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RESCUING CREDITORS FROM BUSINESS RESCUE: DISSECTING THE DETRIMENTAL EFFECTS OF BUSINESS RESCUE ON CREDITORS

by

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Annexure M

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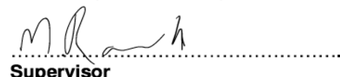
Signature:  **Date**: 30 April 2020

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List of Abbreviations and Definitions

Abbreviation/Defined Term	Full Reference
CIPC	Companies and Intellectual Property Commission
JCCL&P	Journal of Corporate and Commercial Law & Practice
JEF&S	Journal of Economic and Financial Sciences
SCA	Supreme Court of Appeal (of South Africa)
UNCITRAL	United Nations Commission on International Trade Law

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1 CHAPTER 1: GENERAL INTRODUCTION

1.1 BACKGROUND

Chapter 11 of the United States Bankruptcy Code of 1978 sparked a global surge of enthusiasm in favour of the re-organisation, as opposed to the administration of companies experiencing financial difficulties.[1] This has led to many countries globally, including South Africa, falling into step and adopting a preference for re-organisation of financially distressed companies instead of preferring the right of creditors to liquidate such company.[2] The introduction of business rescue into the South African corporate and insolvency law regime, in chapter 6 of the Companies Act 71 of 2008, is evidence of a gravitation towards this new culture of re-organisation.[3] According to Levenstein, insolvency law plays the role of requiring the law to choose whom to pay in situations where there is not enough money to go around.[4] Insolvency law is therefore burdened with the difficult task of balancing and protecting the competing interests of financially distressed companies and, amongst others, their creditors.[5]

The operation of South Africa's business rescue regime came into effect on 1 May 2011 and has, unlike its predecessor (the judicial management regime),[6] found an overwhelming utilisation by numerous companies.[7] Among the most interesting and topical business rescue proceedings ever undertaken, are the recent proceedings instituted in respect of South African parastatal, the South African Airways.[8] One could attribute the keenness by companies to make use of business rescue to its professed "debtor friendly" or "pro debtor" approach, as opposed to the apparently

[1] Bradstreet *et al* "The wolf in sheep's clothing – when debtor-friendly is creditor-friendly: South Africa's business rescue and alternatives learned from the United States' Chapter 11" 2015 *Journal of Corporate and Commercial Law and Practice* 1; see also Cassim *et al Contemporary Company Law* (2012) 861.
[2] *Ibid.*
[3] *Ibid.*
[4] Levenstein *Procedure* (2019) 2-1; see also Wood *Principles of International Insolvency* (2007) 3.
[5] Levenstein 2-5 and 2-6.
[6] Bradstreet "The new business rescue: will creditors sink or swim?" 2011 SALJ 352.
[7] CIPC "Status of business rescue proceedings in South Africa June 2019" http://www.cipc.co.za/files/2615/6326/6395/Status_of_Business_Rescue_Proceedings_in_South_Africa_June_2019.pdf (accessed 07-01-2020).
[8] "SAA to enter urgent business rescue" https://businesstech.co.za/news/government/359906/saa-to-enter-urgent-business-rescue/ (accessed 07-01-2020).

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"creditor friendly" or "pro creditor" judicial management regime.[9] This pro debtor perception is largely due to the less onerous commencement requirements than those under the judicial management regime,[10] and the automatic moratorium provided for in terms of section 133 – see 3 of the Companies Act.[11] The leniency of the business rescue commencement requirements is evidenced by the fact that, companies may now commence business rescue proceedings by, *inter alia*, simply passing a board resolution to that effect in terms of section 129 of the Companies Act.[12] The legislator's debtor friendly approach to business rescue is further proven by the moratorium, which essentially bars the creditors of a rescued company from enforcing any debts owed to them by such company (save in certain exceptional instances) for the duration of the rescue proceedings.[13] This provision of chapter 6 has been a particularly hard pill to swallow for creditors, and the subject of abuse by many companies seeking a way to avoid paying their debts.[14] Unsurprisingly, the moratorium has over the past few years become the cause of strain between the competing rights and/or interests of rescued companies and their creditors.[15]

The Companies Act does not provide a definition of the term "creditor", and accordingly the ordinary meaning thereof will apply.[16] However, the ordinary meaning of a creditor will vary based on whether its application is in respect of winding-up or in

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[9] Levenstein *Appraisal of the new South Africa business rescue regime* (LLD thesis, University of Pretoria, 2015) 27.

[10] Maphiri "The Suitability of South Africa's Business Rescue Procedure in the Reorganization of Small-to-Medium-Sized Enterprises: Lessons from Chapter 11 of the United States Bankruptcy Code" 2018 Michigan Business & Entrepreneurial Law Review 123, Maphiri states that: "[Judicial Management] required a high threshold of proof: a 'reasonable probability' rather than a mere possibility that creditor claims would eventually be paid in full when an enterprise is placed under judicial management"; see also Levenstein (LLD thesis, University of Pretoria, 2015) 57 where it is suggested that the preferred test is "a reasonable possibility" as we have it under the 2008 Companies Act.

[11] Levenstein 10-67.

[12] The Companies Act 71 of 2008 section 129(1).

[13] Section 133(1)(a) to (c) of the Companies Act provides for the following exceptional circumstances in which a creditor may enforce its claim against a company during business rescue proceedings, namely: (a) with the written consent of the practitioner, (b) with the leave of the court and in accordance with any terms the court considers suitable or (c) as a setoff against any claim made by the company in any legal proceedings.

[14] Levenstein 5-6; see also Rajak "The Culture of Bankruptcy" 2013 *International Insolvency Law: Themes and Perspectives* 23, Rajak states that: *"Giving a business the benefit of the rescue regime means preventing the enforcement by creditors of their claims and this is a serious infringement of rights which are fundamental to creditors in any capitalist society. This moratorium carries the added risk of being abused by no-hopers simply seeking a further few months of being kept alive on the equivalent of a life support machine despite already being in a terminal condition."*

[15] Delport et al *Henochsberg on the Companies Act 71 of 2008* (2011) 445.

[16] *Ibid*.

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respect of a compromise in terms of section 155 of the Companies Act.[17] A creditor would, for purposes of a compromise in terms of section 155, be any creditor having a pecuniary claim against the company (regardless of the nature of such claim).[18] The reason behind the requirement for the claim to be pecuniary in nature lies in that, in terms of section 155(6), the majority for voting is determined by the "value" of the creditors' claims.[19] Further guidance regarding the interpretation of the term "creditor" can perhaps be derived from the initial definition thereof in the Companies Amendment Bill B40 of 2010, which defined a creditor as *"a person to whom a company is or may become obligated in terms of any liability or other obligation that would be required to be considered by the company if it were applying the solvency and liquidity test as set out in section 4"*.[20]

Establishing the category of persons who qualify as creditors for purposes of business rescue as attempted above is of importance for this research paper as it will provide guidance as to the persons whose rights are likely to be prejudiced by the pro-debtor business rescue process.

Levenstein describes the meanings of 'pro-creditor' and 'pro-debtor' as follows:

> *"[the term] 'pro-creditor' describes a restructuring regime which favours the interests of the creditor and the party or entity seeking full recovery of its debts due; and 'pro-debtor' describes a regime which favours the interests of the debtor and the ability of such debtor […] to continue to trade and preserve its business and jobs and which allows such […] entity to continue to contribute to the particular jurisdiction's economy. The pro-debtor regime leans in favour of the 'fresh start' principles which allow […] corporates to survive and not end up being sequestrated or placed into liquidation."*[21]

According to section 7(k) of the Companies Act (which sets out the purpose of the Act), business rescue proceedings ought to be undertaken in a manner which:

[17] Delport et al 445.
[18] *Ibid.*
[19] *Ibid.*
[20] *Ibid.*
[21] Levenstein 2-5.

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(i) facilitates the efficient rescue and recovery of financially distressed companies, and (ii) balances the rights and/or interests of all stakeholders (i.e. the company, its creditors, employees and shareholders).[22] Based on this wording, it can be deduced that the purpose which the Companies Act seeks to achieve through business rescue is, to balance the interests of the creditor and the debtor[23] in a manner which is neither predominantly pro-creditor nor pro-debtor. It is accordingly submitted in this dissertation that, the slanted application of the business rescue regime in South Africa does not comply with the professed purpose of the Companies Act.

The Companies Act defines business rescue in section 128(1)(b) as:

"proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for:

(i.) the temporary supervision of the company, and of the management of its affairs, business and property;

(i.) a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and

(ii.) the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company."

The above definition outlines two main objects of business rescue, the first and primary one being to rescue a company in order for it to be restored to be a solvent going concern.[24] In the words of Cassim *et al*, the term 'rescue' means *"a reorganisation of the company to restore it to a profitable entity and avoid*

22 Companies Act section 7(k).
23 *Oakdene Square Properties (Pty) Ltd and others v Farm Bothasfontein (Kyalami) (Pty) Ltd and others:* Judge Classen stated that: [Business rescue] attempts to secure and balance the opposing interests of creditors, shareholders and employees; see also Levenstein 10-62.
24 Cassim et al 864.

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liquidation".[25] Accordingly, in order to say that a company has been rescued, it should be restored to a state of profitability, and its impending liquidation averted.[26] The second and perhaps secondary object of business rescue is that, in the event that the company cannot be rescued, the business rescue proceedings should lead to a better return for creditors than if the company had been immediately liquidated.[27] After almost nine years since the inception of the South African business rescue regime, it seems as good a time as ever to take stock of whether the regime has indeed yielded the results it was envisaged to achieve.

