The Impact of the Moratorium on Creditors of the Company under Business Rescue

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SUMMARY

The notion of the moratorium on legal proceedings against a financially distressed company undergoing business rescue is internationally recognized as a legal intervention necessary for allowing a breathing space for a company to be rescued. In South Africa, section 133 of the 2008 Companies Act makes provision for moratorium and details its main objectives in as far as business rescue is concerned. The main objective of the moratorium is to give effect to the purposes of the Act as enshrined in section 7 of the 2008 Companies Act. In particular, the moratorium is imposed to provide the company the required opportunity to breathe or the necessary period of respite in order to reorganise its affairs in a way as would allow it to operate on profitable basis without the unnecessary disruptions arising from the enforcement of the creditors' claims and legal action taken against it whilst trying to reorganise its affairs. While this purpose is obviously a reasonable one, the rights of third parties to enforce their rights in a form of enforcement actions and legal proceedings against the subject company are seriously affected by moratorium. This dissertation aims at discussing and analysing the provisions in the Act relating to moratorium; to discuss and evaluate the impact that moratorium as provided for in section 133 of the Companies Act of 2008 has on the interests of creditors; as well as to compare the South African company law position in r the moratorium with that of Australian company law.

CHAPTER 1
INTRODUCTION

1. Background information

The South African company law reform has introduced the concept of business rescue regime under Chapter 6 of the Companies Act of 2008.[1] The core purpose of the Companies Act is, amongst others, to provide for the rescue that is efficient and ensuring that the financially distressed company recovers, in such a ways that all the stakeholders that are relevant have their interests and rights balanced .[2] Section 128(1)(b) of the 2008 Companies Act defines business rescue as "proceedings to facilitate the rehabilitation of a company that is financially distressed[3] by providing for-

i. the temporary supervision of the company, and the management of its affairs, business and property;
ii. a temporary moratorium on the rights of claimants against the company or in respect of property in its possession;
iii. the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equities 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."

Prior the introduction of business rescue in South Africa, the corporate rescue mechanism that was used was judicial management.[4] In the South African company law the doctrine of judicial management was introduced by the Companies Act 46 of 1926 and remained relatively unchanged over the years, with the exception of few amendments introduced in 1932,[5] one of

[1] Companies Act 71 of 2008 – hereinafter, the 2008 Companies Act.
[2] Section 7(k) of the 2008 Companies Act.
[3] A "financially distressed" company is defined in section 128 (1)(f)(i) and (ii) "as a company that, at any particular time, appears to be unreasonably unlikely to pay all its debts as they become due and payable within the immediately ensuing six months; or it appears reasonably likely that the company will become insolvent within the immediately ensuing six months".
[4] Burdette "Some initial thoughts on the development of a modern and effective business rescue model for South Africa" 2004 *SA Merc LJ* 241 246.
[5] Companies Amendment Act 11 of 1932 – hereinafter, 1932 Companies Amendment Act.

which was a provision for a moratorium on claims by creditors.[6] Judicial management was always reckoned as a progressive step towards rescuing companies that are undergoing financial constraints since it has been introduced.[7]

Judicial management was later incorporated into the Companies Act 61 of 1973.[8] Although the 1973 Companies Act did not define the doctrine of judicial management, section 427(1) of the Act made provision for circumstances under which a judicial management order could be granted namely:[9]

a) "if, as a result of mismanagement or any other cause, the company –
    i. was unable to pay its debts or was probably unable to meet its commitments; and
    ii. had not become, or was prevented from becoming, a successful business concern; and
b) there was a probability that, if the company was placed under judicial management it would be able –
    i. to pay its debts or meet its obligations; and
    ii. become a successful going concern,

the court could, if it appeared just and equitable, grant a judicial management order".

Section 427(3) of the 1973 Companies Act made provision that the court was duly authorised to grant a judicial management order at the time a liquidation application was heard.[10] Therefore, the discretion that the court had in granting a provisional judicial management order, was dependent on whether the applicant has met all the prerequisites for the order to be granted, and the court would dismiss the application for judicial management or make any other order it deemed fit.[11]

[6] Section 196(1) of the 1932 Companies Amendment Act.
[7] Swart "Business rescue: Do employees have better (reasonable) prospects of success? Commentary on *Employees of Solar Spectrum Trading 83 (Pty) Limited v AFGRI Operations Limited* North Gauteng High Court, Pretoria (unreported) 2012-05-16 Case no 6418/2011; 18624/2011; 66226/2011; 66226A/11" 2014 *Obiter* 406.
[8] Hereinafter referred to as 1973 Companies Act
[9] Section 427(1) of the 1973 Companies Act.
[10] Section 427(3) of the 1973 Companies Act.
[11] Section 428(1) of the 1973 Companies Act.

Upon the issuing of a provisional judicial management order, the court had the discretion to order that all actions, proceedings, execution of all writs, summonses and other processes be put on hold during the process of judicial management and proceed only if the court grants leave for them to proceed whilst the judicial management is ongoing.[12] However, section 432(3) of the 1973 Companies Act did not make provision for moratorium where a final judicial management order was granted, but an assumption was that automatically it would be included if a provisional order containing a moratorium was made final. According to Loubser:[13]

> "the lack of a provision for an automatic moratorium on all actions, proceedings, execution of writs, summonses and other processes against the company during judicial management created a degree of uncertainty because there was no guarantee that the court would include a moratorium in a judicial management order".

The question has been raised whether the procedure of judicial management was available in the case of a small private company.[14] One of the best illustrations for this approach[15] was found in *Silverman v Doornhoek Mines Ltd*[16] which the courts referred to frequently when a consideration of granting a judicial management application was made. In the above-mentioned case, the court stated that "the procedure of judicial management is a special and extraordinary procedure" and "a special privilege given in favour of a company and is to be authorised only in very special circumstances".

Loubser believes that the failure of judicial management to be capable of working successfully as business rescue mechanism was as a result of the fact that judicial management has always been viewed as an extraordinary relief which infringed on the creditors rights and that it should only be available only under extremely unique circumstances.[17]According to Josman J in *Le Roux Management (Pty) Ltd v E Rand (Pty) Ltd*,[18] judicial management was "a system which has barely worked since its initiation in 1926". The failure of judicial management has to a

[12] Section 428(2) of the 1973 Companies Act.
[13] Loubser LLD thesis (UNISA, 2010) 43.
[14] *Rustomjee v Rustomjee (Pty) Ltd* 1960 (2) SA 753 (D) 758.
[15] Loubser "Tilting at windmills? The quest for an effective corporate rescue procedure in South African law" 2013 *SA Merc LJ* 450.
[16] 1935 TPD 349.
[17] Loubser (LLD thesis, UNISA, 2010) 43.
[18] *Le Roux Management (Pty) Ltd v E Rand (Pty) Ltd* [2001] 1 All SA 223 (C) 238.

large extent been attributed to the notion that it focused more on the interests or creditors[19] and this led to the liquidation of most companies.[20] The conservative and restrictive attitude of the courts in relation to the interpretation of the provisions relating to judicial management, more especially section 427(1) of the 1973 Companies Act is one of the other reasons advanced for the failure of the judicial management.[21]

Although there has always been a debate on whether judicial management needed to be calibrated or needed an outright restructuring, or a comprehensive restructuring of the 1973 Companies Act opened an invitation of opportunities to replace the old regime of corporate rescue. Consequently, when the 2008 Companies Act was promulgated in 2009, there was already a need for change in this area of South African company law.[22] As indicated, the 2008 Companies Act introduced the business rescue regime. The basic philosophy behind the business rescue regime is that it is better for a company which is financially distressed to be rescued than to be liquidated.[23] As its apparent from its name, business rescue takes into cognisance the value of a business entity remaining functional, as opposed to the business entity itself and while the overarching purpose of business rescue under the Companies Act is to maintain the business, it also offers creditors a greater prospect of full recovery of the claims they have against the entity.[24]

The crux of the business rescue regime is the automatic stay of proceedings, also known as the moratorium.[25] The moratorium on legal proceedings against a company under business rescue, therefore plays an integral role, since it makes provision of the crucial space to breathe needed to enable the company to restructure its affairs.[26] In particular, section 133 of the South African 2008 Companies Act provides that there are no legal proceedings (enforcement actions included) which may commence or proceeded against a company, or relating to any property belonging to or in the lawful possession of the company except where the practitioner gives written consent or when the court grants leave for same and in according to such terms which

