Perspectives of post-commencement financiers regarding their voting rights on a business rescue plan

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Mini-dissertation submitted in partial fulfilment in requirement for the degree

Master of Laws

LLM In Insolvency Law

in the

Faculty of law

at the

University of Pretoria

Supervisor: Dr JS van Wyk

November 2024

Abstract

Post-commencement financiers provide a lifeline to companies under business rescue and these financiers have their best interest in the survival of these companies. Should it be that the business rescue plan is unsuccessful, the chances are that the post commencement financiers will be the largest creditors.

In *Wescoal Mining (Pty) Ltd v Mkhombo NO*, a dispute arose regarding the appropriate adoption of a business rescue plan during the meeting. One critical legal issue was whether the Companies Act bestows voting rights exclusively to the company's creditors who existed at the initiation of business rescue, or if creditors accruing after the commencement may also partake in voting on the plan. Following an assessment by Judge Wilson, it was established that only creditors with claims predating the commencement were eligible to participate in the voting process. Subsequently, Judge Wilson believed that section 135 of the Companies Act places post-commencement financiers as creditors in a different class and provides for their protection and interests in a different way.

Against this background, the dissertation evaluates the position of post-commencement creditors when it comes to voting on a business rescue plan.

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Chapter 1: Introduction

1.1. Background

In South Africa, business rescue is outlined in Chapter 6 of the Companies Act ("the Act").[1] The Act holds significant importance within the realm of business rescue proceedings, embodying purposes such as to "promote innovation and investment in the South African markets"[2] and 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".[3]

Business rescue is a process that offers temporary protection to a company, allowing it to restructure its affairs with the goal of restoring solvency.[4] The concept of business rescue is explicitly defined in section 128(1)(b) of the Act as "proceedings to facilitate the rehabilitation of a company that is financially distressed" and provides for a structured process for companies facing financial difficulties to reorganize and recover.

Section 128(1)(b) of the Companies Act specifically provides for

> "(i) the temporary supervision of the company, and of the management of its affairs, business and property;
> (ii) a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and
> (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 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 that would result from the immediate liquidation of the company".

[1] 71 of 2008. In this dissertation, all references to sections of legislation refer to sections in the Companies Act 71 of 2008 (the Act) unless specifically states otherwise.
[2] Section 7(c).
[3] Section 7(k).
[4] Smith *et al Hockly's Law of Insolvency Winding-up and Business Rescue* (2022) chapter 25.

The substantive requirement for commencement of business rescue will be when a company encounters financial distress and finds itself incapable of meeting its debt obligations as and when they fall due within the subsequent six months.[5] In addition, it may reasonably appear that the company will face insolvency within the same period and,[6] therefore, requires proactive solutions to address the company's financial challenges.

The commencement of business rescue is further regulated by section 129 of the Act. In the event of financial distress and with a reasonable expectation of rescuing the company, the board of directors has the authority to pass a resolution for placing the company under business rescue.[7] In addition to the formalities of placing the company in business rescue, it is necessary to complete the required formalities, which include appointing a business rescue practitioner ("the practitioner").[8] The practitioner must meet the qualifications outlined in section 138 of the Act.

The primary duty of the appointed practitioner is to promptly undertake a thorough investigation of the company's operations and financial matters.[9] This investigation should be conducted diligently and comprehensively to ensure a complete understanding of the company's affairs. Upon the conclusion of the investigation, it is imperative for the practitioner to thoroughly evaluate whether the company holds any potential for viability and potential rescue.[10] If the practitioner determines that the company is feasible, they are required to develop a comprehensive business rescue plan outlining the proposed restructuring strategies and detailing the specific measures that will be employed to rescue the company.[11]

[5] Section 128(f)(i).
[6] Section 128(f)(ii).
[7] Section 129(1) and (2).
[8] Section 129(3).
[9] Section 141(1).
[10] Section 141(1).
[11] Section 150.