Although there is not yet a set criteria for evaluating the success of business rescue, Conradie and Lamprecht propose that the key success indicators used to evaluate business rescue regimes internationally, are: (i) the status of the business as a going concern, at termination of business of rescue proceedings, and (ii) whether the business rescue proceedings yielded a higher return to creditors as opposed to an immediate liquidation.[28] Conradie, however qualifies the first success indicator, pointing out the risk of it being short-lived and requiring follow-up evaluations after the termination of business rescue.[29] Accordingly, this dissertation will be narrowly directed at evaluating the success of business rescue through the lens of the second success indicator, i.e. the question of whether business rescue yields a better return and outcome for creditors than immediate liquidation would.[30]

A moratorium is perceived as being an essential ingredient to any modern business rescue regime and is a common feature in many corporate reorganisation regimes across the world.[31] The United States' Chapter 11 of the Bankruptcy Code, which will be discussed in more detail in chapter 4 of this dissertation, also incorporates an automatic moratorium.[32] The purpose of a moratorium is to afford financially distressed companies the financial "breathing space" required to enable them to

[25] Cassim et al 861.
[26] *Ibid.*
[27] *Idem* 864.
[28] Conradie and Lamprecht "Business rescue: How can its success be evaluated at company level?" 2015 Southern African Business Review 2.
[29] *Ibid.*
[30] *Ibid.*
[31] Levenstein 5-44.
[32] Cassim et al 861; see also Levenstein 5-44.

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restructure their affairs and get back on their feet.[33] Levenstein proposes that the preservation of a company's assets through a moratorium is effected with the interests of creditors in mind.[34] He bases his aforementioned argument on the UNCITRAL guidelines, which provide that:

"An insolvency law should preserve the estate and prevent premature dismemberment of the debtor's assets by individual creditor actions to collect individual debts. Such activity often reduces the total value of the pool of assets available to settle all claims against the debtor and may preclude reorganization or the sale of the business as a going concern. A stay of creditor action provides a breathing space for debtors, enabling a proper examination of its financial situation and facilitating both maximization of the value of the estate and equitable treatment of creditors. Some mechanism may be required to ensure that the stay does not affect the rights of secured creditors."

It is accordingly conceded that, the moratorium in section 133 of the Companies Act is very much in line with international standards, and perhaps indispensable to a successful business rescue regime.[35] It is however important to caution against having a regime which over-emphasises the rescuing of companies to the detriment of the interests and rights of all stakeholders.[36] The central issues which will be addressed in this dissertation are, the ways in which the moratorium negatively affects creditors, and how the existing legislative provisions can be amended and/or new supplementary legislative provisions can be included to curb the moratorium's detrimental effects on creditors.

1.2 PURPOSE AND OBJECTIVE OF THE STUDY

The purpose and objective of this study is to identify the various prejudices which creditors of rescued companies suffer at the hand of the moratorium in terms of section 133 of the Companies Act. Having identified the various instances where creditors may be prejudiced by the moratorium, the study will propose changes in the

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[33] Cassim et al 879.
[34] Levenstein 5-45.
[35] *Ibid*.
[36] *Idem* 5-41.

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legislative drafting and/or the application of the business rescue provisions in order to close those gaps which make the moratorium prejudicial to creditors, and susceptible to abuse by companies. The study will draw inspiration from the corporate rescue regime of the United States of America (USA), as the pioneering jurisdiction for modern corporate re-origination,[37] in exploring and making the proposed solutions to the difficulties highlighted herein.

According to the Companies Act, business rescue is a tool geared at facilitating the the efficient rescue and recovery of financially distressed companies, in a way which balances the interests of *all* stakeholders.[38] This wording suggests that the legislator envisaged that business rescue proceedings would be conducted in a manner which not only favours the rescued company, but also its stakeholders. Therefore, the aim of this dissertation is to identify those instances where the South African business rescue regime fails to adequately balance the competing interests of the company and its stakeholders, with a specific focus on creditors.

1.3 RESEARCH QUESTIONS

In order to achieve the research objective and aim, this dissertation attempts to address and answer the following research questions:

(i.) What are the goals of the legislation regarding the interests of stakeholder interests during business rescue proceedings?

(ii.) How does the practical application of the legislation favour the interests of the rescued company as opposed to its creditors?

(iii.) What international legislation and practices can be adopted to supplement our legislation and/or practices in order to eradicate existing imbalances between the interests of companies and their creditors?

(iv.) How does the USA's "debtor in control" approach to corporate rescue compare to South Africa's Business Rescue Practitioner (BRP) approach, particularly with regard to their respective abilities to yield successful rescue results?

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[37] Maphiri 2018 *Michigan Business & Entrepreneurial Law Review* 123.
[38] Companies Act section 7(k).

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1.4 METHODOLOGY

The method of research used for this dissertation will be a desktop research method. The dissertation will encompass recent South African literature on the topic of business rescue, particularly taking a critical view on its shortcomings and potential areas of improvement. Due to the fact that business rescue is a foreign concept largely influenced by Chapter 11 of the United States Bankruptcy Code, this dissertation will contain a comparative analysis of the USA corporate rescue regime. A brief comparison will also be made between the corporate rescue regime of the United Kingdom (UK) and South Africa, as the UK has also been acknowledged as being among the leading jurisdictions on this subject.

1.5 SCOPE

This dissertation focuses only on the disadvantages which may be encountered by creditors (not other stakeholders or interested/affected parties) during business rescue proceedings. The reasons for narrowing the scope of this dissertation to creditors (and not stakeholders in the broad sense) are that: (i) as stated in paragraph 1.1 above, the return yielded to creditors is one of the key success indicators for business rescue,[39] and (ii) the balance between the rescued company's interests and those of its creditors is often the most difficult to achieve and the most sensitive to maintain.[40]

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[39] Conradie and Lamprecht 2015 *Southern African Business Review* 2

[40] Levenstein 2-5 explains: *"These competing interests represent fundamental and ancient attitudes to the manner in which business should be conducted: on the one hand, stern values of discipline, prudence, responsibility and diligent care of other people's money, expressed in an intense moral disapproval of defaulting debtors, and, on the other hand, sympathy for the weak, expressed in antipathy to creditors and a wish to redistribute. The fact that these emotions are so bitterly entwined in bankruptcy law is the despair of economists, but they are a fact of life and help explain why practically every facet of bankruptcy law, big or small, is contentious."*; see also Wood *Principles* 4.

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Furthermore, the study will primarily, but not exclusively, focus on business rescue proceedings commended voluntarily by way of a board resolution in terms of section 129 of the Companies Act, as these account for the majority of all business rescue proceedings instituted in South Africa.[41]

The general over-all merits of business rescue will not be interrogated either, except in as far as it is used to justify or supplement an argument made in relation to the main topic.

1.6 CHAPTER SUMMARY

Chapter 1: General Introduction

Chapter one (which is the present chapter) gives a brief introduction and background to the study. Certain key concepts and definitions which will be of relevance in the study are also briefly explained in this chapter. The chapter furthermore gives a brief justification of the foreign jurisdiction which will be used for comparative purposes.

Chapter 2: Business Rescue Procedure – A Step in the Right Direction?

Chapter two will entail a historical glimpse at the predecessor of business rescue and its development. It will provide an in-depth look into the concept of business rescue as we know it today, as well as related or interlinking concepts both in the Companies Act and the Insolvency Act.[42]

Chapter 3: The Distress of the Creditor

Chapter three will contain case law and practical situations in which creditors have been or could potentially be detrimentally affected by business rescue proceedings.

Chapter 4: Business Rescue in Foreign Jurisdictions

Chapter four will look at the ways in which the burdensome effects of business rescue on creditors can be alleviated or remedied through possible reform. This objective will be achieved by having cognisance to foreign jurisdictions, particularly

[41] Pretorius "Business Rescue Status Quo report" 31 https://pmg.org.za/files/151110Business_Rescue.pdf (accessed 28-02-2020).
[42] Insolvency Act 24 of 1936.

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the USA, where the practice of corporate rescue has been dealt with for far longer than in South Africa, yielding successful results.

Chapter 5: Conclusion and Recommendations

Chapter five gives a summary of what has been put forward in this research paper and suggests possible remedies to solve the problem statement.

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2 CHAPTER 2: BUSINESS RESCUE – A STEP IN THE RIGHT DIRECTION?

2.1 INTRODUCTION

According to Judge Kgomo, in the high court case of *Merchant West Capital Working Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Ltd*:

> "*business rescue is […] a system that is aimed or geared at temporarily protecting a company against the claims of creditors so that its business can thereafter be disposed of (if concern could not be saved) for maximum value as a going concern in order to give creditors and shareholders a better return than they would have received had the company been liquidated.*"[43]

Judge Kgomo's words perfectly embody and summarise, what seems to have been the legislator's envisaged goal when the business rescue legislation was drafted. Business rescue was meant to create a system which not only protects a company against the claims of creditors but does so with the goal of either salvaging the company from eminent liquidation, or at least getting such a company to a place whereby the sale of the company as a going concern will yield a higher return for creditors than immediate liquidation would have.[44] This was and remains to be the ultimate goal and purpose of business rescue. The question is, however, whether this dual purpose is indeed being fulfilled in practice.

This chapter aims to highlight the various ways in which the practical application of our corporate reorganisation legislation fails to uphold this dual purpose of business rescue. It is argued that, although business rescue is indeed being used to protect companies against the claims of its creditors, more often than not, it fails to yield the "better return" for creditors which should follow such a period of protection. Before dissecting the aspects of business rescue which adversely affect creditors, it

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[43] *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Ltd* (2013/12406) [2013] ZAGPJHC 109 (10 May 2013).
[44] *Ibid.*

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is necessary to take a look at the historical and legislative framework of the South African business rescue regime.

2.2 THE HISTORY AND FOUNDATION OF CORPORATE RESCUE IN SOUTH AFRICA

The Companies Act provides for two ways in which business rescue proceedings may be commenced, the first being voluntarily by way of a directors' board resolution in terms of section 129, and the second being by way of court order in terms of section 131. The arguments postulated in this research will be mainly, focused on business rescue proceedings commenced in the first manner (that is, by voluntary board resolution) as this form of commencement, according to a study prepared by Prof Marius Pretorius for the CIPC, accounts for approximately 90% of the business rescue filings in South Africa.[45]

In terms of section 129 of the Companies Act, a company's board of directors may decide to adopt a board resolution with a majority vote to voluntarily place the company in business rescue. Section 129(1)(a) and (b) provides that such a resolution may only be passed if the company is financially distressed and there is a reasonable prospect of rescuing the company. In essence section 129 allows a company, acting through its board of directors, to unilaterally involve itself in business rescue proceedings by passing a resolution, and only thereafter notifying relevant stakeholders thereof.[46] The legislator intentionally made provision for this low hurdle entry route in order to minimise costs and encourage the management of financially distressed companies, to utilise the business rescue procedure at the earliest sign of trouble.[47] This low hurdle approach, although well intended, is problematic in that it allows the directors of a company to institute business rescue proceedings notwithstanding the possibility that the company's financial difficulties could be as a result of their own mismanagement.[48] The voluntary commencement of business

[45] Pretorius "Business Rescue Status Quo report" 31 https://pmg.org.za/files/151110Business_Rescue.pdf (accessed 28-02-2020).
[46] Cassim et al 866.
[47] *Ibid.*
[48] *Idem* 867.