[19] Loubser "Judicial Management as a business rescue procedure in South African corporate law" 2004 *SA Merc LJ* 162.
[20] Matasane "The impact of the business rescue provisions on the rights of creditors" (LLM dissertation, UP, 2016) 1.
[21] See *Silverman v Doornhoek Mines Ltd* 1935 TPD 350 353.
[22] Bradstreet "The new business rescue: Will creditors sink or swim?" 2011 *SALJ* 358.
[23] Cassim et al *Contemporary Company Law* 2012 at 862.
[24] Matasane LLM dissertation 2.
[25] Section 133 of the 2008 Companies Act.
[26] *Cloete Murray and Another NNO v FirstRand Bank Ltd t/a Wesbank* 2015 (3) SA 438 (SCA) para 14.

may be considered appropriate by the court.[27] This demonstrated a vast development on judicial management where an application for moratorium had to be made specifically and the court makes an order for it.[28]

In Australia, there is a prohibition that is generalised as part of the provisions of moratorium on the property that is possessed by the company during the period of administration on the property owners rights and the rights of lessors of property.[29] Since the main goal of the period of administration is to give the company a chance to consider a rescue, and appointing an administrator has an important influence on the rights that unsecured creditors has and this is made clear in numerous ways namely, the automatic stay of legal proceedings against the company where consent of the administrator or the court was not sought,[30] the process of execution if commenced with cannot proceed any further[31] and any other attempt to enforce a judgment is halted.[32]

This dissertation will discuss the impact of section 133(1) of the 2008 Companies Act on the rights of creditors, with a focus on the rationale for the moratorium and the provisions of the Act which seek to protect or minimise the adverse effect on the interests of creditors.

1. Problem statement and research objectives

The 2008 Companies Act introduced business rescue which is said to reflect a more legitimate concern for assisting struggling businesses to be back onto its feet than was apparent in the previous regime of judicial management.[33] According to its definition, business rescue provides rehabilitation by *inter alia*, granting an interim moratorium on the claimants rights against the company or in respect of property possessed by the company.[34] Therefore, this dissertation seeks to explore the effect of the business rescue moratorium on creditors by discussing, amongst others, its objectives in terms of the Act. This study aims at achieving the following objectives:

[27] Section 133(1) of the 2008 Companies Act.
[28] See the discussion above.
[29] Section 440C of the 2001 Corporations Act.
[30] Section 440D of the 2001 Corporations Act.
[31] Section 440G of the 2001 Corporations Act.
[32] Section 440F of the 2001 Corporations Act.
[33] Bradstreet 2011 *SALJ* 358.
[34] See para 1 above.

1) To discuss and analyse the provisions in the Act in relation to the business rescue moratorium;
2) To discuss and evaluate the impact of the business rescue moratorium on the interests of creditors;
3) To compare the South African position in regard to the moratorium with that of Australia.

To achieve the objectives of this study, the following research questions will be answered:

i. what is the current legal position pertaining to the business rescue moratorium?
ii. what is the impact of the moratorium on the interests of creditors of the company under business rescue?
iii. what is the legal position in Australia with regards to the moratorium and its impact on the interests of Australian creditors of a company under business rescue?

2. Research methodology

This research will follow a doctrinal research methodology conducted through case law, legislation and journal articles. A comparative study will be undertaken in regard to Australian company law. The reason behind the choice of jurisdiction is because, like South Africa, Australia does not have legislation that separately deals with insolvency but incorporates its corporate insolvency provisions within its general Corporations Act.[35]

The Australian equivalent of Chapter 6 of the 2008 South African Companies Act is found in Part 5.3A of the Corporations Act 2001.[36] Prior to the current regime, Australia used official management as a form of insolvency administration which was based similar to the South African judicial management procedure.[37] However, unlike the South African provisions, the official manager in Australia is appointed by way of meeting of creditors as opposed to an application to court.[38] The official management procedure was replaced by voluntary administration enshrined in Part 5 of the 2001 Corporations Act.

The object of part 5 of the 2001 Corporations Act is

[35] Chapter 5 of the Corporations Act 2001 (Cth).
[36] Anderson "Viewing the proposed South African business rescue provisions from an Australian Perspective" 2008 *PER* 1.
[37] Anderson 2008 *PER* 3.
[38] *Ibid.*

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

i. Maximises the chances of the company, or as much as possible of its business, continuing in existence; or
ii. If it is not possible for the company or its business to continue in existence – results in a better return for the company's creditors and members than would result from an immediate winding up of the company".[39]

The South African "business rescue", seeks to maximise the chances of the company to continue being in existence on solvent basis. However, if it is impossible to achieve the latter, there should be returns which are better for the creditors or shareholders of the company.[40] Therefore there are almost same goals in the procedures in the two jurisdictions as each jurisdiction takes into cognisance the continuous existence of the company.[41] These similarities make the comparison even more worthwhile in achieving the objectives of this study.

3. Structure of the dissertation

This dissertation consists of five chapters.
Chapter 1 is the present chapter discussing the general background on business rescue, stating the problem and research objectives, explaining the research methodology as well as providing the structure of the dissertation.

Chapter 2 provides a discussion and analysis of the South African position regarding the business rescue moratorium on legal proceedings against the company and the moratorium on property interests in terms of section 133 of the Companies Act 71 of 2008.

Chapter 3 will explore the impact of the moratorium on the rights of creditors.

Chapter 4 is a comparative study of the Australian company law in regards to the moratorium.

[39] Section 435A of the 2001 Corporations Act.
[40] Anderson 2008 *PER* 7.
[41] *Ibid.*

Chapter 5 contains the conclusion and recommendations for law reform.

CHAPTER 2
THE SOUTH AFRICAN POSITION REGARDING THE BUSINESS RESCUE MORATORIUM

2.1 Introduction

The aim of this chapter is to explain the concept of moratorium in detail and its provisions and making comparing, with the judicial management order which was applicable under the Companies Act of 1973. The effects and purposes that moratorium has on the rights of creditors will also be demonstrated through case law, journal articles and legislation.

It will also be demonstrated how the Supreme Court of Appeal have approached the definition of the concept of moratorium on legal proceedings as provisioned in section 133(1) of the Companies Act of 2008 in the cases of *Cloete Murray NO* and *Another v FirstRand Bank Ltd*[42] and *Chetty v Hart.*[43]

2.2 Brief description of the judicial management process under the 1973 Companies Act

Under the 1973 Companies Act, a provisional order of judicial management may make provision that all the actions, proceedings, the execution of all writs, summonses and other processes against the company will be put on hold for the duration of judicial management and may proceed only if the court grants leave for them to proceed.[44] Consequently, under judicial management it was not automatically the case that there was a moratorium on enforcement actions against the company, there was supposed to be an application specially applied for that.[45] What is apparent from the way the above provisions of the Companies Act of 1973 have been worded, is that a moratorium did not mean that the company is discharged

[42] 2015 (3) SA 438 (SCA).
[43] 2015 (6) SA 424 (SCA)
[44] Section 428(2) of the 1973 Companies Act.
[45] Loubser *Some Comparative Aspects of Corporate Rescue in South African Company Law* (LLD thesis, UP, 2010) 32.

or released from payment of its debts, but that it is only protected from the claims being enforced during judicial management.[46]

Furthermore, section 432(3) did not make provision for a moratorium in the case where a judicial management order is made final, but it is an assumption that it would be included automatically should a provisional order incorporating a moratorium be made final.[47]

2.3 An exposition of the moratorium provision under the 2008 Companies Act

As soon as business rescue commences, there is an automatic stay on or deferral of legal proceedings and enforcement action by creditors against the company, its property, and its assets.[48] This means that the rights of both secured and unsecured creditors are suspended and this extends to any property lawfully possessed by the company.[49] Section 133(1) of the 2008 Companies Act provides that:

> "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 within any forum...".

According to Cassim, the moratorium prejudices creditors and property owners whose claims are deferred for the sake of rescuing viable companies.[50] However, she believes that the moratorium is envisioned to protect the company from harassment by its creditors and property owners and it is, therefore, essential to the effectiveness of business rescue.[51]

The following section discusses the effects and purposes of moratorium and what moratorium provides for on legal proceedings and on proprietary rights as provided for under the 2008 Companies Act and it will be demonstrated how the courts have approached the concept of moratorium and give clarity on what the scope of moratorium on legal proceedings and enforcement actions entail.

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[46] *Ibid.*
[47] *Ibid.*
[48] Section 133(1) of the 2008 Companies Act
[49] Cassim 2017 *SA Merc LJ* 422.
[50] *Ibid*.
[51] *Ibid*.