Before completing the business rescue plan, the practitioner must engage in consultations with the company's creditors, individuals who will be affected, and the company's management team.[12]

Upon the publication of the business rescue plan as provided for in section 150 of the Act, the appointed practitioner will facilitate and preside over a meeting attended by creditors, affected parties, and management to deliberate on the proposed rescue plan.[13] During the said meeting, the practitioner will open the floor for empowering discussions and collaborative negotiations in alignment with section 152(1)(d). Additionally, there will be an opportunity to collectively vote on any motions to

> "(i) amend the proposed plan, in any manner moved and seconded by holders of creditors' voting interests, and satisfactory to the practitioner; or
> (ii) direct the practitioner to adjourn the meeting in order to revise the plan for further consideration".[14]

Simply put, the approval of the rescue plan is contingent upon any modifications proposed by the creditors and deemed acceptable by the practitioner. As a result, if instructed, the practitioner may defer the meeting for further examination and review of the plan.

1.2. Problem statement

The primary objective of this study is to clarity the rights of creditors to participate in the voting process for the proposed plan in a fair and just manner. In the context of corporate insolvency and, specifically, business rescue, it is imperative that the presence of two distinct classes of creditors be recognised. Firstly, there are creditors with pre-existing claims predating the onset of the rescue proceedings. These creditors are owed debts before the business rescue process commences. Secondly, there are creditors emerging and becoming associated with the business subsequent to the commencement of the business rescue proceedings. Accordingly, the

[12] Section 150.
[13] Section 151(1).
[14] Section 152(1)(d)(ii) and (ii).

differentiation between these creditors will have a significant impact on the prioritization of claims.

To elucidate the prioritization process outlined in the Act, it specifies that the initial claims to be addressed are the remuneration of the business rescue practitioner, along with associated expenses and other claims arising from the business rescue procedure.[15] Once these initial claims are addressed, creditors holding post-commencement financing are positioned next in the order of payment. These claims are settled sequentially according to their inception, with secured claims given precedence over unsecured creditors.[16] Subsequent to post-commencement secured creditors, unsecured post-commencement creditors are ranked next, determined by the timing of the emergence of their claims.[17] These creditors are afforded priority over all other creditors, including preferential creditors, who existed prior to the initiation of the business rescue proceedings.[18]

Kgomo J made a ruling in *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company Ltd*[19] the order of preference which is – following the claims of unsecured post-commencement creditors, ordinary "secured lenders or other creditors" occupy the next tier in the hierarchy of creditor repayment. Thereafter "employees for any remuneration which became due and payable before business rescue proceedings." At the lowest level are the "unsecured lenders or other creditors for any loan or supply made before business rescue proceedings began", whose claims are generally considered least likely to be satisfied.

In conclusion, business rescue proceedings can have negative implications for creditors that provided financing prior to the initiation of the business rescue process. It is important to note that post-commencement finance, although associated with a greater risk due to the company's prior financial difficulties, receives a higher priority in terms of repayment compared to pre-commencement creditors, which is evident in

[15] Section 135(1).
[16] Section 135(3)
[17] Section 135(3)(b)
[18] Section 135(3)(a)(ii)
[19] 2013 JDR 1019 (GSJ) par 21.

the ruling of Merchant West.[20] As a result, those providing post-commencement finance may have a better likelihood of recovering their investments.

Following the initiation of business rescue proceedings, the focus will be on the creditors and the provisions outlined in section 135 of the Act. Section 135 expounds on the specific provisions governing the nature and scope of post-commencement financing and specifically states:

> "(1) To the extent that any remuneration, reimbursement for expenses or other amount of money relating to employment becomes due and payable by a company to an employee during the company's business rescue proceedings, but is not paid to the employee –
>
> (a) the money is regarded to be post-commencement financing; and
>
> (b) will be paid in the order of preference set out in subsection (3)(a).
>
> (2) During its business rescue proceedings, the company may obtain financing other than as contemplated is subsection (1), and any such financing –
>
> (a) may be secured to the lender by utilising any asset of the company to the extent that it is not otherwise encumbered; and
>
> (b) will be paid in the order of preference set out in subsection (3)(b).
>
> (3) After payment of the practitioner's remuneration and expenses referred to in section 143, and other claims arising out of the costs of the business rescue proceedings, all claims contemplated-
>
> (a) in subsection (1) will be treated equally, but will have preference over –
>
> (i) all claims contemplated in subsection (2), irrespective of whether or not they are secured;
>
> (ii) all unsecured claims against the company; or
>
> (b) in subsection (2) will have preference in the order in which they were incurred over all unsecured claims against the company.
>
> (4) If business rescue proceedings are superseded by a liquidation order, the preference conferred in terms of this section will remain in force, except to the extent of any claims arising out of the costs of liquidation".