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rescue is accordingly susceptible to abuse,[49] as will be highlighted below. Cassim *et al* submit that the requirement in regard to a reasonable prospect of rescuing the company, ensures that companies which are not economically viable are placed into immediate liquidation instead of business rescue.[50] However, compliance with this pre-requisite will be difficult to regulate because business rescue proceedings commenced by way of board resolution are not subjected to any regulatory pre-vetting procedure, in that no court or regulatory body substantively assesses the business rescue filing prior to its commencement. This is quite a drastic shift from the previous position under the judicial management regime which mandatorily required prior court approval.[51] The judicial management regime had been in place since the Companies Act No. 46 of 1926, and continued to exist under the 1973 Companies Act until it was replaced by business rescue in 2011.[52]

Judicial management was first introduced in the 1926 Companies Act, which made judicial management available as an alternative remedy to companies that were not able to pay their debts, or whose financial affairs would ordinarily warrant having them wound up.[53] If a court believed there was a reasonable probability that placing a financially troubled company under proper management would restore it to a position whereby it would be able to meet its obligations, the court had the power and discretion to grant a judicial management order.[54] What this meant was that the company would continue in its existence under the management of a judicial manager and would be restored to its normal management once all its creditors had been paid.[55] The reason behind the introduction of judicial management was primarily rooted in the realisation that South Africa's developing economy could not afford the winding-up and dissolution of companies which contribute towards the development of industries and commercial enterprises, due to momentary setbacks which were reasonably capable of being overcome.[56]

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[49] Levenstein (LLD thesis, University of Pretoria, 2015) 564, acknowledges that*: "… abuse of the [business rescue] process exists. Certain boards will take the opportunity to take advantage of the moratorium and have creditor claims stayed".*
[50] Cassim et al 865.
[51] Levenstein 3-1.
[52] *Ibid.*
[53] *Ibid.*
[54] *Ibid.*
[55] *Ibid* 3-2.
[56] *Ibid.*

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The concept of judicial management was further developed in the 1973 Companies Act. The 1973 Companies Act provided for the judicial management of companies which were unable to pay their debts or meet their obligations and were prevented from becoming successful concerns as a result of mismanagement (or for any other reason), if there was a reasonable probability that placing them under judicial management would enable them to pay their debts and/or meet their obligations and become successful concerns.[57] The court could, in the aforementioned circumstances grant a judicial management order in respect of such a company, if it seemed just and equitable to do so.[58] A successful application to place a company under judicial management hinged on the court being satisfied that it was sufficiently shown that the company in question had the ability to become a successful concern.[59] This was a particularly stringent requirement and a difficult hurdle to overcome as it left no room for the possibility of placing a company in judicial management if it would yield a better return for creditors upon the sale of the company as a going concern, or its eventual liquidation.[60]

The highly onerous requirements of judicial management resulted in financially distressed companies often opting to go the "compromise/arrangement" route to bring about the results of corporate rescue.[61] This alternative route made it possible for a company to enter into a compromise/arrangement with its creditors and/or members for a number of purposes including, but not exclusively, relating to business rescue.[62] In spite of this alternative mechanism being more burdensome, expensive and offering less protection against claims, companies still opted to use it as a rescue vehicle instead of judicial management.[63] This was a clear manifestation of the failure of judicial management as a business rescue mechanism.[64]

Similarly to the business rescue regime, judicial management sought to enable the

[57] section 427(1) of the 1973 Companies Act; see also Levestein *South African Business Rescue* 3-4.
[58] *Ibid.*
[59] *Ibid.*
[60] Loubser "Some comparative aspects of corporate rescue in South African company law" (LLD-thesis, University of South Africa, 2010) 17. See also Blackman et al *Commentary on the Companies Act* (2003) 153.
[61] Ibid 138.
[62] *Ibid.*
[63] *Ibid.*
[64] *Ibid* 139.

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restructuring of financially distressed companies by giving them financial "breathing space" through a moratorium against creditors.[65] However, unlike with business rescue, the moratorium in terms of the 1973 Act was not automatic.[66] According to section 428(2)(c) of the 1973 Act, the court had a discretion to grant a moratorium on all actions against the company.[67]This was yet another one of the elements for which the judicial management system was criticised.[68] Given the fundamental role played by the moratorium in facilitating the successful rescue and restructuring of the distressed company, it made little sense that in some instances the court could refuse to grant a moratorium at all.[69] This could possibly be attributed the failure or otherwise limited success achieved by judicial management.[70]

A further contrast between the business rescue process and judicial management is that, under the judicial management regime, the company had to show that there was a reasonable probability that being placed under judicial management would enable it to pay its debts or to meet its obligations and become a successful concern.[71] On this point, the standard imposed in respect of business rescue is far less onerous in that, the company need only prove that a reasonable prospect of success exists.[72] The Companies Act, however, gives no guidelines as to the standard of proof required in this regard.[73] It appears as though one need not prove that the rescue will succeed, but merely that reasonable prospects exist.[74] For this reason Wassman, it is submitted, correctly suggests that the prospects should be assessed objectively.[75]

The stringent requirements of the judicial management system were often impossible to attain, leading to the general underutilisation thereof and ultimately culminating in its dismal failure. It is with this understanding and perhaps fear that the legislator

[65] Ofwono "Suggested Reasons for the failure of Judicial Management as a business rescue mechanism in South African law" (PGD-thesis, University of Cape Town, 2014) 3; see also Burdette 'Some Initial thoughts on the Development of a Modern and effective Business Rescue Model for South Africa (Part 1)' 2004 SA Merc LJ 241.
[66] *Ibid.*
[67] *Ibid.*
[68] *Ibid.*
[69] *Ibid.*
[70] *Ibid.*
[71] *Ibid.*
[72] Wassman "Business rescue – getting it right" (February 2014) *De Rebus.*
[73] *Ibid.*
[74] *Ibid.*
[75] *Ibid.*

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seems to have approached the drafting of the business rescue provisions, not wanting to create a similarly debtor unfriendly and stringent system as the failed judicial management. Although several parallels (such as the moratorium and the management of companies by third parties) can be drawn between the business rescue and judicial management regimes, the most prominent difference is the leniency of the procedural requirements of business rescue in contrast to those under judicial management.[76] This leniency, although welcomed by many academics and legal practitioners such as Levenstein, can pose a threat to the interests of creditors, as will be highlighted below.

2.3 THE BUILDING BLOCKS OF BUSINESS RESCUE AND ITS CONSEQUENCES

The key provisions of the Companies Act on which this dissertation focuses are found in section 133. Section 133 provides for a general moratorium and reads as follows:

> *(1) "During business rescue proceedings, no legal proceeding, including enforcement action, against the company, or in relation to any property belonging to the company, or lawfully in its possession, may be commenced or proceeded with in any forum, except [in specific limited circumstances set out in subsections (a)-(f);*
>
> *(2) During business rescue proceedings, a guarantee or surety by a company in favour of any other person may not be enforced by any person against the company except with leave of the court and in accordance with any terms the court considers just and equitable in the circumstances."*[77]

The moratorium essentially gives a company in business rescue, immunity against claims from creditors, both its own as well as those in whose favour it is a guarantor or surety[78] for the duration of such rescue proceedings. It is also important to note

[76] Maphiri 2018 *Michigan Business & Entrepreneurial Law Review* 123.
[77] There are, however, a few exceptional circumstances listed in section 133(1)(a)-(f) of the Companies Act which the moratorium does not apply to.
[78]This position is confirmed by Rogers AJ in the case of *Investec Bank Ltd v Bruyns* 2012 (5) SA 430 (WCC).

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that the moratorium applies to all the company's creditors, including the dissenting and secured creditors.[79]

In addition to the aforementioned detrimental effects of the moratorium on creditors, the Act's failure to place a clear and definitive time limitation for termination of business rescue proceedings, undoubtedly places creditors at an even greater disadvantage. On the aforementioned point, the provisions of section 132(3) of the Companies Act are of relevance. Section 132(3) merely requires that, in the event that a company's business rescue proceedings should continue beyond 3 months from commencement thereof (or such longer time as the court may allow upon application by the BRP), the BRP must prepare and submit a monthly progress report on such proceedings. The aforementioned provision highlights and brings to the fore, the current unconcise and unrestricted time frames within which the business rescue proceedings are to take place.

Yeats et al[80] set out a summary of the situations under which business rescue proceedings will terminate, namely when –

(i.) the court sets aside the resolution or order in terms of which the proceedings were initiated; or

(ii.) business rescue proceedings are converted to liquidation proceedings by the court; or

(iii.) the business rescue practitioner files a notice of termination of the rescue proceedings with CIPC; or

(iv.) a business rescue plan has been proposed and rejected and no affected person has sought to extend the proceedings; or

(v.) the business rescue plan has been adopted and the practitioner has filed a notice of 'substantial implementation' of that plan.[81]

Accordingly, if none of the above-mentioned events occur, business rescue proceedings shall be entitled to continue indefinitely. This dissertation will interrogate

[79] Cassim et al 879.
[80] Yeats et al *Commentary on the Companies Act of 2008* (2018) 6-13; see also section 132(2)(a) to (c) of the Companies Act.
[81] *Ibid.*

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and seek to ventilate the effect which such uncertainty and lack of restriction in time frames negatively affects creditors and their own businesses. It is submitted that, the legislator's failure to restrict and confine business rescue proceeding to certain time periods is undesirable, as it poses the risk of giving companies immunity from paying their debts under the guise of the moratorium, for an indefinite period of time while the creditors suffer the harsh consequences indefinitely.[82] Furthermore, even in the event that the business rescue proceedings do come to an end within a reasonable time, the provisions of section 150(5)(2)(b) of the Companies Act allows for a business rescue plan to provide for a moratorium that extends beyond the duration of the business rescue proceedings.[83]

Considering the above, it is not difficult to imagine the endless and severe ways in which creditors could be negatively affected and prejudiced by this moratorium. It is widely accepted that business rescue must be conducted as quickly as possible in order to lessen the prejudice to creditors and employers.[84] The Companies Act attempts to mitigate the prejudice which the moratorium may cause affected creditors by providing for a stay on the computation of the prescription period of such creditors' claims against the company.[85] This provision however, does not come even close to remedying the prejudice and detrimental effects which affected creditors may suffer.