2.3.1 Effects and purposes of moratorium

The importation of the business rescue regime in South Africa has been heralded as one of the distinct features of the 2008 Companies Act.[52] As stated in section 7(k) of the Act, the overarching purpose for the introduction of the business rescue is "to provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders."[53] However, an attempt to exercise fairness between the rights and interests of stakeholders comes costly to companies creditors.[54] This is so because the Act contains important limitations against any action taken by third parties against the company during the business rescue process, against its property or property in its possession.[55]

Alluding to this, Binns-Ward J stated in *Koen v Wedgewood Village Golf & Country Estate (Pty) Ltd*:[56]

> "that the mere commencement of business rescue proceedings substantially affects the rights of third parties to enforce their rights against the subject company. These rights are particularly affected because during business rescue proceedings, all the legal proceedings and enforcement action against the company in business rescue are temporarily suspended and thus creditors are prevented from recovering their legitimate claims".

This interim restraint on the creditors' claims against the company is provisioned in the 2008 Companies Act as a moratorium which is sustained for as long as the business rescue proceedings continues.[57]

The moratorium on the rights of those who have claims against the company has been signified as the most important ramification that comes as a result of the business rescue proceedings commencing.[58] The judicially acknowledged purpose of the moratorium is to give the company the required space to breathe free from legal actions and enforcement action or the crucial respite period to enable it to reorganise its affairs in such a way as would allow it to carry on

[52] Nwafor Moratorium in Business Rescue Scheme and the Protection of Company's Creditors 2017 *Corporate Board: Role, Duties and Composition* 59.
[53] Section 7(k) of the 2008 Companies Act.
[54] Nwafor 2017 *Corporate Board: Role, Duties and Composition* 59.
[55] Rushworth A critical analysis of the business rescue regime in the Companies Act 71 of 2008 2010 *Acta Juridica* 375.
[56] 2012 (2) SA 378 (WCC) Para 10.
[57] Nwafor 2017 *Corporate Board: Role, Duties and Composition* 60.
[58] Cassim *et al Contemporary Company Law* 2012 793.

operation on profitable basis.[59] As the main objective of the business rescue is that the financially distressed company continues with business and that it trades-out of its financial problems, Cassim believes this cannot be achieved without the protection of the moratorium.[60]

The effect that moratorium has, according to Osode, does not extend to a modification of rights that are in existence which are acquired by the company's creditors in the period prior the company being under business rescue. According to Osode, it efficiently restricts those rights "in the sense that creditors may not enforce their rights while the company is under the rescue process without the written consent of the business rescue practitioner or in certain circumstances, the court".[61]

In the case of *Moodley v On Digital Media (Pty) Ltd*,[62] the court held that the ambit of the said moratorium does not extend to legal proceedings brought against a company that is placed under business rescue and its practitioner relating to the business rescue plan, inclusive of the interpretation and execution thereof towards implementation.

According to Anderson, any corporate rescue regime requires a circuit breaker to allow the company a period of respite to consider the prospects of saving the company.[63] This breathing space from the creditors' claims, Bradstreet asserts, constitutes one of the crucial favourable outcome factor for any business rescue endeavours because it allows a company to bestow its resources to measures that will contribute towards recuperating the company out of financial trouble instead of using the already constrained resources towards paying off existing debts.[64] More specifically, Bradstreet believes the moratorium is intended to protect the company against creditors in a quest of enforcing their claims against the company, thereby exacerbating the financial distresses of the company and distracting the business rescue practitioners from focusing on saving the company.[65]

2.3.2. Moratorium on legal proceedings

[59] Nwafor 2017 *Corporate Board: Role, Duties and Composition* 60.
[60] Cassim *et al* 2012 864.
[61] Osode "Judicial Implementation of South Africa's New Business Rescue Model: A Preliminary Assessment" 2015 *Penn St. J.L. & Int'L Aff.* 464.
[62] 2014 (6) SA 279 (GJ).
[63] Anderson "Viewing the proposed South African business rescue provisions from an Australian perspective" 2008 *PER* 17/31.
[64] Bradstreet The new business rescue: Will creditors sink or swim? 2011 *SALJ* 372.
[65] Bradstreet 2011 *SALJ* 372.

The 2008 Companies Act explicitly provides that no legal proceeding, inclusive of enforcement actions, may be initiated or continued with against the company or its property or in respect of property lawfully possessed by the company, during the subsistence of business rescue proceedings, subject to certain exceptions which include:[66]

a) "the written consent of the practitioner;
b) the leave of the court and in accordance with any terms the court considers suitable;
c) set-off against any claim made by the company in any legal proceedings, regardless of whether those proceedings were initiated before or after the business rescue proceedings began;
d) criminal proceedings against the company or any of its directors or officers;
e) proceedings concerning any property or right over which the company exercises the powers of a trustee; or
f) proceedings by a regulatory authority in the execution of its duties after written notification to the business rescue practitioner".

Since business rescue was introduced in South Africa, the courts have continuously struggled to interpret and apply the fundamental elements of the moratorium provisions whilst also aiming to give due respect to the judicially acknowledged legislative intention that influenced the promulgation and the idea behind the notion of business rescue in general.[67] For instance, in *Cloete Murray NO and Another v FirstRand Bank Ltd*,[68] Fourie AJA stated that:

> "[t]he way I see it, the legislature intended to allow the company in distress the necessary breathing space by placing a moratorium on legal proceedings and enforcement action in any forum, but not to interfere with the contractual rights and obligations of the parties to an agreement."[69]

According to Nwafor, the moratorium by virtue of its nature cannot function in isolation.[70] He believes legal proceedings and enforcement actions are naturally and significantly additional aspects of contractual rights and responsibilities of parties to an agreement that are in existence.[71] As seen from the case of *Chetty v Hart*,[72] the moratorium provided for by section

[66] Section 133(1) of the 2008 Companies Act.
[67] Nwafor 2017 *Corporate Board: Role, Duties and Composition* 61.
[68] 2015 (3) SA 438 (SCA).
[69] *Cloete* case, para 40.
[70] Nwafor 2017 *Corporate Board: Role, Duties and Composition* 61.
[71] *Ibid.*
[72] *Chetty v Hart* 2015 (6) SA 424 (SCA).

133(1) only puts on suspension legal proceedings against a company under business rescue and not legal proceedings instituted by the company.

2.3.3 Moratorium on proprietary rights

According to Cassim, the moratorium on proprietary rights is designed and intended by the legislature to stop property owners from instinctively or automatically claiming repossession of their goods or property from a company under business rescue, as this would in many cases defeat the objective of the business rescue endeavour by denying the company a chance to trade-out of its financial distress, or to be successfully restructured.[73] In particular, the moratorium aims at striking a balance between the proprietary rights and interests of property owners in recovering their property from a company under business rescue and the rights and interests of the company, its creditors as a whole, its employees, and other relevant stakeholders in the retention by the company of such property.[74] More importantly, restrictions on the property owners' right to dispossess the company of the property needed by the company for the purposes of the rescue aids the company to continue its commercial and business activities and thus grants it the opportunity to achieve a successful rescue.[75] Cassim states:[76]

> "One of the effects of the moratorium on property interests is that owners of property are immobilized from exercising their proprietary rights to recover property in the lawful possession of a company under business rescue, unless the business rescue practitioner gives written consent".

Furthermore, no guarantee or a surety may be enforced against a company undergoing business rescue in relation to the company's liabilities in favour of any other person, unless the court grants leave and on terms it considers just and equitable in the circumstances.[77]

2.3.4 Interpretation of moratorium on legal proceedings through case law

2.3.4.1 Cloete Murray and Another v FirstRand Bank

[73] Cassim "The Effect of the Moratorium on Property owners during business rescue" 2017 *SA Merc LJ* 435.
[74] Cassim 2017 *SA Merc LJ* 435.
[75] *Ibid.*
[76] Cassim 2017 *SA Merc LJ* 423.
[77] Section 133(2) of the 2008 Companies Act.

