financial difficulties. However, it should be noted that while rescuing the company, the rights of creditors should be taken into consideration. It is evident from the above discussion that business rescue procedures provide creditors with sufficient rights to be involved in the process. One can argue that the rescue system in South Africa is creditor-friendly since the best interests of creditors are of paramount important. In other words, creditors play an important role during business rescue proceedings in South Africa.

Chapter 6 of Companies Act 71 of 2008 provide creditors with the right to commence the business rescue proceeding in terms of compulsory proceedings and creditors must prove before court that the company is financially distressed, that it is unable to meet its obligation and that there is a reasonable prospect to rescue the company. However, the Act is too silent on the definition of 'reasonable prospect' and this causes difficulties when creditors make an application to place the company under business rescue. The creditors also have the right to vote to reject or adopt the business rescue plan. It should be noted that this is the stage where the company's future is determined and the powers to determine the future of the company are given to creditors as one of the most important parties during the business rescue proceedings. The Act further gives the creditors the right to form their committee which will advocate for their best interests, working hand in hand with business rescue practitioner.

However, it should be noted that their rights are subject to limitation especially when considering the creditors' claim prohibited by moratorium. The moratorium prohibits any legal proceedings against the company during the business rescue proceedings, in order to provide the company with breathing space. The moratorium is also provided during the business rescue proceedings and is subject to exceptions. It is safe to say the South African rescue system is in line with international standards since it has

similar features with other jurisdictions especially the United Kingdom and Australia and even though they might not be the same dealing. The above-mentioned jurisdictions also provide creditors with rights to commence the proceedings and voting rights. The rights of creditors are very crucial either during administration (United Kingdom) or during voluntary administration (Australia), just like they are under Chapter 6 of the South African business rescue regime.

However, when considering the recommendation under the Companies Act 71 of 2008, the focus should be on the courts' involvement which increases unnecessary costs and delays in the business rescue process. The South African law reform commission should learn from Australian rescue mechanism not to involve the courts in order to reduce the costs of business rescue proceedings. It is unreasonable to subject the company which is already insolvent to court proceedings which require money and thus leading to more debts to the company. Furthermore, the word 'reasonable prospect' should be provided with a proper meaning either through the amendment of the Act or through courts' interpretation, in order to make it simple for creditors to establish reasonable prospect when deciding to commence business rescue proceedings.

Finally, even though the creditors have extensive powers than other relevant stakeholders, the rescue procedure should still be done in a manner that balances the rights of all relevant stakeholders. In other words, creditors should not be allowed to use their extensive powers to jeopardise the rights and interests of other parties who are affected by the business rescue proceedings. The company must be rescued from its financial difficulties if possible and the jobs must be saved even though the Companies Act of 2008 did not specifically state this as one of its main objectives of rescuing financially distressed companies.

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