Bearing in mind the far-reaching consequences and possible prejudices that stakeholders (particularly creditors) of companies may face as result of business rescue proceedings, it is rather alarming that the procedure is not a little more regulated and subject to some form of vetting process. Cassim *et al,* affirm the fact that not all companies are suitable for business rescue, and submit that in some cases business rescue may be a prohibitively expensive process for a company.[86] In instances where business rescue does not seem like a suitable remedy, a compromise in terms of section 155 of the Companies Act[87] or perhaps immediate

[82] Wassman *"Business rescue – getting it right"* De Rebus <http://www.derebus.org.za/business-rescue-getting-right/> (accessed 13-06-2019).
[83]Delport et al 482; see also *Levenstein* 9-22, explains that: *"Such a moratorium would not be a wide one but would be specific to a creditor or a specific group of creditors".*
[84] Yeats 6-13; see also Cassim et al 876 -877.
[85] Companies Act section 133(3).
[86] Cassim et al 863.
[87] Maphiri 2018 *Michigan Business & Entrepreneurial Law Review* 121.

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liquidation could prove more suitable. The suitability of business rescue in respect of a company will largely depend on the cause of such company's financial distress.[88]

The Companies Act allows for affected persons to approach the court for an order setting aside a board resolution to commence business rescue any time after its adoption until the adoption of a business rescue plan.[89] Such an application to the court can be made based on three possible grounds, namely that –

(i.) there is no reasonable basis for believing that the company is financially distressed;
(ii.) there is no reasonable prospect of rescuing the company; or
(iii.) the company failed to comply with the procedural requirements in section 129 of the Companies Act. [90]

Although the above procedure offers some protection against the abuse of the business rescue procedure, it is submitted that subjecting the procedure to more thorough scrutiny by the court would be a more suitable solution.[91] The objection procedure made available to affected persons is quite onerous in that a formal court application can be quite lengthy and costly on the affected person. A further stumbling block lies in the fact that the Companies Act gives the high court, instead of a lower court, jurisdiction in respect of the objection applications.[92] This is a stumbling block because the costs to approach the high court will certainly be higher than the costs in respect of a lower court.[93] The general legal costs that come with instituting the objection application, as well as the risk of an adverse cost order in the event of an unsuccessful application are all deterring factors for affected persons. These deterrents will, without a doubt, result in a lot of affected persons being prejudiced by their fear or inability to afford to exercise their right to object against business rescue proceedings.

[88] Cassim et al 863.
[89] Companies Act section 130; see also Cassim et al 870.
[90] *Ibid.*
[91] *Ibid.*
[92] Companies Act section 128(1)(e).
[93] It is a generally known fact in litigation practice that litigating in a higher court is more expensive than in a lower court.

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The above submissions clearly call for an amendment of the legislation to provide for a process in terms of which the initiation of business rescue proceedings will be subjected to a vetting procedure at an earlier stage. It is argued in this dissertation that, an early vetting process will serve the purpose of ascertaining whether business rescue is in fact a viable and suitable solution for a particular company on a case by case basis. In addition to a vetting process, requiring the consultation of stakeholders at the outset could also prove beneficial.

2.4 SHAREHOLDERS AS CREDITORS

2.4.1 Shareholder Approval Requirements

A note-worthy observation pertaining to the procedural requirements for initiating business rescue, is that the board resolution to place a company in business rescue is not subject to shareholder approval[94] (save for in the case where the company's memorandum of incorporation provides otherwise).[95]

The legislator's omission to subject the voluntary commencement of business rescue proceedings to shareholder approval is questionable, seeing as the voluntary winding-up of a company is subject to the special resolution of the shareholders.[96] One could perhaps argue that, because the shareholders' input and approval is required for implementation of the business rescue plan, it provides sufficient protection.[97] However, it would appear that requiring shareholder approval so far into the process may prove to be too late to make a significant difference and provide a sufficient safeguard.

To drive this point home, it is necessary to highlight the fact that, business rescue proceedings are considered to have commenced when the company files a resolution to place itself under supervision in terms of section 129(3) of the

[94] Cassim et al 866.
[95] Section 129(1) of the Companies Act is an unalterable provision. Section 15(2)(iii) of the Companies Act permits provisions in the company's memorandum of incorporation which impose on the company a higher standard, greater restriction, or any similarly more onerous requirement, than would otherwise apply to the company in terms of an unalterable provision of the Act. A provision subjecting a section 129(1) board resolution to approval by shareholder resolution would therefore be valid in terms of section 15(2)(iii).
[96] Companies Act section 80(1).
[97] Companies Act section 146.

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Companies Act, with the CIPC.[98] The company is required to notify affected persons (which include such company's shareholders and creditors) of the business rescue proceedings, and to appoint a BRP within five days of filing the aforementioned resolution (or such longer period as the CIPC may allow upon application).[99] Therefore, in terms of the current business rescue provisions of the Companies Act, only after the company is placed under business rescue (and after the moratorium is already in effect) does the consultation process with affected persons begin.[100] At this stage, the shareholders can no longer prevent the effects of the moratorium, as it would have already come into effect. This is important, given the fact that shareholders can often find themselves in a debtor-creditor relationship with the rescued company, in instances where such shareholder has a loan claim against the company. The result of the moratorium on this type of loan claim would be that, where payment in respect of such loan would otherwise be due, payable and enforceable by the shareholder, the shareholder would be barred from instituting action to enforce payment of such claim.[101]

Therefore, seeing as shareholder-creditors may also be subjected to the burdensome consequences of the moratorium, it is worth canvassing for a legislative requirement subjecting the voluntary commencement of business rescue to shareholder approval. Shareholder-creditors should be afforded this additional protection because, they most likely took on the risk of loaning the company money reliant on the "safety net" that they have power to decide on fundamental decisions regarding the company, which may adversely affect the repayment of such loan. It is therefore necessary for legislation to provide an avenue for shareholders to steer the direction in which the company goes in as far as the voluntary institution of business rescue proceedings are concerned, just like they have with regard to the voluntary winding up of the company.

Although it can be argued that the impact of the moratorium affects shareholders in their capacity as creditors (not as shareholders), a counterargument can be

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[98] Companies Act section 132(1)*(a)*(i); see also Cassim et al 867.
[99] Companies Act section 129(3)(a) read with section 128(1)(a).
[100] Section 128 of the Companies Act's definition of "affected person" includes a shareholder or creditor of the company.
[101] Companies Act section 133(1).

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postulated that the shareholders gave the loan under the auspices of their role as shareholders of the company. The risk which the shareholders of the company are willing to take in loaning the company money is cushioned by the security of knowing that they have a controlling interest in the company and have decision making powers in respect of decisions which may affect the financial fate of the company.

2.4.2 Set-Off

Another interesting company shareholder dynamic which exists is the situation whereby a company and its shareholder(s) are mutually indebted to one another. In such a case, the shareholder would be entitled to set-off the amount it owes the company against the amount in which the company is indebted to such shareholder.[102] This principle of applying set-off as between a company and its shareholder prior to the liquidation of such company, was accepted by the court in the case of *Trans-African Insurance Co Ltd*.[103] In addition, the Companies Act, in section 133(1)(c) expressly precludes the enforcement of debt by way of set-off from the ambit of the moratorium.[104] Therefore, shareholders of a company could escape the snare of the moratorium in the event that there are mutual debts between such shareholder and the rescued company, capable of being set-off.

Set-off can also prove to be a useful tool for other creditors of a rescued company, not just those who are shareholders. More recently, in the case of *Kritzinger & Another v Standard Bank of South Africa*, the court dismissed an interdict application to prevent Standard Bank from setting-off the debt owed to it by the company against funds held by the Standard Bank on its behalf.[105] As is evident from the case, banks could therefore be the biggest beneficiaries of the set-off provisions in the case of one of its debtor companies going into business rescue. The consequence of this is that, creditors can use setting off the mutual debts

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[102] The principle of set off is a long-standing principle established under South African common law as set out in the case of *In re: Trans - African Insurance Co Ltd* 1958 (4) SA 324 (W).
[103] *In re*: *Trans-African Insurance Co Ltd* 1958 (4) SA 324 (W) - Set -off operating before company liquidated — Nothing in Companies Act of 1926, as amended, to preclude allowance thereof as between shareholders and company.
[104] Companies Act section 133(1)(c).
[105] *Kritzinger v Standard Bank of South Africa* (3034/2013) [2013] ZAFSHC 215 (19 September 2013).

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between themselves and the rescued company to not only circumvent the burdensome consequences of the moratorium, but also (in the event of eventual liquidation) to "in essence" jump the preferential queue of payment (despite being an unsecured creditor). This is highly advantageous for the benefitting creditor but can be very prejudicial to the entire body of creditors.

Set-off is a fairly easy manner of recourse to achieve because the expunction of debts takes place automatically *ipso jure* when two parties are mutually indebted and both debts are in balanced existence[106] and creditors should, where possible, take full advantage of this tool. Opportunities for set-off are however rare, and thus in the absence of a mutual debt-creditor relationship between the company and a creditor-shareholder, such shareholder will be subjected to the effects of the moratorium without having been afforded an opportunity to object prior to the board of directors filing for business rescue. For this reason, it is important to at least incorporate a legislative requirement in the Companies Act for shareholder approval prior to the commencement of business rescue in order to facilitate the consultation of shareholders earlier on in the process.