The interpretation of section 133(1) of the 2008 Companies Act gained momentum when the Supreme Court of Appeal (SCA) had to decide on a case between Cloete Murray (First Appellant), Mabutho Louis Mhlongo (Second Appellant) and the Respondent FirstRand Bank Ltd t/a Wesbank.[78] In *Cloete,* FirstRand Bank Ltd t/a Wesbank entered into a Master Instalment Sale Agreement (MISA) with Skyline Crane Hire (Pty) Ltd (hereafter, Skyline) on 22 July 2010. In terms of the agreement, Wesbank movable goods were sold and delivered to Skyline, on condition that ownership of the goods is retained by Wesbank until such time there has been full payment of the purchase price.[79] Two years later in 2012, Skyline was voluntarily placed under business rescue by its board of directors in terms of section 129 of the 2008 Companies Act.[80] This was filed with the Companies and Intellectual Property Commission in terms of section 132(1)(a)(i) of the 2008 Companies Act on the 30th of May 2012 being the commencement date of business rescue proceedings.[81]

At the stage it was put under business rescue, Skyline was already behind with the monthly payments in terms of the MISA, resulting in Wesbank sending the letter to Skyline on 30 May 2012 for cancellation of the MISA as a result of Skyline's failure to pay the monthly instalments flowing from the agreement. The letter stated, among other things, that the MISA was immediately cancelled and that Wesbank reserved their right to repossess the goods, value and sell them, to make credit from the proceeds of sale to the relevant accounts and to make a claim for damages.[82]

The business rescue practitioner gave consent to Wesbank to repossess and sell the goods as indicated in the MISA and the proceeds from the sale of the goods were more than enough to settle the debt owed to Wesbank, leaving a surplus of R800 000 which Wesbank retained as, according to them, set-off in respect of the amounts allegedly owed to it by Skyline.[83] Shortly after that, Skyline was placed in provisional liquidation by the North Gauteng High Court order, with the final order granted on 10 September 2012. The Master of the High Court appointed the appellants as the co-liquidators (hereafter called the liquidators) of Skyline.[84]

[78] Laubscher "Cloete Murray and Another v FirstRand Bank Ltd t/a Wesbank [2015] ZASCA 39" (2015) *PER/PELJ* 1882.
[79] *Cloete,* para 2.
[80] *Cloete,* para 3.
[81] *Cloete,* para 3.
[82] *Cloete,* para 5.
[83] *Cloete,* para 6.
[84] *Cloete,* para 7.

After appointment, the North Gauteng High Court was approached by Skyline's liquidators challenging the validity of Wesbank's cancellation of the MISA and requesting that the court declare such cancellation void for conflicting with the provisions of section 133(1) of the 2008 Companies Act. It was argued by the liquidators that the payment of full proceeds of the sale should be made over to them in order to be dealt with in terms of sections 83 and 84 of the Insolvency Act 24 of 1936 which stipulated that the creditors claims in respect of instalment sale transactions are to be dealt with at sequestration or liquidation.[85] Wesbank, on the other hand, contended that they had acted lawfully and explicitly repudiated a claim that they were prohibited from cancelling the MISA and dealing with the goods in the manner they had done by section 133(1) of the 2008 Companies Act.[86] The North Gauteng High Court dismissed Skyline liquidator's application but granted a leave to appeal to the SCA.[87]

The SCA first deliberated on the objectives of the Act when coming to the efficient rescue and recovery of a company that is financially distressed.[88] The court then stipulated that section 7(k) of the 2008 Companies Act specifies the manner in which business rescue process should be carried out in balancing the rights and interests of the relevant stakeholders and that section 128(1)(b) defines "business rescue" as "proceedings to facilitate the rehabilitation of a company that is financially distressed".[89] The business rescue means that the company is temporarily supervised as well as there is a moratorium on the rights that the claimants has against the company regarding their property or property in the possession of the company.[90]

The SCA acknowledged the fact that, in general, a moratorium which applies on legal proceedings against a company under business rescue is of great significance since it makes provisions of ensuring that there is a necessary breathing period or respite, at least periodically, to allow the company to reorganize its affairs, in order to draw up a business rescue plan designed to attain the objectives of the business rescue.[91] The SCA further looked at sections 134(1)(c) and 136(2) of the 2008 Companies Act which provide, *inter alia*, that during business rescue proceedings " 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, unless

[85] *Cloete*, para 8.
[86] *Cloete*, para 9.
[87] *Cloete*, para 11.
[88] Laubscher 2015 *PER/PELJ* 1882.
[89] *Ibid*.
[90] Section 128(1) of the 2008 Companies Act.
[91] Laubscher 2015 *PER/PELJ* 1885.

the practitioner consents to this in writing".[92] Section 136(2), on the other hand, specifically provides that a contract that has been concluded prior the company being placed in business rescue is not suspended or cancelled by virtue of the business rescue proceedings.[93] However, the business rescue practitioner may suspend, or apply to the court, to cancel any obligation of the company under the contract.[94]

The court considered the provisions of section 133(1) of the Act, which was the integral part of the argument by the liquidator.[95] The court commented that section 133 of the Act should be interpreted, with the crux of the issue being whether the Wesbank's cancellation of the MISA by means of its cancellation letter of 30 May 2012 should be considered to be an "enforcement action" as section 133(1) of the Act meant.[96] The court elucidated that the concept "legal proceeding" is renowned in South African legal culture and usually refers to a lawsuit. The court was in agreement with the notion that the cancellation of an agreement does not constitute a "legal proceeding" as envisaged in section 133(1) of the Act.

Consequently, it was held by the court that Wesbank's cancellation of the agreement by Wesbank was lawful as it did not constitute a "legal proceeding" and indeed did not require the practitioner or the courts consent, as such it was not a constituent of an "enforcement action" to cancel the agreement as stated in section 133(1) of the Act. It pointed out that the terms "enforcement" and "cancellate/ion" are exclusively mutual, and by not interpreting them as being mutually exclusive would be contrary to the langu/age, context, provision and purpose of section 133(1) of the Act.[97]

According to Laubscher, if the interpretation of statute principles are practically applied by the court it would be easier for the court to arrive at a value decision.[98] He adds that the court's interpretation of section 133(1) of the Act, which formed the basis of the argument by the appellants', reflected that firstly, the cancellation of an argument cannot be construed as part of "legal proceedings".[99] Furthermore, he comments that the argument by the appellant that "enforcement action" and "cancellation" are to be considered similar in this case was found not

[92] Section 134(1)(c) of the 2008 Companies Act.
[93] Section 136(2) of the 2008 Companies Act.
[94] *Cloete*, paras 13– 15.
[95] Cloete, para 28–33.
[96] *Ibid.*
[97] *Cloete*, para 33-34.
[98] Laubscher 2015 *PER/PELJ* 1894.
[99] *Ibid*.

to be acceptable.[100] Laubscher also asserts that the case highlighted the court's unwillingness to involve itself in as far as the contractual rights and obligations of the parties to an agreement are concerned.[101] This reluctance, he believes, is in accordance with the embedded principle of our law that the legislature should not intend to change the existing laws more than is important, particularly if it deprives the existing rights.[102]

2.3.3.2 Chetty v Hart

The parties to this dispute were Shamla Chetty, trading as Nationwide Electrical (Ms Chetty) and TBP Building and Civils (Pty) Ltd (TBP)[103]. Arbitration proceedings were the way the parties elected to settle the disputes they had.[104] However, before the hearing, TBP was placed under business rescue. Thereafter, the arbitrator, oblivious of the company's position, heard argument and consequently made his award.[105] TBP then became liable to Ms Chetty for payment of an amount of R420 573.93 plus interest in terms of the award by the arbitrator. Ms Chetty, on the other hand, was held liable to TBP for substantively more, namely, an amount of R4 238 451.95 plus interest and costs. Ms Chetty dissatisfied with this outcome, opted to have the award entirely overturned by making an application seeking the court to review and set aside an order in the KwaZulu-Natal Local Division, Durban. At the commencement of litigation, TBP was in liquidation, and was no longer under business rescue.[106] There were several matters that arose on the papers before the court *a quo*. In particular, the court *a quo* was tasked on making a decision as to whether the arbitration award made while TBP was under business rescue was prohibited by the general moratorium on legal proceedings against companies under business rescue under section 133(1) of the 2008 Companies Act.[107]

The appellants contention was rejected by the court *a quo* (Nzimande AJ), whose crux of the argument was that an arbitration proceeding should be construed as legal proceedings, holding instead in favour of the respondent that the 'ordinary meaning' of a legal proceeding was a 'lawsuit' or 'hofsaak', which was exclusive of arbitrations from its scope. Consequently, the

[100] *Ibid.*
[101] *Ibid.*
[102] *Ibid.*
[103] *Chetty v Hart* case, para 1.
[104] *Chetty*, para 1.
[105] *Ibid.*
[106] *Ibid.*
[107] *Para* 2.