[20] 2013 JDR 1019 (GSJ) par 21.

Simply put, section 135 specifies that post-commencement finance ("PCF") can be obtained and outlines the priority order for repaying such funding. It must be noted that considering the current economic conditions in South Africa, obtaining PCF is essential for companies as it provides a vital lifeline for their survival. The PCF offers financial support that can significantly bolster a company's ability to weather the challenges posed by the current economic climate in South Africa.

Based on recent case studies and legal analyses, there has been a substantial and contentious debate over the hierarchy of creditors, particularly focusing on the rights and standing of secured creditors when business rescue proceedings are initiated.

A controversial case in point: *Wescoal Mining (Pty) Ltd Another v Mkhombo NO and Other.*[21] During the business rescue of Arnot Opco (Pty) Ltd ("Arnot"), the company in business rescue and the second respondent, a dispute arose regarding the appropriate adoption of a business rescue plan during the meeting.[22] One critical legal issue was whether Mashwayi Projects (Pty) Ltd ("Mashwayi"), a creditor by way of cession/ post commencement creditor and the fourth respondent, could vote at the meeting which is held in terms of section 151 of the Companies Act ("section 151 meeting").[23]

In Middleburg, Arnot was responsible for operating a coal mine.[24] Mashwayi obtained cessions from some of Arnot's creditors and secured a lease for a part of Arnot's rail allocation.[25] It was agreed that Mashwayi would become a creditor of Arnot once the business rescue proceedings began, as it was mutually understood and the common cause.[26] Wescoal and Salungano Group Ltd ("Salungano") were creditors of Arnot at the initiation of the business rescue proceedings.[27] Wescoal was further Sulangano's wholly-owned subsidiary.[28]

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[21] *Wescoal Mining (Pty) Ltd Another v Mkhombo NO and Other* (2023-079991) [2023] ZAGPJHC 1097; 2024 (2) SA 563 (GJ) (2 October 2023) (hereinafter "*Wescoal*").
[22] *Wescoal* par 2.
[23] *Wescoal* paras 12 and 13.
[24] *Wescoal* par 1.
[25] *Wescoal* par 3.
[26] *Wescoal* par 14.
[27] *Wescoal* par 2.
[28] *Wescoal* par 2.

Wescoal and Salungano contended that Mashwayi did not hold creditor status with Arnot until after the business rescue proceedings had begun.[29] They asserted that Mashwayi's opposition votes should not have been considered.[30] They claimed that the votes opposing Mashwayi should not have been taken into account.[31] Furthermore, they contended that if Mashwayi's votes were excluded, the business rescue plan would have garnered the necessary 75% approval.[32] Mashwayi's dissenting vote was a contributing factor to the rejection of the business rescue plan.[33] Considering Mashwayi's opposing vote, it became evident that the plan would not have gained the necessary support for approval.[34]

Wescoal and Salungano argued that a creditor who became involved subsequent to the commencement of proceedings, for example Mashwayi, was devoid of the voting authority to sanction a business rescue plan.[35]

The matter before the court pertained to whether the Companies Act bestowed voting rights in a meeting called under section 152 exclusively to the company's creditors who existed at the initiation of business rescue, or if creditors accruing after the commencement may also partake in voting on the approval of a business rescue plan.[36]

Wilson J (“Judge Wilson”) ruled that Mashwayi's dissenting vote should not be considered because post-commencement claims do not carry voting rights. The decision was based on an understanding that the word "creditor" in sections 151 and 152 – in that it refers specifically to individuals or entities holding claims that were established before the start of the business rescue process.[37]

Following an assessment by the court, it was established that only creditors with claims predating the commencement were eligible to participate in the voting

[29] *Wescoal* paras 13 and 14.
[30] *Wescoal* par 13.
[31] *Wescoal* par 12.
[32] *Wescoal* par 14.
[33] *Wescoal* par 12.
[34] *Wescoal* par 12.
[35] *Wescoal* par 14.
[36] *Wescoal* par 19.
[37] *Wescoal* par 20.

process.[38] Subsequently, section 135 of the Companies Act places post-commencement financiers as creditors in a different class and provides for their protection and interests in a different way.[39] Judge Wilson then concluded that the plan had been appropriately approved and adopted in accordance with the relevant procedures.[40]

1.3. Research question

In the midst of all this, the research problem poses the following thought-provoking question: Should post-commencement financiers who provide funding, after a company has entered into business rescue proceedings, have the right to vote on the business rescue plan, be involved in making decisions, and influencing the outcome of the process?