2.5 THE BUSINESS RESCUE PRACTITIONER AND RESCUE COSTS

The wording in the Companies Act makes it clear that, the point at which business rescue may be commenced is when a company is financially distressed.[107] A company is financially distressed when there is a reasonable likelihood that: (i) the company will not be able to pay its debts in the ordinary course of business as they become due in the ensuing 6 months (commercial insolvency), or (ii) the company will become insolvent in the ensuing 6 months (balance sheet or factual insolvency).[108] The rescuing of commercially insolvent companies is highly encouraged, as this upholds one of the aims of modern insolvency, which is the early discovery of and intervention in cases of looming insolvency.[109] This however does

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[106] Fari "Set-off as a means of debt recovery" (LLM-thesis, University of Pretoria, 2018) 14, confirms that: *"It is accepted in South African law that set-off applies by operation of law provided that [there are mutual obligations, the debts are of the same kind, the debts are due and enforceable and both debts are liquidated]*".
[107] Section 128(1)(b) of the Companies Act.
[108] Companies Act section 128(1)(f); see also Levenstein 1-4.
[109] Cassim et al 862..

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not exclude factually insolvent companies (the liabilities of which exceed their assets) from being eligible for business rescue.[110] Although saving the company from eminent liquidation is the first goal of business rescue, where this is no longer possible, the alternative goal is to use the proceedings to help get a better return on it upon its liquidation or sale as a going concern.[111]

However, considering how expensive business rescue proceedings are, it is likely that (if a company is eventually liquidated) payments of such expenditures will result in an even less return for creditors than immediate liquidation.[112] According to Prof Marius Pretorius' study, the general view is that distressed businesses cannot afford the cost of business rescue and that incurring those costs is often the cause of their eventual liquidation .[113] This view finds overwhelming support in the discussion of the business rescue practitioner's fees and costs of business rescue set out below.

The fees of BRPs have been described as being highly exorbitant, ranging from an hourly rate of R1,250.00 and R2,000.00 per hour, or a daily fee of R15,625.00 to R25,000.00 per day (depending on the size or type of company).[114] The Companies Act expressly deals with the BRP's fees and expenses incurred during business rescue (not expenses incurred in lodging an application in terms of s 141(2)(a)(ii) of the Companies Act) in sections 135 and 143 of the Companies Act.[115] In terms of section 135, the fees and expenses incurred by the BRP during business rescue will have preference in the order in which they were incurred over all unsecured claims against the company.[116] Section 135(4) confirms that the fees and expenses of the BRP will continue to enjoy the aforementioned preference even after business rescue proceedings have ceased and the company is placed into liquidation in terms of s 141(2)(a) (ii) of the Companies Act.[117] At this point (that is, the commencement of

[110] Levenstein 1-5.
[111] *Ibid.*
[112] Pretorius "Business Rescue Status Quo report" 39 https://pmg.org.za/files/151110Business_Rescue.pdf (accessed 28-02-2020).
[113] *Ibid.*
[114] Companies Act section 134 and Regulation 128 of the Companies Regulations.
[115] van der Merwe et al "The risky business of a business rescue practitioner" May 2018 *De Rebus* 22.
[116] *Ibid.*
[117] *Ibid.*

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liquidation) the provisions of the Insolvency Act become applicable and govern further proceedings with regard to the company.[118]

The SCA recently dealt with the interpretation of the above-mentioned statutory provisions pertaining to the ranking of the BRP's claim for fees and expenses, in the matter of *Diener NO v Minister of Justice and Others.*[119] The SCA held, with specific reference to section 143(5) of the Companies Act, that the section does not elevate the business rescue practitioner's claim for fees and expenses incurred in business rescue to enjoy a *super–preference* in liquidation proceedings.[120] This case dealt particularly with the ranking of a BRP's fees and expenses incurred in business rescue, where such business rescue proceedings are discontinued and replaced by the institution of liquidation proceedings[121] in accordance with section 141(2)(a)(ii) of the Companies Act. The SCA essentially confirmed the ranking of claims against the insolvent estate in liquidation proceedings as being first, secured claims, then liquidation costs and lastly the BRP's fees and expenses incurred in business rescue (in accordance with the Insolvency Act and Companies Act).[122]

This ranking is highly prejudicial to the concurrent creditors of the company in that, should the company end up being placed in liquidation, they will (after payment of the secured creditors, liquidation expenses and the BRP) be left with an even smaller piece of the pie to share.[123] This view is supported by Rajak, who acknowledges that *"an artificially protected debtor that doesn't [recover financially] is very likely to leave an even smaller estate than would have been available had the debtor company gone straight into liquidation"*.[124] Liquidation has often been vilified by various academics, and is considered to be an extreme measure of relief.[125] Although the merits of a "proper" business rescue regime (as opposed to the liquidation of a company) are undisputable,[126] the detrimental effects of an improperly utilised and

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[118] van der Merwe et al May 2018 *De Rebus* 22.
[119] *Diener N.O. v Minister of Justice* (926/2016) [2017] ZASCA 317 (1 December 2017).
[120] *Ibid.*
[121] van der Merwe et al May 2018 *De Rebus.*
[122] *Ibid.*
[123] Levenstein 5-6.
[124] Rajak 2013 *International Insolvency Law: Themes and Perspectives* 23.
[125] Wood *Principles of Insolvency Law* 31.
[126] Cassim et al 861.

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regulated regime can be more disastrous for creditors than immediate liquidation.[127] If for example, a company was placed in immediate liquidation, the company would have only incurred liquidation expenses instead of incurring both business rescue and liquidation expenses. The elimination of business rescue expenses would result in a larger residual amount (after paying the liquidation expenses and the secured creditors) at liquidation of the company, from which concurrent creditors could benefit.

Statistics indicate a very low rate of success in business rescue proceedings. According to a report published by CIPC providing an overview of the status of business rescue proceedings within South Africa based on applications submitted to CIPC for the period between 1 May 2011 and 30 June 2019[128] the following observations can be made out of a total 3298 business rescue filings:

(i.) 23% were terminated by way of filing a (CoR125.2) Notice of Termination in terms of section 141(2)(b) of the Companies Act, meaning that the BRP had concluded that there are no longer reasonable grounds to believe that the company is financially distressed;

(ii.) 17% were substantially implemented by way of filing a (CoR125.3) Notice of Substantial Implementation in terms of section 152(8) of the Companies Act;

(iii.) 12% ended in direct liquidation;

(iv.) 8% were declared a nullity;

(v.) 1% was set aside by the court; and

(vi.) 39% were still active and ongoing.

The above figures as at June 2019, clearly indicate that the success rate of business rescue proceedings is not high enough to justify the prejudice and burden suffered by creditors in the name of business rescue. Chapter 3 delves into the finer details of the

[127] Rajak 2013 *International Insolvency Law: Themes and Perspectives* 23.
[128] Companies and Intellectual Property Commission "Status of Business Rescue Proceedings in South Africa" http://www.cipc.co.za/files/2615/6326/6395/Status_of_Business_Rescue_Proceedings_in_South_Africa_June_2019.pdf (accessed 07-01-2020).

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distress which creditors often find themselves in when a company indebted to them goes into business rescue.

2.6 CONCLUSION

Although business rescue can do wonders for a company and its creditors when implemented successfully, its failure can prove disastrous for creditors. This view finds further support in the scenarios and cases discussed in Chapter 3 below, which highlight the various prejudicial situations creditors may find themselves in, due to the failed pursuit and/or abuse of business rescue by companies, instead of the immediate liquidation of such companies.

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3 CHAPTER 3: THE DISTRESS OF THE CREDITOR

3.1 INTRODUCTION

In the rush to save financially "wounded" companies through business rescue, it is important that we do not lose sight of the potential injuries the creditors of such company may suffer in the process. The moratorium could result in far reaching financial consequences for creditors, including the financial distress or even demise of such creditors' businesses due to non-payment by the debtor company.

The first ever South African court case to deal with Chapter 6 of the Companies Act since its inception,[129] was the High Court case of *Swart v Beagles Run Investment 25 (Pty) Ltd*.[130] In the case, the sole director and shareholder of Beagles Run Investments 25 (Pty) Ltd (hereafter, the "respondent"), applied for an order in terms of section 131 of the Companies Act (that is, business rescue proceedings instated by court order) placing the respondent in business rescue (hereafter, the "application").[131] The application was brought based on the grounds that the respondent's business was financially distressed as envisaged in section 128(f) of the Companies Act.[132] This application was opposed by the creditors of the respondent, who alleged that the application amounted to an abuse of process and that it was an attempt by the respondent to avoid or postpone paying its debts.[133]

The court held, *inter alia*, that when weighing up the interests of the company and the creditors, those of the creditors should prevail.[134] Furthermore, the court highlighted (regarding its task to assess whether the requirements for commencing business rescue in terms of section 131[135] had been met) the novelty of business rescue proceedings and the absence of previous case law on the matter before it.[136] On this point, the court looked to the provisions of judicial management for guidance,

[129] Locke *et al "Corporate Law and Stock Exchanges"* 2013 *ASSAL* 231 324.
[130] *Swart v Beagles Run Investment 25 (Pty) Ltd* 2011 (5) SA 422 (GNP).
[131] *Ibid*.
[132] *Ibid*.
[133] *Swart v Beagles* 12.
[134] *Swart v Beagles* 41.
[135] Section 129 of the Companies Act.
[136] *Swart v Beagles* 23; see also Locke et al 2013 *ASSAL* 325.

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especially regarding the meaning of 'successful concern'.[137] The court held that it must be reasonably probable that the company is capable of ultimate solvency, and that it will (within a reasonable time) become a 'successful concern' and yield a return for its shareholders and creditors.[138]

The court dismissed the application because it found that it was not indicated that the granting of business rescue would place the creditors in a better position than they would be, should it be wound up.[139] This decision has been criticised by Delport.[140] However, the court prevented the potential misuse or abuse of process by the respondent at the expense of its creditors, and should therefore, in my view be supported.