court a quo made a ruling that the moratorium on legal proceedings in section 133 was not applicable to arbitrations and there were no grounds to challenge the arbitration award on that ground. The application was dismissed but the court a quo granted leave to appeal.[108]

In interpreting the term 'legal proceedings', the SCA first considered the issue of language for provision at stake, the language and structuring of the statute wholly, and also its objective according to the Legislation[109] The court applied the ordinary grammatical rules and syntax in order to interpret and give effect to the language employed in the provision in the legislation.[110] Where more than one meaning was given to a certain word, the SCA found that the more practical and business-like meaning is to be favoured over the one with the conflicting effect.[111] The various definitions of legal proceedings as provided for in legal dictionaries, international arbitration law and the Internet were considered.[112] It was then found by the SCA that, contextually dependent, the phrase 'legal proceedings' may be given a wide enough interpretation inclusive if arbitration tribunals as provided for by the three aforementioned sources.[113]

The SCA went further to stipulate that depending on the context within which the phrase was used, it was equitably capable of including proceedings before the courts as well as other tribunals, such as arbitration tribunals, to resolve legal disputes over rights and remedies.[114] The SCA referred to the decision in *Cloete* and observed, without deciding, that the phrase 'legal proceedings' generally bears the meaning of a 'lawsuit' or 'hofsaak' and that 'enforcement action' was a species of or has its origin in such legal proceedings.[115] The SCA emphasized, though, that *Cloete* was concerned not with the meaning of legal proceedings, but of 'enforcement action', which it said had its origin in 'legal proceedings.[116]

The SCA went further to consider 'legal proceedings' in a wider context, by analysing other provisions of the 2008 Companies Act, including sections 142(3)(b), 5(1), 7(k), 128(1) (b) and 133(1).[117] The SCA continued its purposive interpretation by considering section 128(1)(b) of

[108] *Para* 4.
[109] *Para* 8.
[110] *Ibid*.
[111] *Ibid*.
[112] *Chetty v Hart* case, para 12.
[113] *Chetty v Hart* case, para 12.
[114] *Chetty v Hart* case, para 13.
[115] *Chetty v Hart* case, para 14.
[116] *Chetty v Hart* case, para 16.
[117] *Chetty v Hart* case, para 24.

the 2008 Companies Act which defines 'business rescue' as proceedings which facilitate the rehabilitation of a financially distressed company by making provision for the temporary supervision and moratorium on the claimants rights, as well as the development and implementation of a plan to rescue the company.[118] Taking into consideration the omnipresent use of arbitrations to resolve disputes in the commercial space, the SCA found that it would be mistaken to be exclusive by not including them in the scope of section 133(1) of the 2008 Companies Act.[119]

The SCA concluded that the phrase 'legal proceedings' may, depending on the context used, be interpreted conservatively, to mean court proceedings or widely, to include proceedings before other tribunals including arbitral tribunals.[120] It went further to stipulate that the language used in section 133(1) itself suggested that a broader interpretation commended itself, an approach with which academic commentators[121] agree with.[122] The SCA emphasised that the objectives of section 133(1), which are to enable the practitioner to breathe in order to rearrange company's financial affairs, also required it to be considered in a wide spectrum, like court proceedings also involve diverse resources – both time and money – that may be an impediment to the effectiveness of business rescue proceedings.[123]

2.4 Conclusion

The whole idea of the business rescue process is clearly to give a company that is financially distressed the necessary breathing space from legal proceedings in order to achieve the main objectives of the 2008 Companies Act. The primary objectives of placing a company under business rescue would not be achieved if there was no moratorium on legal proceedings. The concept of moratorium on legal proceedings as demonstrated in *Chetty* case extends to arbitrations and other quasi-judicial proceedings which are likely to disturb the primary objectives of business rescue.

[118] *Chetty v Hart* case, para 28.
[119] *Ibid.*
[120] *Chetty v Hart* case, para 35.
[121] Cassim et al *Contemporary Company Law* 2 ed p 881 footnote 99; Henoschberg on the Companies Act 71 of 2008 vol 1 page 478(12).
[122] *Chetty v Hart* case, para 35.
[123] *Ibid.*

The courts' approach, as demonstrated in *Cloete Murray*'s case, is to give creditors some form of protection to enforce their rights against the companies under business rescue as it was held that cancellation of the instalment sale agreements does not constitute 'enforcement action' as alluded by section 133 of the Companies Act of 2008. This means that creditors may restore possession of their properties held by a company under business rescue by merely cancelling the agreements they have with the company under business rescue and restore possession of their properties other than resorting to instituting legal action against the company under business rescue.

As indicated above, the primary objectives of business rescue can well be achieved by balancing the rights of creditors of the company under business rescue and ensuring that the business rescue is as effective as possible. By virtue of this, creditors are also afforded an opportunity to enforce their rights against the company for as long as their enforcement actions do not constitute legal proceedings as per the provisions of section 133 of the Companies Act of 2008.

The legal developments on moratorium demonstrates that the company under business rescue is afforded the necessary protection from creditors who may enforce their rights or debts through other quasi-judicial proceedings like arbitration as it was held in the *Chetty* case. This does not mean that creditors cannot take other actions to enforce their rights in respect of property belonging to them as long as the action they take against the company does not fall within the scope of legal proceedings or enforcement action as provisioned by section 133 of the Companies Act of 2008.

CHAPTER 3

THE IMPACT OF THE MORATORIUM ON THE RIGHTS OF CREDITORS

3.1 Introduction

As observed from the previous chapters, the rationale behind the establishment of the moratorium provisions is to give the company space to sort out its financial affairs without dealing with legal proceedings and enforcement actions from creditors. However, this stay on legal proceedings negatively impacts creditors as their claims on the company are put on hold for the time which the company is under busines rescue. This chapter will demonstrate the consequences suffered by the creditors of the company under business rescue as a result of moratorium. The primary objectives of the moratorium will also be discussed to demonstrate the intention of the legislature on how the concept of moratorium came about. The protection of creditors of the company under business rescue will also be discussed in order to establish through legislation and case law on how the creditors rights are protected as a form of balancing their interests against that of the company under business rescue.

3.2 Objectives of moratorium

As indicated in Chapter 2, attaining the objectives of the South African business rescue regime comes at a prize to creditors, one of which is the suspension of their rights against the company in rescue.[124] Section 7 of the 2008 Companies Act assures the same creditors that the provision for the company to be rescued and recover from being financially distressed this will be done in a manner wherein the rights and interests of all stakeholders are balanced.[125]

According to the World Bank, the rescue of a financially distressed company provides, among other things, a higher return for creditors based on the greater values of the enterprise continuing as a going concern.[126] In terms of the 2008 Companies Act legislative objectives, a

[124] Chapter 2, para 2.1.
[125] S 7(k) of the 2008 Companies Act.
[126] World Bank *Principles for Effective Insolvency and Creditor/Debtor Regime* 2011 6.

rescue will be construed as having had a favourable outcome if the company will return to continue with operations on a going concern basis, or if the realisation of assets under business rescue will give in returns that are better for the creditors of the company and its shareholders than they would have should the company be wound up immediately.[127] These objectives are analogous to the objectives of the Australian corporate rescue procedure as will be discussed in chapter 4.

In the international arena, the concept of moratorium on legal proceedings constitutes a significant element of most statutory corporate rescue regimes and is supported by the UNCITRAL model for insolvency legislation as an essential component of a corporate rescue process. In particular, the UNCITRAL Guide emphasises that:

> "In reorganization proceedings, the application of a stay facilitates the continued operation of the business and allows the debtor a breathing space to organize its affairs, time for preparation and approval of a reorganization plan and for other steps such as shedding unprofitable activities and onerous contracts, where appropriate… Given the goals of reorganization, the impact of the stay is greater and therefore more crucial than in liquidation and can provide an important incentive to encourage debtors to initiate reorganization proceedings".

The South African courts continue to offer judicial support to the provisioned purposes of legislation through interpreting and applying the relevant provisions in Chapter 6 of the 2008 Companies Act, highlighting the importance of business rescue to the socio-economic growth of the nation.[128]

This chapter will discuss, in detail, how the provisions of the moratorium provisions as found in South African legislation negatively impacts on the rights and interests of creditors as well as how legislation has tried to balance the infringements that moratorium has on the interests of the company undergoing business rescue.