1.4. Significance of the study

During periods of economic upheaval within organizations, it is frequently noted that securing funding becomes progressively more difficult, particularly in the wake of recent financial downturns.[41]

Excluding post-commencement creditors from voting may dissuade potential new financiers from providing support to companies in business rescue. When considering investing in financially distressed companies following the initiation of bankruptcy proceedings, it becomes apparent that post-commencement financiers are exposed to a significant risk. If the company fails to recover and the only remaining option is to liquidate, these investors face the potential loss of their entire investment. It is commonly assumed that creditors providing financing after a company has filed for business rescue are aligned with the company's interests and are committed to its success.

[38] *Wescoal* par 20.
[39] *Wescoal* par 24.
[40] *Wescoal* par 40.
[41] Pretorius and Du Preez "Constraints on decision making regarding post-commencement finance in Business rescue" 2013 *Southern African Journal of Entrepreneurship and Small Business Management* 168 at par 1.

Based on an extensive review of multiple articles, it becomes evident that PCF is considered the essential financial support system for financially distressed companies that holds paramount significance for their continued operation and potential recovery. The re-emergence of a distressed company into a solvent state not only ensures its viability but also significantly benefits all creditors and relevant stakeholders, as opposed to the alternative route of liquidating the company.

The Wescoal's judgment will have ramifications that may influence the foundations of business rescue because post-commencement creditors are not granted the same rights as pre-commencement creditors.

1.5. Structure of the dissertation

Chapter 1 introduces the research problem and highlights the significance of the study. It provides a background to the study by outlining the significance of post-commencement financiers and the potential ramifications of the *Wescoal* judgment. It provides a contextual backdrop to the research by delineating the significance of post-commencement financiers and the prevailing challenges. These challenges are pertinent irrespective of whether a post-commencement financier is classified as a creditor and accorded the right to participate in the voting process for a proposed business rescue plan.

Chapter 2 offers a comprehensive overview of the business rescue process. Furthermore, it delves into the intricate approval and voting procedures of the business rescue plan, bringing attention to the active participation of a diverse range of creditors and stakeholders. This chapter will further examine the intricate details of the creditor hierarchy, examining how it is determined by additional case law and the specific legal precedents that shape it.

Chapter 3 presents a comprehensive examination of post-commencement financing and elucidates the critical significance of such financing in the recovery of financially distressed enterprises while also delving into specific challenging aspects of post-commencement finance that are problematic in practise, which is evident in the Wescoal judgment. This analysis delves into how this type of financing plays a vital

role in stabilizing and supporting business rescue efforts, delivering essential assistance during a company's recovery process.

Chapter 4 concludes the study through a comprehensive comparison of South African insolvency law and that of the United States.

Chapter 2: The business rescue process

2.1. Introduction

Chapter 2 delves into the concept of business rescue, an essential legal mechanism established to support financially distressed companies in South Africa.[42] The chapter outlines the objectives of business rescue, which focus on providing struggling businesses with an opportunity to restructure and continue operating, as opposed to facing liquidation.[43] The Companies Act 71 of 2008 lays out the framework for business rescue, creating a systematic process that involves various key stakeholders, including the business rescue practitioner, creditors, and shareholders.[44] This chapter explores the legal and procedural dimensions of business rescue, emphasizing the steps in the process, the prioritization of creditor claims, and the legal safeguards provided to the company during rescue proceedings. This chapter establishes the foundational concepts necessary for comprehending the structure of business rescue. It sets the stage for a deeper exploration of its practical applications and the challenges that may arise, which will be discussed in the subsequent sections of the dissertation.