Although it has been argued time and again that business rescue could be abused by companies to the detriment of its creditors,[141] the recent investigation in terms of section 417 of the Companies Act into the events preceding the liquidation of Harrison and White Investments (H & W) has exposed the true extent to which such abuse can be perpetuated.[142] According to Moneyweb, the directors of H & W placed it in business rescue one day after FirstRand Bank demanded immediate payment of a loan in respect of which H & W had defaulted on payment.[143] A report compiled by former judge Eberhard Bertelsmann pursuant to the section 417 investigation reflects that H & W was insolvent at the time it was placed in business rescue and should have been placed in immediate liquidation instead.[144]

3.2 THE RIGHTS OF PROPERTY OWNERS

The Companies Act provides that during the business rescue process, no person may exercise any right in respect of any property in the lawful possession of the

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[137] *Swart v Beagle* 25; Locke et al 2014 *ASSL* 325.
[138] *Ibid.*
[139] *Ibid.*
[140] Delport et al 446 criticised the court in *Swart v Beagles* for: *"… [comparing] this new proceeding [business rescue] with the previous judicial management provisions, as the 2008 Companies Act makes no reference to 'successful concern' and it is also not a requirement in terms of the business rescue proceedings"*; see also Locke et al 2014 *ASSL* 325.
[141] Rajak see foot note 14 above.
[142] "The dark underbelly of the business rescue industry" https://www.moneyweb.co.za/in-depth/investigations/the-dark-underbelly-of-the-business-rescue-industry/ (accessed 09-01-2020).
[143] *Ibid.*
[144] *Ibid.*

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company, unless the written consent of the BRP is obtained.[145] This will be the case notwithstanding anything to the contrary in the relevant agreement.[146] Cassim highlights the moratorium's effect on property owners.[147] The author questions the encroachment on the property rights of a landlord (the "property owner") who has concluded a lease agreement with a company which goes into business rescue.[148] In such a situation the rescued company will, by virtue of the provisions of the moratorium, be entitled to remain in occupation of the leased property without having to pay rent to the property owner (that is, the creditor).[149]

Although the BRP may decide to continue paying rent, the business rescue proceedings will effectively be carried out at the expense of the property owner, should they decide not to do so.[150] The harsh consequences of the moratorium on property owners may prove to be even more far reaching than those which may be suffered by any of the other creditors. This is because the property owner will over and above the loss of income suffered from the non-payment of rent by the rescued company, remain obliged to continue paying other charges (for example, municipal and utility charges, water and electricity) in connection with the occupation of the leased premises, notwithstanding the non-payment of rent.[151] This is because, the primary obligation for payment of the aforementioned charges remains with the property owner, which effectively means that the rescued company will continue to enjoy not only the free occupation of the premises but the usage of utilities at the expense of the property owner.[152]

In such a situation, the property owner will not be able to exercise his proprietary rights to recover its property in the lawful possession of a company under business rescue unless the written consent of the BRP is obtained.[153]

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[145] Section 134(1)(c) of the Companies Act; see also Yeats 6-16.
[146] *Ibid.*
[147] Cassim "The effect of the moratorium on property owners during business rescue" 2017 *SA Merc LJ* 419.
[148] *Ibid.*
[149] *Ibid.*
[150] *Ibid.*
[151] *Idem* 420.
[152] *Ibid.*
[153] *Idem* 423; see also the Companies Act section 134(1)(c) which provides that: *"During a company's business rescue proceeding […] despite any provision of an agreement to the contrary, no person may exercise any right in respect of any property in the lawful possession of the company, irrespective of whether the property is owned by the company, except to the extent that the practitioner consents in writing".*

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Cassim[154] offers possible avenues of recourse for property owners to avoid or mitigate the above-mentioned risks.

3.3 THE VOTING INTEREST OF CREDITORS: UNFAIR DEMOCRACY

Section 152(4) of the Companies Act provides that:

"*A business rescue plan that has been adopted is binding on the company, and on each of the creditors of the company and every holder of the company's securities, whether or not such a person –*

(a) was present at the meeting;

(b) voted in favour of adoption of the plan; or

(c) in the case of creditors, had proven their claims against the company".

Based on the above provision and the wording of section 152(2) of the Companies Act,[155] it appears that a business rescue plan diminishing the debt of Company A, can be adopted by a 75% vote of all creditors who voted (notwithstanding the fact that Company A did not vote in favour thereof).[156] Accordingly, a creditor without a large voting interest will be bound by the decisions of the majority of creditors.[157]

However, according to section 154(1):

"a business rescue plan may provide that, if it is implemented in accordance with its terms and conditions, a creditor who has acceded to the discharge of the whole or part of a debt owing to that creditor will lose the right to enforce the relevant debt or part of it".

The wording of section 154(1) seems to imply that a creditor must first agree to any provision in the business rescue plan which would result in the deprivation of its right

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[154] Cassim 'The safeguards and protective measures for property owners during business rescue' 2018 *SA Merc LJ* 40.

[155] Section 152(2) of the Companies Act provides that: *"In a vote called in terms of subsection (1)(e), the proposed business rescue plan will be approved on a preliminary basis if-*
(a) it was supported by the holders of more than 75 percent of the creditors voting interests that were voted; and
(b) the votes in support of the proposed plan included at least 50 percent of the independent creditors" voting interests, if any, that were voted."

[156] *Ibid.*

[157]

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to claim all or part of its debt owing, before it can be validly binding against it. It is unclear whether this means that if a creditor *did not accede* to such discharge, they will not be bound to the provisions of the business rescue plan discharging its debt and remain capable of enforcing such debt, seeing as the overall approval of the business rescue plan is determined by majority vote.[158] This uncertainty stems from the fact that provisions of section 152(2) provides that the body of creditors (not each respective creditor whose debt will be affected) vote for the implementation of the business rescue plan and thereby accede to it.[159] This ultimately means that the majority of the body of creditors have the final say as to the extinguishing of debts, in as far as the business rescue plan makes provision for such discharge, even of those debts which are not their own.

3.4 Compromise and Suretyship

The third issue, which is that of suretyship and compromise, is brought to light by the Western Cape High Court decision in the case of *Tuning Fork (Pty) Ltd t/a Balanced Audio v Greeff and another.*[160] In this case, the plaintiff was the creditor of a financially distressed debtor company (that is Tuning Fork) which was undergoing business rescue. A business rescue plan which was duly adopted, stipulated that the plaintiff would be paid a dividend of the actual amount owing to him, as full and final payment. Following the adoption of the business rescue plan , the plaintiff applied for a summary judgment against the debtor's sureties. These sureties had undertaken unlimited continuing suretyship for Tuning Fork's present and future debts, and also bound themselves as sureties and co-principal debtors. The application for summary judgment was opposed by the sureties on the ground that the compromise made in terms of the business rescue plan extinguished the debt and released them of their liability. This argument by the sureties was upheld by the court, and the summary judgment accordingly denied. The court stated that if a business rescue plan provides for the discharge of the principal debt by way of a release of the principal debtor, and the claim against the surety is not preserved in the business rescue plan, or in the deed of suretyship, the surety is discharged.

[158] Section 152(2) of the Companies Act.
[159] *Ibid*; See P Delport (2014) at 532 (2).
[160] *Tuning Fork (Pty) Ltd t/a Balanced Audio v Greeff and another* (2014) 3 ALL SA 500 (WCC).

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At first glance, the court in this decision appears to have missed the mark, seeing as such a decision pretty much undercuts the very reason for which suretyships exist.[161] However, upon closer look at the *ratio decidendi,* it becomes more apparent that it is not an issue of wrong decision making by the court, but one of inadequate drafting on the legislature's part. The Companies Act clearly makes provision in section 155 (which applies to a company, irrespective of whether or not it is financially distressed as defined in section 128(1)(f), unless it is engaged in business rescue proceedings),[162] that an arrangement or compromise contemplated in the particular section does not affect the liability of any person who is a surety of the company.[163] The Companies Act is however silent on the effects of a compromise between creditors and a company in terms of a business rescue plan. This is rather surprising because there exists in principle no valid reason why a compromise in terms of section 155 and one in terms of a business rescue plan under section 128 should be treated differently.

The court in Tuning Fork, being unwilling to read into section 128 a provision similar to that of section 155(9), applied the common law principles of suretyship.[164] Therefore based on the position at common law that a suretyship is accessory in nature, when the principal debt is extinguished, so is any liability in terms of a suretyship agreement.[165] As such, because the principal debt was extinguished in terms of the compromise stipulated in the rescue plan, the liability of the sureties was accordingly extinguished.[166] This legal position filters through in various other cases such as, *Absa Bank Limited v Du Toit* where the court found that a provision in the business rescue plan for "*full and final settlement of its indebtedness"* extinguished the principal debt;[167] and the *DH Brothers Industries (Pty) Ltd v Gribnitz NO* case, where the court held that if the business rescue plan provided for a discharge of the

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[161] See also *Hitachi Construction Machinery Southern Africa Co (Pty) Ltd v Botes* (205/2018) [2019] ZANCHC 7 (15 March 2019), where the court found that not holding the sureties liable would *"render the terms of the deed of suretyship nonsensical and militates against the very reason for a creditor obtaining security against the indebtedness of a debtor, i.e. to mitigate the risk of the debtor being unable to fulfil its obligations due to inter alia business rescue"*
[162] Companies Act section 155(1).
[163] Companies Act section 155(9).
[164] *Tuning Fork* case.
[165] I*bid.*
[166] *Ibid.*
[167] *Absa Bank Limited v Du Toit* (7311/13) [2013] ZAWCHC 194 (13 December 2013).