3.3 Consequences of the moratorium provisions on the rights of creditors

The moratorium on legal proceedings means that creditors are prohibited from enforcing their claims against the company, without the practitioners' consent, with the courts leave and according to any of the terms considered by the court to be suitable, or as a set-off against any

[127] Conradie & Lamprecht "Business rescue: How can its success be evaluated at company level?" 2015 *SABR* 6.
[128] Nwafor "*Corporate Board: Role, Duties & Composition"* 2017 at 59.

claim the company made in legal proceedings, no matter whether those proceedings were instituted prior or after the commencement of business rescue proceedings.[129]

Bradstreet stipulates that even though creditors may be bound to construe moratorium as being prejudicial to their rights of recovery, the goal of the moratorium is to facilitate a successful rescue, which may fundamentally result in creditors being repaid in full.[130] Viewed from the Australian perspective, Friedman states that the objectives of the moratorium is to buy the administrator enough time to evaluate the affairs of the company under administration so as to determine whether the company can be saved and to stop "the proverbial race to the courthouse door".[131]

Generally, the moratorium affects the rights and interests of the creditors of the company in rescue including security rights, rights of sale, other contractual rights, rights of foreclosure, reciprocal rights arising from performance by creditors, and rights to set-off.[132] However, while the impact that moratorium has does not go as far as altering the existing rights that the company's creditors have acquired in the period prior commencement of business rescue, it does effectively suspend those rights "in the sense that creditors may not enforce their rights while the company is under the rescue process without the written consent of the business rescue practitioner or in certain circumstances, the court."[133]

However, since the moratorium is a restriction on commencing or proceeding with 'any legal proceeding' against the company in rescue, it does not prevent a creditor from cancelling an agreement with a company in business rescue.[134]

The right of the lessor to cancel its lease agreement with a company in business rescue, may conceivably be contested by the suspension of the agreement by the business rescue practitioner in terms of section 136(2)(a) of the Act.[135] In particular, section 136(2) of the 2008 Companies Act provides that, "during business rescue proceedings the practitioner may:[136]

[129] Section 133(1) (a)—(c) of the 2008 Companies Act.
[130] Bradstreet 2011 *SALJ* 373.
[131] Friedman "Voluntary administration: use and abuse" 2003 *Bond Law Review* 336. See also Lewis "Trouble down under: some thoughts on the Australian-American corporate bankruptcy divide" 2001 *Utah Law Review* 194.
[132] Rugumamu LLD thesis (UKZN, 2017) 32.
[133] Osode "Judicial implementation of South Africa's new business rescue model: A preliminary assessment" 2015 *PSJL & Int'A* 464.
[134] *Cloete Murray NO and Another v FirstRand Bank* Ltd 2015 (3) SA 438 (SCA). See also chapter 2 *supra*.
[135] Cassim 2017 *SA Merc LJ* 426.
[136] S 136(2)(a) of the 2008 Companies Act.

a. entirely, partially or conditionally suspend, for the duration of the business rescue proceedings, any obligation that –
    i. arises under an agreement to which the company was a party at the commencement of the business rescue proceedings; and
    ii. would otherwise become due during those proceedings; or
b. apply urgently to a court to entirely, partially or conditionally cancel, on any terms that are just and reasonable in the circumstances, any obligation of the company."[137]

3.4 Protection of the rights of creditors

The 2008 Companies Act seeks to protect creditors of a company undergoing business rescue by giving them the right to request the business rescue practitioner to give them the written consent or the court to give them permission to be able to exercise their rights in respect of the claims they have against the company.[138] Where a creditor seeks consent from the practitioner, the practitioner may not withhold to give consent without just cause without considering the purpose of the 2008 Companies Act, the condition of the company as well as the nature of the right claimed.[139] The practitioners powers to award or refuse consent must, therefore, not be used as a form bargain to counter negotiations to the benefit of one creditor or disadvantage of the other creditor.[140]

In *Cloete Murray NO and Another v FirstRand Bank Ltd*,[141] the court held that the prerequisite of the practitioner to give written consent in section 134(1)(c) is purely directory, not peremptory and that it is imperative to take into cognisance the fact that one cannot be penalised for failing to fulfil what is required by legislation, nor does the provisions of legislation makes mention that the failure to fulfil the requirement of acquiring consent of the business rescue practitioner results in the particular action taken by the creditors to be treated as a nullity. According to Cassim, proceedings are not considered a nullity, where such legal proceedings or an enforcement action are brought without the statutory requirement of obtaining consent of the court or the business rescue practitioner.[142]

[137] S 136(2) of the 2008 Companies Act.
[138] S 133(1)(a) and (b) of the 2008 Companies Act.
[139] S 134(2) of the 2008 Companies Act.
[140] Nwafor *Corporate Board: Role, Duties & Composition* Vol 13, issue 2, 2017 64.
[141] 2015 (3) SA 438 (SCA) para 24. See also chapter 2.
[142] Cassim et al *Contemporary Company Law* 2012 880

The objective of the Companies Act of 2008 as provided for in section 7(k) is to "provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders".Nwafor is of the opinion that, it is essential for these considerations of the weighing of the competing interests with preference given to the creditors who stand to suffer the highest risk should the business rescue proceedings not be successful.[143]

The Court has, however, warned that section 133(1) should not be used as a shield by companies to avoid paying legitimate claims.[144] Nwafor also advises that since the creditors' rights are abridged already by the moratorium, they should not be subjected to any further unnecessary adversity by not being given an opportunity from participating in the judicial process during the subsistence of the moratorium.[145] According to Nwafor, the necessity to curtail the aggressive effect of the business rescue proceedings on the creditors whose rights are placed on hold, requires the business rescue practitioner to conduct the proceedings expeditiously. The business rescue practitioner should conduct proceedings in such a way that unconscionable company directors are prevented from using the statutory provisions as a ploy to look for the interests of their own by prohibiting creditors from enforcing their legal rights and claims they have against the company or the assets of the company.[146]

According to Burdette, because a moratorium on creditors' rights may have a detrimental effect on such creditors, there is a need to examine how any such prejudice can be restricted or eradicated.[147] In particular, Burdette believes creditors' interests can be protected by, *inter alia*:[148]

i. "limiting the duration of the moratorium;
ii. providing for the moratorium to be lifted;
iii. putting measures in place to ensure that the value of encumbered assets is protected against diminution (whether it be as a result of the use of the asset or as a result of the application of the moratorium);
iv. consulting with secured creditors on the use and sale of the encumbered assets;

[143] Nwafor "*Corporate Board: Role, Duties & Composition"* 2017 at 65.
[144] *Chetty v Hart* [2015] 4 All SA 401 para 40. See also chapter 2.
[145] Nwafor "*Corporate Board: Role, Duties & Composition"* 2017 at 66.
[146] *Ibid.*
[147] Burdette "Some initial thoughts on the development of a modern and effective business rescue model for South Africa (Part 2)" 2004 *SA Merc LJ* 421.
[148] Burdette 2004 *SA Merc LJ* 421.

v. paying of interest as far as the proceeds of the asset allow; and

vi. taking over the asset where the asset is worth less than the secured claims".

3.5 Conclusion

Although the moratorium bars creditors from enforcing their rights and through legal proceedings and enforcement actions taken against the company that is placed under business rescue, it is not an absolute bar as legislation also gives the creditors the necessary protection if there is a need for them to enforce their rights through legal proceedings and enforcement action against the financially distressed company. Creditors are afforded an opportunity to approach the business rescue for the requisite written consent of enforcing their rights or instituting legal proceedings against the company under business rescue, and if the business rescue practitioner so grants them consent, the creditors may proceed with their intended legal proceedings as discussed above in paragraph 3.4. The creditors also have an advantage of having their claims against the company being paid in full upon the company being successfully rescued.

The primary goal of moratorium is to allow a financially distressed company to reorganise itself without harassment from creditors with legal action. Such breathing space is of importance for the business rescue practitioner to strategise and formulate a proper rescue plan that is proper which aims at achieving the main objective of the rescue process.[149]

Creditors are also afforded protection by legislation in that they can approach the business rescue practitioner to seek consent for them to be able to institute legal proceedings against the company under business rescue. The business rescue practitioner must assess the creditors interests and other relevant aspects and if satisfied that the legal proceedings to be instituted by the creditors does not affect the business rescue process, he or she must not unnecessarily withhold such consent.[150]

[149] Cassim et al *Contemporary Company Law* 2012 at 879
[150] Section 134(2) of the Companies Act of 2008

CHAPTER 4

COMPARATIVE STUDY - AUSTRALIAN COMPANY LAW IN REGARDS TO THE MORATORIUM

4.1 Introduction

There are almost undistinguishable goals with the business rescue procedure in the South African company law and Australian company law as each of the jurisdictions recognises the continuous existence of the company despite its circumstances. A discussion of the South African Companies Act provisions on the business rescue moratorium as found in the Companies Act of 2008 displays that the South African provisions are more focused on ensuring that the company is rescued is a way that is mutually convenient to all the relevant stakeholders. This chapter discusses the exposition of moratorium provisions under the Australian company law as governed by the Corporations Act of 2001, in comparison with the exposition of moratorium under South African company law as governed by the Companies Act of 2008.