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main debt (to which the creditor agreed or "acceded"), it had the effect in terms of common law that the liability of a surety for that debt would also cease to exist.[168]

The SCA enunciated an important principle regarding suretyships and business rescue, in the case of *New Port Finance Co (Pty) Ltd v Nedbank Ltd* by stating that, if the deed of suretyship contains a clause that affords the creditor a right to pursue the surety, even if the principal debt had been compromised, the provision in the deed of suretyship will override a compromise in the Business Rescue Plan.[169] In the recent case of *Hitachi Construction Machinery Southern Africa Co (Pty) Ltd v Botes*, the applicant creditor, on the strength of a deed of suretyship, claimed the balance of the business rescue debt from the respondent sureties, as well as the balance in respect of post-commencement financing together with interest.[170] The sureties opposed the application on the following grounds: (i) that once the business rescue plan of the company in rescue (Blue Chip) was adopted, the applicant lost the right to claim any further amounts from the sureties, and (ii) they placed the quantification of the indebtedness in dispute. The position that the business rescue plan released Blue Chip from its debt to the applicant was not in dispute. However, the court had to consider whether this meant that the debt had been extinguished.The court made reference to principle set out in the New Port case, that section 154 of the Companies Act *"deals only with the ability to sue the principal debtor and not with the existence of the debt itself*". The liability of a surety is not affected by the business rescue, unless the business rescue plan specifically makes provision for the situation of sureties. In this case, the business rescue plan of Blue Chip did not provide for the position of sureties. Accordingly, the court held that, even though the debt may not be enforceable against Blue Chip as the principal debtor, it did not extinguish the liability of the sureties to pay. The sureties' argument that, since no amount remained owing by Blue Chip in terms of the business rescue plan , the sureties were not liable in terms of the deed of suretyship, *"[w]ould render the terms of the deed of suretyship nonsensical and militates against the very reason for a creditor obtaining security against the indebtedness of a debtor, i.e to mitigate the risk of the debtor being unable to fulfil its obligations due to inter alia business rescue"*. The court concluded

[168] *DH Brothers Industries (Pty) Ltd v Gribnitz NO* 2014 (1) SA 103 (KZP).
[169] *New Port Finance Co (Pty) Ltd and Another v Nedbank Ltd* 2016 (5) SA 503 (SCA).
[170] *Hitachi v Botes* 7.

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that the business rescue plan did not release the sureties from their indebtedness to the applicant.

The court in Tuning Fork not wanting to read in a similar provision to that in section 155(9), was justified in light of the *ius dicere non dare* principle, which dictates that courts may only "state or interpret" the law but may not "create" law. The mandate therefore lies with the legislature to correct this gap for the sake of protecting the interests of creditors of companies undergoing rescue. In the meantime, it is imperative that while this discrepancy still exists, creditors be meticulous in ensuring the drafting in of special clauses into the suretyship agreements concluded in their favour, to protect their claims against sureties in the event of business rescue.

It is interesting to note the interconnection between the issue of suretyship and the moratorium in light of the decision in *Investec Bank Ltd v Bruyns*[171]. In this case, the court held that the defence of the moratorium is a defence *in personam* and not a defence *in rem*. This means that the defence can only be raised by the distressed company (whether against its own creditors or even creditors in favour of whom they had given suretyship) but not by the sureties who signed a suretyship in favour of the distressed company. The result of this is that, in the absence of a debt extinguishing compromise (like the one in the Tuning Fork case), the creditors of the distressed company may enforce claims against sureties who undertook liability in favour of the distressed company, even during business rescue. This creates another avenue for protecting creditors of distressed companies from losing their claims against sureties, by ensuring that the wording used in respect of a compromise in terms of a rescue plan does not amount to an extinction of debt.

[171] *Investec Bank Ltd v Bruyns* (19449/11) [2011] ZAWCHC 423; see also Beukes "Business rescue and the moratorium on legal proceedings" June 2012 *De Rebus* 34.

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3.5 CONCLUSION

This chapter has clearly highlighted that the South African business rescue regime is a minefield, fraught with several potential pitfalls for creditors. These pitfalls include the deprivation of creditors' rights under suretyship agreements and their rights to enforce payment of debts owed to them. Legislative reform is required in order to mitigate the risks and infringement of rights faced by creditors under the current business rescue provisions. The next chapter of this mini dissertation, being chapter 4, entails a comparative study between South Africa's corporate rescue model and that of the US and the UK in an attempt to find ways to bridge the gaps in the South African rescue model.

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4 CHAPTER 4: BUSINESS RESCUE IN FOREIGN JURISDICTIONS

4.1 INTRODUCTION

The introduction of business rescue into the South African corporate law regime has brought our insolvency law system in line with foreign jurisdictions across the world.[172] It is under the influence of Chapter 11 of the US Bankruptcy Code that our Companies Act introduced a debtor-friendly business rescue regime into our generally creditor-friendly insolvency law system.[173] The widely acknowledged success of the US Chapter 11 has resulted in the global perception that it should be the standard for corporate reorganisation.[174] It is therefore fitting and beneficial to undertake an analysis of the US corporate rescue regime in comparison to the South African regime. This chapter will accordingly entail a comparative analysis of the corporate rescue provisions of the US Chapter 11. A brief discourse of internationally accepted principles to modern insolvency and reorganisation will also be incorporated in this chapter. The UK's reorganisation provisions will also be discussed to the extent that such provisions may be relevant to this dissertation. The justification for selecting the US and the UK for purposes of this comparative analysis lies in that, both countries have been deemed to be the leading jurisdictions in corporate rescue and the most closely aligned to the South African business rescue regime.[175] The purpose of this comparative analysis is mainly to glean inspiration from these leading jurisdictions for the possible reform of the South African business rescue regime.

4.2 COMMON GROUND ACROSS THE BORDERS

Levenstein submits that there are four internationally accepted foundational themes in business rescue that are deemed to be the *sine quibus non* of any successful restructuring regime.[176] This submission is based on the UNCITRAL *Legislative*

[172] Levenstein 5-1.
[173] Cassim et al 866.
[174] Maphiri 2018 *Michigan Business & Entrepreneurial Law Review* 123.
[175] Levenstein 5-2.
[176] *Ibid*.

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Guide on Insolvency Law,[177] which sets out the key objectives and a suggested structure for an effective and efficient insolvency system which focuses on the reorganisation of financially distressed entities.[178] The first of the four themes outlined by Levenstein is the ability for financially distressed companies to restructure their debt, which theme is seen as essential for any corporate rescue regime.[179] This restructuring of debt is founded on the understanding that creditors must accept compromised amounts, instead of full payment of their debts.[180] The second theme is the a 'stay' on claims, without which the restructuring efforts of a company are likely to fail.[181] The third theme is the ability to have a rescue plan approved despite opposition from minority dissenting creditors, by way of majority rule.[182] Dissenting creditors against a rescue plan are generally either forced to go along with the majority or forced to sell their claims (or be bought out) even at a negligible liquidation value.[183] It is inconceivable how the former position could be acceptable.[184] and will not be repeated here. The fourth and final theme is the 'discharge', which dictates that all creditors' claims must be discharged against the debtor company in accordance with the approved rescue plan.[185] The unfairness of this concept has also been discussed in detail above.[186]

In his doctoral thesis, Levenstein[187] emphasised the following principles as being among the common imperative elements of corporate rescue culture across global borders:

(i.) the automatic stay on the claims of creditors against the rescued company which applies upon the commencement of formal business rescue proceedings; and

[177] UNCITRAL Legislative Guide on Insolvency Law (Parts 1 and 2) 933 https://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf.
[178] Levenstein *South African Business Recue* 5-2. See also UNCITRAL Legislative Guide on Insolvency Law (Parts 1 and 2) 933.
[179] *Ibid.*
[180] *Ibid.*
[181] *Ibid.*
[182] *Ibid.*
[183] Levenstein *South African Business Recue* 5-2 and 5-3.
[184] This point has been discussed at length in paragraph 3.3 above
[185] Levenstein 5-2 and 5-3.
[186] See paragraph 3.4 above.
[187] Levenstein (LLD thesis, University of Pretoria, 2015) 101.

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(ii.) the ability to have the business rescue plan approved despite the opposition of dissenting creditors.

It is interesting to note that the two above-mentioned elements are viewed as being some of the key elements of corporate rescue culture across the world, whereas this dissertation describes them as being some of the elements with the most undesirable consequences for creditors.[188] Based on the aforementioned position, and the in-depth discussion above on how these elements prejudice creditors, it is safe to say that corporate rescue, at its very root is designed in a way which will always prejudice creditors in one way or another. This then raises the question as to whether the Companies Act's aim of providing for the rescue of companies in a manner which is beneficial to *all* interested parties[189] is actually being fulfilled, or whether the benefits of business rescue are meant to be slanted (as is alleged in this dissertation) in favour of the rescued company to the detriment of its creditors? I believe that in the South African context, the answer to this question should be an unequivocal yes. With this in mind, it is important to look at how other countries successfully apply corporate rescue for the benefit of all those involved (including creditors), notwithstanding the above-mentioned key elements which often prove detrimental.

4.3 THE UNITED STATES

The US Chapter 11, similarly to the South Africa Companies Act, provides for the initiation of reorganisation proceedings voluntary (by filing of a petition by the debtor) and involuntary (by filing of a petition by creditors).[190] The business rescue proceedings under the Companies Act are triggered by the financial distress of a company.[191] While financial distress is a prerequisite for business rescue in South Africa, this is not the case under Chapter 11 of the US Bankruptcy Reform Act of 1978[192] The US Bankruptcy Code does not require companies to reach a certain solvency threshold before qualifying for reorganisation, but merely requires them to

[188] See discussion in Chapter 3 above.
[189] Companies Act preamble.
[190] United States Courts 'Chapter 11 – Bankruptcy Basics' https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics (accessed 26 April 2020).
[191] Cassim et al 865.
[192] Levenstein 5-6.

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have a *bona fide* intention to effect such reorganisation.[193] The opportunity to file for bankruptcy at any point in time is an exemplary preventative measure, which allows companies to effectively reorganise before their financial difficulties reach a point of no return. This could possibly be a contributory factor towards the success of the US bankruptcy procedures, one which South Africa could draw inspiration from.