In terms of the Australian company law the provision similar to business rescue as provided for in South African company law is called voluntary administration which has almost similar provisions in as far as moratorium in South Africa is concerned. The voluntary administration under the Australian company law also makes provision for moratorium which gives a company under voluntary administration some space to breathe, during which creditors cannot enforce their claims whilst the company is under voluntary administration.[151]

4.2 Purpose of moratorium under the Australian Corporations Act 2001

The purpose of Part 5.3A, as stated in section 435A of the Corporations Act 2001, is to "allow the business, property and affairs of an insolvent company to be administered in such a way that:

i. maximizes the chances of the company, or as much as possible of its business, continuing in existence; or

[151] Backer Mckenzie Overview of Australian corporate insolvency regimes www.bakermckenzie.com/australia.

ii. if it is not possible for the company or its business to continue in existence — results in a better return for the company's creditors and members than would result from an immediate winding up of the company."

Thus, the overarching goal that voluntary administration seeks to achieve is to rescue companies that are capable of working successfully again from liquidation, where there is a threat that being financially distressed would consequently result in the creditors taking necessary steps to apply for the liquidation of the company.[152] According to Sellars, the voluntary administration scheme has the objectives of overcoming the inadequacies of the schemes preceding it by providing a procedure that is relaxed and relatively of low-cost procedure of which an enterprise may be given a space to breath, in order to try to make certain arrangements and compromises with its creditors.[153]

The most significant element of the Australian corporate rescue regime is the moratorium incorporated in divisions 6 and 7 of the Part 5.3A of the Corporations Act 2001.[154] It is an element of the provisions in Australian company law that epitomizes a minimal interference of the creditors rights.[155] Thus, the voluntary administration regime is effectually a moratorium that is more of a formal nature, which aims at facilitating a stay on creditors actions in a unique way, thereby providing an opportunity for a company to reorganise and increase the possibility of the company being rescued from being wound up and producing a situation which will ultimately be advantageous to the creditors and other stakeholders as opposed to when the company is wound up.[156]

4.3 An exposition of the moratorium provisions under the 2001 Corporations Act

As part of the moratorium provisions, the Corporations Act provides for a general proscription on the rights of the owners or lessors of property that are in the possession of the company during the period of the administration.[157] In this regard, the court proceedings against the company are automatically put on hold without the written consent of the administrator or the

[152] Blazic "In search of a Corporate Rescue Culture: A review of the Australian Part 5.3A legislation" 2010 *SBS HDR Student Conference* 8.
[153] Sellars "Corporate Voluntary administration in Australia" 2001 *OECD* 1.
[154] Anderson & Morrison "Part 5.3A: The Impact of changes to the Australian corporate rescue regime" 2007 *Insolv LJ* 245.
[155] Anderson & Morrison 2007 *Insolv LJ* 245.
[156] Blazic (2010) *SBS HDR Student Conference* 8.
[157] S 440C of the Corporations Act 2001 (Cth).

court,[158] the execution process if commenced with cannot go ahead,[159] and any other attempt to make enforcement of a judgement is prohibited.[160]

Therefore, one of the most significant effects ensuing from the time an administrator is appointed is the fact that moratorium is triggered on actions taken against the company during the period of administration.[161] According to Sellers, the reasoning behind the freezing of actions taken against the company during the administration period is to afford the administrator and the creditors an opportunity to evaluate the circumstances of the company and work out the best solution for the company.[162] He argues that if any creditor was allowed to carry on with their individual claims during the administration process, the administrator would have to involve him or herself in having to oppose the proceedings, thereby detracting him from the other crucial work he has to do in a short space of time, leading to the incurrence of substantial expenditure, which would be to the detriment of the other creditors, the stakeholders of the company and the company.[163]

More specifically, the moratorium during voluntary administration protects the company's property during the period of administration and specifically protects the company from being liquidated;[164] imposes restrictions on third parties from enforcing their property rights[165] except charges over all or substantially a chargee where the enforcement action has begun before the appointment of an administrator,[166] and charges over perishable property;[167] an owner or lessor making recovery of property which is utilised by the company,[168] except where the owner or lessor has already commenced exercising his or her rights to repossess the particular property prior the appointment of an administrator[169] or where the property is capable of being destructed;[170]proceedings from being started or commenced with against the company and any

[158] S 440D of the Corporations Act 2001.
[159] S 440G of the Corporations Act 2001.
[160] S 440F of the Corporations Act 2001.
[161] Sellars 2001 *OECD* 4.
[162] *Ibid.*
[163] *Ibid.*
[164] S 440A (1) of the Corporations Act 2001.
[165] S 440B of the Corporations Act 2001.
[166] S 441B of the Corporations Act 2001.
[167] S441C of the Corporations Act 2001.
[168] S 440C of the Corporations Act 2001.
[169] S 441F of the Corporations Act 2001.
[170] S 441G of the Corporations Act 2001.

action enforcing the creditors rights relating to the proceedings;[171] and an administration of a surety by the directors or relatives from being triggered.[172]

This moratorium is applicable to secured creditors with certain exception to a limited extent, and also applicable to the owners or lessors or property possessed, used or occupied by the company under voluntary administration with limited exceptions and to unsecured creditors.[173]

4.3.1 Moratorium on charges and owners or lessors of property

In order to achieve the purposes of voluntary administration as enshrined in Part 5.3A of the Corporations Act 2001, the Act creates a statutory moratorium which seeks to impose limitations to the actions which creditors or other persons can take against the company under administration and its property.[174] Section 440B provides that:

> "during the administration of a company, a person cannot enforce a charge on property of the company, except:
>
> i. with the administrator's written consent; or
> ii. with the leave of the Court."

Once there is an appointment of the administrator to a company, the chargees and owners or lessors of property used, leased or occupied by the company, are prohibited from being able to enforce the rights they have in respect of the property without the requisite consent of the administrator or the permission of the court.[175] Where action was taken by a charge, owner or lessor before the commencement of the administration, and there is satisfaction to the court that the person involved can be otherwise sufficiently protected the court has a discretion to make an order averting enforcement action.[176] This prevents particular charges, owners or

[171] Ss 440D and 440F of the Corporations Act 2001.
[172] S 440J of the Corporations Act 2001.
[173] Legal Committee of the Companies and Securities Advisory Committee (hereinafter CSAC Legal Committee) *Corporate Voluntary Administration* Report 1998 8.
[174] Explanator-y Memorandum to the Corporate Law Reform Bill 1992 par 512; Australian Law Reform Commission, Report number 45, General Insolvency Inquiry, Volume 1, Australian Government Publishing Service, Canberra, 1988 para 94.
[175] Ss 440B and 440C of the Corporations Act 2001.
[176] Ss 441D and 441H of the Corporations Act 2001.

lessors from abandoning the prospects of the business, provided that there is a way in which their rights can be protected in one way or the other.[177]

A Federal Court of Australia's decision of, *Canberra International Airport Pty Limited v Ansett Australia Limited,*[178] encompasses a more extensive statement containing concepts and principles gorvening an application for leave to obtain permission:

> "Leave may be granted if the statutory restraint imposed on the lessor will occasion the lessor loss or detriment (financial or otherwise) of a relevant kind. The loss or detriment may be regarded as relevant to a grant of leave where the Court considers it is greater than any benefit or advantage that might inure to creditors by reason of the statutory restraint. The outcome of a grant of leave may depend on the history of the administration, the conduct of the parties, and whether terms may practically be imposed on a grant or refusal of leave to protect competing interests."[179]

More often than not, the Court may be bound to give permission where the applicant can prove to the court that the acquiring of possession will not in any viable way be detrimental to the options available for the company which may be considered by the creditors.[180]

4.3.2 Moratorium against the commencement or continuation of legal proceedings

The Australian legislation imposes a moratorium on the beginning or continuation of proceedings taken against the company or its property except with the permission of the voluntary administrator in writing or with the permission of the court.[181] This prohibition against commencing or continuing court proceedings against a company in voluntary administration constitutes a crucial feature of the Australian corporate rescue.[182] The objective and role of the moratorium provisions is to ensure that a company in voluntary administration is not exposed to a multiplicity of actions which would otherwise be both costly and wasting

[177] CSAC Legal Committee Report (1998) 8. See also Explanatory Memorandum to the Corporate Law Reform Bill 1992, para 533.

[178] [2002] FCA 329.
[179] *Canberra International Airport Pty Limited v Ansett Australia Limited* [2002] FCA 329, para 24.
[180] Nicols & McLennan "The rights of owners, lessors and charges in a voluntary administration" 2002 *Allens Arthur Robison* 7.
[181] S 440D (l) of the Corporations Act 2001.
[182] Bri Ferrier "Seeking leave to commence or continue with proceedings against a company in winding up or administration" 2016 *Technical Insights* 1.

time, and in some instances superfluous, diverting the attention of the administrator and available funds away from the orderly liquidation of the company.[183]

In *Foxcroft v The Ink Group Pty Ltd*,[184] the court remarked that:

> "The provisions of Part 5.3A... provide that there shall be a complete freeze of proceedings against the company during the administration so that the administrator can have time to assess the situation, and the company's creditors have an opportunity to work out the net position and adopt an attitude under section 439C which will be in their common interest. To allow one creditor or potential creditor to proceed would not only take the administrator's attention from what he needs to do under the division in a relatively short period of time, but it would also involve costs in running the legal action... as well as perhaps giving the claimant some advantage over other creditors... Accordingly, it seems to me that an application under section 440D will rarely be granted."

The statutory restraint on actions and proceedings is accompanied by the courts powers to give permission to proceed with actions and proceedings. However, the relevant sections do not give direct indication of the instances where such leave is to be granted.[185] For instance in *Re Java 452 Pty Limited* (administrator appointed),[186] Byrne J considered an application by the lessor for permission to institute action under section 440C to take repossess the premises from which a café was operated by the company in administration. The lessor has potentially established a new tenant who intended or rather verbalised his intention to make improvements to the property. The administrator refused the application for leave on the basis that a company could not be put on sale as a going concern without possession of the company. The application by the lessor was refused by Byrne J. In doing so, a number of considerations were pointed out by the judge, more specifically factors such as that there was a creditors' meeting scheduled to take place in 6 days' time and in the interim, there wouldn't be any material prejudice suffered by the lessor. Byrne J also made emphasis on the significance of giving the company's creditors the opportunity to consider the company's future on the basis that it still had possession of property which was important to its business.

[183] *Ibid.*
[184] (1994) 12 ACLC 1063.
[185] Bri Ferrier 2016 *Technical Insights* 1.
[186] (1999) 32 ACSR 507 at 518.

Considering the above case, the Australian courts evidently acknowledge the effect of the moratorium on the secondary object business rescue, by refusing to grant a landlord leave to take possession of its premises from a tenant company under administration in circumstances where the repossession of the premises would have obstructed the possible sale of the company as a going concern.[187]

4.3.3 Moratorium on triggering the liability of certain guarantors of the company.

Under the Australian voluntary administration procedure, a moratorium prevails against any guarantee of a company's liability made by a director of the company, who is considered a natural person, or by a spouse of such a director, *de facto* spouse or relative of such a director.[188]

In *Gan v Saunders and another*,[189] a company did not make payments that have been guaranteed by a third party. The creditor began proceedings for the collection of outstanding payments from the guarantors. The company was placed into voluntary administration during the proceedings against it. The creditors concluded that a deed of company arrangement should be executed, and it was. The creditor pursued its claim against the guarantors notwithstanding the creditors' resolution to place the company under voluntary administration. The guarantors were reliant on a clause in the deed of company arrangement which prohibited the creditors that were bound by it from impeaching any legal proceedings with respect to any debt incurred by the company, arguing that it proceedings against the guarantors were covered.

The court differed with this argument stipulating that a language that is very clear enough is needed to rationalise the way that provisions such as halting proceedings against third parties are interpreted. The contention of the guarantors was that the creditor's debt by the company was extinguished by the deed and that as a result of that there is no other way that the creditors could pursue their claims against the guarantors. The court rejected this contention by relying on the decision of the Court of Appeal of *New South Wales in Hill v Anderson Meat Industries*,[190] which held that with regard to a Scheme of Arrangement that the extinguishment of the debt took place by operation of law and as a result thereof it does not mean that the surety is to be discharged. The court further remarked that the results are that while a director who is

[187] Cassim "The effect of the moratorium on property owners during business rescue" 2017 *SA Merc LJ* 435.
[188] S 440J of the Corporations Act 2001.
[189] 15 ACSR 298.
[190] [1992] 2 NSWLR 704.

a natural person, or a spouse, de facto spouse or relative of such a director who has made guarantees of liability against the company that is placed under voluntary administration would be given protection for the period of the administration if the guarantors wish be protected for the period of the deed of company arrangement it must be spelt out clearly in explicit terms.[191]

4.3.4 Conclusion

There are clear similarities on the doctrine of business rescue moratorium in both South African and Australian company law regimes. Business rescue seeks to achieve similar objectives in both legal systems hence my submission about the apparent similarities on moratorium in both countries. However, unlike in South Africa, the appointment of an administrator in Australia automatically places moratorium on legal actions taken against the company and the moratorium remains in effect for the duration of the administration.

[191] Cassim 2017 *SA Merc LJ* 435.

CHAPTER 5

CONCLUSION AND RECOMMENDATIONS FOR LAW REFORM

5.1 Introduction

The discussion above depicted the similarities as well as differences between the South African moratorium provisions and Australian provisions. In particular, the discussion showed that both Australia and South Africa have the same objectives of saving the company as a going concern by allowing a breathing space in a form of a moratorium. However, as shown in the discussion in chapter 3, the quest to save a financial distressed company is costly to the creditors whose right of recourse to the court to claim their contractual and proprietary rights are put on hold by moratorium during the subsistence of the business rescue proceedings.[192]

As Nwafor pointed it out, there is a need to curtail the antithetical effect that the business rescue proceedings have on the creditors whose rights are postponed.[193] This means that the proceedings should be conducted speedily with the responsibility on courts to be vigilant against abuse of process by irresponsible directors of the as a technique used by them to frustrate the creditors and prevent them from enforcing their legitimate rights against the company or the company's assets.[194]

As pointed out by Beukes, the moratorium on legal proceedings by creditors is an indispensably significant aspect of the business rescue proceedings as it gives the court a chance to hear the business rescue application and also gives the business rescue practitioner a chance to function effectively.[195] Beukes further pointed out that it is the courts responsibility to bear in mind the objectives of business rescue proceedings, and also give effect to moratorium on enforcement actions and legal proceedings to allow the hearing of an application for business rescue and also to allow the business rescue to function effectively.[196]

[192] Nwafor 2017 *Corporate Board: Role, Duties and Composition* 66.
[193] *Ibid.*
[194] *Ibid.*
[195] Beukes "Business rescue and the moratorium on legal proceedings" 2012 *De Rebus* 34.
[196] *Ibid.*

According to Nwafor "a comparison of the South African Companies Act provisions on the business rescue moratorium with that of the Australian Corporations Act depicts that the South African provision is narrowly focused on rescuing the company and not the company's business as such, even as the contrary could have been the legislative intention".[197] The Australian provisions, on the other hand, explicitly refers to rescuing the company or the business of the company.[198]

5.2 Recommendations

In light of the above discussion, the following recommendations are made:

1. It is recommended that the moratorium provisions under the South African business rescue regime should be guarded against abuse by the business rescue practitioners in order to protect the rights of the creditors of the company of the company under business rescue to not be deprived an opportunity to bring forth their claims.
2. It is further recommended that legislation be amended to give proper guidelines or requirements that the creditors should meet in order to make an application to obtain consent to institute legal proceedings or enforce their actions against a company under business rescue, should the creditors feel that the business rescue practitioner is unreasonably withholding consent for legal proceedings to be instituted.
3. There should also be a clear definitive guideline in legislations as to what constitutes legal proceedings and enforcement actions during business rescue proceedings, to give a clear guideline to the creditors as to which actions and proceedings are guarded my moratorium whilst the company is undergoing business rescue.
4. There should be a strict time limit for the company to be on business rescue in order to protect the creditors whose rights have been infringed by moratorium to have to wait indefinitely to bring their legitimate claims.

[197] Nwafor "The goals of Corporate Rescue in Company Law: A comparative Analysis" 2017 *Corporate Board: role, duties and composition* 30.
[198] *Ibid.*

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