Another difference between the South African and US reorganisation procedure is that, despite what has been perceived to be a shift towards a debtor-friendly model of reorganisation the South African business rescue regime makes use of an independent third party to enter immediately and oversee the reorganisation.[194] The debtor's powers to initiate business rescue proceedings and appoint the BRP creates an outward appearance of being similar to the US 'debtor-in-possession' (DIP) reorganisation approach, an thus being more 'debtor-friendly'.[195] It has however been argued that the creditors' powers to influence the BRP ultimately perpetuates a creditor-friendly approach to reorganisation.[196]

In contrast, the US Chapter 11 allows for the debtor to continue managing the company in good faith, with the bankruptcy court playing a minimal role of overseeing and keeping check of the administration process.[197] There are however exceptional circumstances, such as in the case of fraud or gross mismanagement by the existing management, whereby an administrator or trustee will be appointed to manage the company.[198] The DIP approach ensures minimal disruption to the running of the company's business and also eliminates the expense of remunerating the BRP.[199] This is another element of the US bankruptcy procedure which the South African business rescue procedure could adopt.[200]

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[193] Conradie and Lamprecht "Business rescue: How can its success be evaluated at company level?" 2015 *Southern African Business Review* 7.
[194] *Ibid.*
[195]Levenstein "SA Business Rescue Procedure" https://www.lexisnexis.co.za/news/research-and-guidance/a-discussion-on-the-mechanics-of-business-rescue-with-reference-to-his-recently-published-book (accessed 04-01-2020).
[196] *Ibid.*
[197] Bradstreet "The leak in the Chapter 6 lifeboat: Inadequate regulation of business rescue practitioners may adversely affect lenders' willingness and the growth of the economy" 2010 *SA Merc LJ* 199.
[198] Calitz and Freeboy "Post Commencement Finance Under the 2008 Companies Act" 2016 *De Jure* 276.
[199] *Ibid.*
[200] See recommendations in Chapter 5 below.

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Another mechanism found under Chapter 11, which is not a feature of the Companies Act, is the imposition of additional reporting and filing requirements on small business debtors.[201] For example, Chapter 11 requires small business debtors to file their most recent balance sheet, cash flow statement, federal tax return of its petition, statement of operations along with its bankruptcy petition.[202] The omission of these additional provisions from the Companies Act could be the reason why the business rescue procedure is so susceptible to abuse as there is no substantive vetting procedure by the courts prior to the commencement of business rescue.

An automatic stay, similar to the South African moratorium, forms part of the reorganisation regime under Chapter 11 of the Bankruptcy Code.[203] The operation of the stay takes effect from the date of filing the bankruptcy petition, and suspends all judgments, collection activities, foreclosures, and repossessions of property by the creditors of debts and/or claims which arose prior to its filing.[204] There are exceptional actions which have been carved out in section 362(b) of Chapter 11, in respect of which the stay will not apply.[205] This US position is similar to the South African position and does not provide much guidance as to the possible time frame limitations which may be imposed as to the applicability of the moratorium.

4.4 THE UNITED KINGDOM

The United Kingdom's corporate rescue procedure is known as the 'insolvency procedure' and is governed by Part 11 of the Insolvency Act 1986, as amended by the Insolvency Act, 2000 ("UK Insolvency Act").[206] Although the UK Insolvency Act provides a formal restructuring procedure, a lot of the country's company reorganisations take place in terms of informal negotiations with creditors, which are not governed by any formal restructuring or insolvency process.[207] These informal reorganisation are however only possible if the company's creditors are supportive of

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201 Maphiri 2018 *Michigan Business & Entrepreneurial Law Review* 125.
202 *Ibid.*
203 United States Courts 'Chapter 11 - Bankruptcy Basics' https://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics (accessed 26-04-2020).
204 *Ibid.*
205 *Ibid.*
206 See terminology in the UK Insolvency Act. See also Levenstein 5-4 and 5-6.
207 Levenstein 5-7.

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the reorganisation.[208] For purposes of this dissertation, comparison will only be made to the UK's formal restructuring procedures and not the informal processes.

The UK's formal restructuring process is initiated by way of company voluntary arrangements, which are entered into between the company, its creditors and shareholders.[209] This process in terms of the UK Insolvency Act entails a proposal by either the company's directors, liquidator or administrator of a reorganisation plan.[210] The provision for delayed or reduced debt payments or a capital restructuring are common features in such a reorganisation plan.[211] The UK makes use of a unique administration style called the "pre-pack" whereby, all the aspects related to selling the debtor company's business, such as the valuation of the business and the identification of a purchaser, are undertaken at the beginning of the administration process.[212] This approach allows for a swift and efficient transfer of the business during the earliest phase of the administration proceedings.[213] It also serves the purpose of effectively preserving the going-concern value of the business and the jobs of employees.[214]

The "pre-pack" administration style seems to be in line with the objectives of a successful reorganisation procedure,[215] in that it provides for rescuing financially distressed companies through a qualified administrator.[216] Notwithstanding the foregoing, commentators allege that the pre-pack approach stifles transparency, in that negotiations of deals are done in secret.[217] The approach is also criticised for its failure to achieve the best possible value of the business.[218] This approach has nonetheless proven to be a success in the UK, and it stands to be seen whether it could be adopted in South Africa to avoid prolonged reorganisation proceedings while creditors suffer loss at the hand of the moratorium.

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208 Levenstein (LLD thesis, University of Pretoria, 2015) 109.
209 Levenstein 5-8; see also Part 1 of the UK Insolvency Act.
210 *Ibid.*
211 *Ibid.*
212 *Ibid.*
213 *Ibid.*
214 *Ibid.*
215 Levenstein (LLD thesis, University of Pretoria, 2015) 108.
216 *Ibid.*
217 *Ibid.*
218 *Ibid.*

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Lastly, the UK, similar to South Africa, has not adopted the DIP approach. Its corporate rescue regime places the management of the company's affairs in the control of an independent practitioner.[219]

4.5 CONCLUSION

It is quite apparent from the above discussions that the South African business rescue regime is, in many respects, in line with international standards. There are however some elements which the Companies Act could stand to adopt from the abovementioned foreign jurisdictions. Chapter 5 below will incorporate, as part of the remedial recommendations made by this dissertation, the specific foreign elements which should be adopted in the South African business rescue regime.

[219] Bradstreet 2010 *SA Merc LJ* 199.

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5 CHAPTER 5: CONCLUSION AND RECOMMENDATIONS

5.1 CONCLUSION

The above legal discourse provides sufficient evidence that, notwithstanding the alignment of the South African corporate reorganisation regime with international standards, further legal reform is required to overcome the current hinderances to its successful application. As discussed in chapter 3 above,[220] statistics reflect that an alarmingly large percentage of business rescue proceedings ultimately end in the liquidation of the debtor company. This is cause for concern as it results in creditors not only being subjected to the moratorium's detrimental effects, but also the risk of receiving an even smaller distribution at liquidation due to the costs incurred in respect of the failed business rescue attempt. In order to justify the infringement of creditors' rights by the moratorium, business rescue proceedings must result in the recovery of the debtor company or in a better return for creditors at liquidation. The current failure rate of business rescue proceedings is unfair and often has far more disastrous consequences for creditors than an immediate liquidation.

It is in no way alleged that placing companies in immediate liquidation is the perfect answer, as liquidation is not without its own flaws. Two of the most obvious disadvantages to creditors when a company is liquidated are, the risk of receiving a negligible distribution (if anything at all) and/or paying a contribution if there is a shortfall due to the company having insufficient assets.[221] However, immediate liquidation could prevent the company from continuing to incur more debt, as in the situation of a moratorium against a property owner who would continue to lose monthly rental income owed to it by the company without any recourse.[222] The below recommendations are made in order to address the gaps in the South African corporate rescue regime which prevent its successful application.

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[220] See paragraph 2.6 above.
[221] Levenstein 2-4.
[222] See discussion in paragraph 3.2 above.

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5.2 RECOMMENDATIONS

The availability of the US bankruptcy procedure to all companies, including those that are not financially distressed, allows sufficient opportunity to effectively reorganise companies before their financial situations becomes too dire. This dissertation suggests that the South African business rescue regime should be developed to incorporate a similar approach to business rescue. This proposal is consistent with the widely recognised aims of modern insolvency to discover and intervene in cases of impending insolvency at the possible earliest stage.[223] The wording of section 128(1)(*f*)(i), which promotes the reorganisation of commercially insolvent companies[224] could be used as a stepping stone for the introduction of the suggested approach into the South African legal framework. An example of this would be, extending the six-month period referred to in section128(1)(f)(i) to increase the time frame within which a company may be deemed to be 'financially distressed' to 24 months. In the interim, companies should be encouraged to make use of the section 155 compromise procedure (which is available to all companies regardless of whether or not they are financially distressed) at the earliest sign of financial difficulty, to reach a similar outcome.[225] The section 155 compromise comes without the detrimental effects to creditors of a moratorium, while allowing financially challenged companies to attain the discharge of their debts at a compromised amount.

Furthermore, it is suggested that in an attempt to curb the currently exorbitant costs of business rescue, the incorporation of a DIP approach similar to that of the US should be considered. A hybrid approach, whereby the appropriateness of either appointing a BRP or using the DIP approach is assessed, on a case by case basis, would be most suitable in the South African context.[226] Eliminating the BRP costs will increase the money available for distribution to creditors if the company is eventually liquidated and will also make business rescue accessible to smaller companies that cannot in fact afford to pay a BRP.[227]

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[223] Cassim et al 862.
[224] See also Levenstein 1-5.
[225] Maphiri 2018 *Michigan Business & Entrepreneurial Law Review* 124.
[226] Maphiri 2018 Michigan Business & Entrepreneurial Law Review 125: *"[The] appointment of a business rescue practitioner should be optional and reserved for the discretion of the court or the [debtor company] itself in order to reduce costs and make the procedure more accessible".*
[227] Maphiri 2018 *Michigan Business & Entrepreneurial Law Review* 121.

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An element which is not addressed by any of the foreign jurisdictions is the limitation of the periods within which reorganisation proceedings must terminate. It is suggested in this dissertation that the legislator should consider putting a strict and certain time frame within which business rescue proceedings should terminate, failing which a special extension must be made to the court before the proceedings may be extended. This will curb the misuse of the moratorium as a mere delay tactic for debtors to avoid paying their debts. A further suggestion, which will serve to protect the rights of shareholder creditors is to amend the Companies Act so that the board resolution for initiating business rescue shall be subject to shareholder approval.

Lastly, the legislator leaves it to the reader's presumption that the company or its directors may not dispose of the company's assets during the window period between the date on which business rescue takes effect and the appointment of a BRP.[228] This lacuna is an oversight worth being addressed for the sake of certainty and protection of creditors and other stakeholders.[229]

[228] Cassim et al 869.
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