The recent economic maturing and downturn has sparked a surge in corporate liquidations, making the need for effective corporate rescue more essential than ever.[45] Chapter 6 of the Companies Act provides the specific regulations and guidelines that govern the process of business rescue within the framework of South African law. Henceforth, the company will be placed under the guidance of an independent business rescue practitioner who will be entrusted with the responsibility of overseeing the company's operations.[46] The primary goal of the business rescue

[42] Section 128(b).
[43] Section 128(b)(iii).
[44] Section 150.
[45] Kahn "Business rescues - Panacea or poison pill?" 2010 *Business Tax and Company Law Quarterly* 19; and Loubser *Some comparative aspects of corporate rescue in South African company law* (2010, LLD thesis, UNISA) 3-4.
[46] Section 128(1)(d)

practitioner is to carefully navigate the company towards a positive transformation of its financial standing.[47]The meaning and purpose of business rescue

Business rescue can be defined as “proceedings that facilitate the rehabilitation of a company that is financially distressed”.[48] Section 128(1)(b)(i) provides for the temporary supervision of the company, granting the business rescue practitioner the authority to effectively oversee and administer the company's operations, business activities, and assets during the business rescue process. This includes the responsibility to manage the company's affairs, business, and property. Further, section 128(1)(b)(ii) indicates that a temporary moratorium is placed on the rights of claimants – meaning that claimants are prohibited from exercising their rights during this specific period. Section 128(1)(b)(iii) further allows for the development and implementation of an approved business rescue plan aimed at rescuing the company. The business rescue plan involves restructuring the company's affairs, business, assets, debt, and other liabilities in a way that maximizes the likelihood of its success.[49] The business rescue plan is an essential undertaking led by the business rescue practitioner. The business rescue plan is aimed at implementing strategic measures to rescue the company from financial distress and operational challenges and plays a pivotal role in guiding the company to long-term and sustainable success.

The purpose of business rescue is to provide a legal process for rehabilitating a financially distressed company.[50] This includes restructuring its affairs, business, property, debt, and liabilities. Business rescue proceedings may only be initiated if there is a reasonable prospect that the company can be saved from insolvency and turned around. Section 133 of the Act includes a provision for a stay or moratorium on all legal proceedings against the company once business rescue proceedings are filed. This means that once the company initiates business rescue proceedings, all legal actions against the company are put on hold, except under conditions as provided for in section 133(1)(a) – (e).

[47] Section 128(b)
[48] Section 128.
[49] Section 128(b)(iii).
[50] Hockly’s par 25.1

2.2. Commencement of business rescue proceedings

Company directors have the choice to commence business rescue proceedings voluntarily by signing a board resolution. Alternatively, if affected parties deem it necessary, they can apply to the court for a formal order to initiate business rescue proceedings.[51]

Accordingly, when the company's board elects to initiate voluntary business rescue proceedings, the board is required to have substantive evidence to support their belief that the company is currently facing a financial decline. The board must be reasonably optimistic that the company has a credible prospect of overcoming these financial difficulties and surviving.[52]

In the event that business rescue proceedings are instigated, whether, through voluntary or compulsory means as outlined above, the subsequent action entails the appointment of an independent business rescue practitioner to assume control of the company during this period.

2.2.1. Commencement by way of filing a directors' resolution

As provided for in section 129(1), the company's board of directors have the authority to vote and adopt or pass a resolution to place the company under business rescue, bearing in mind the provisions of section 129(2)(a) wherein it is stipulated that such a resolution may not be adopted in the instance where liquidation proceedings have been initiated against the company. "This rule targets the abuse of voluntary business rescue to thwart liquidation applications".[53]

The directors must firmly believe that the company is indeed experiencing a financial decline but certainly has the potential to navigate through the financial distress.[54] "In considering whether the substantive requirements for business rescue are satisfied, the board must act in good faith."[55] Acting in good faith implies being transparent, fair,

[51] Hockly's par 25.3
[52] Hockly's par 25.3.1
[53] Hockly's par 25.3.1
[54] Section 129(1)(a) and (b).
[55] Hockly's par 25.3.1

and sincere in all intentions (own emphasis). It is further to be noted that the resolution only becomes effective once it has been filed with the Companies and Intellectual Property Commission ("CIPC"). When the resolution has been filed with the CIPC, the company must comply with the provisions of sections 129(3) and (4) of the Act – which determines the following:

> "(3) Within five business days after a company has adopted and filed a resolution, as contemplated in subsection (1), or such longer time as the Commission, on application by the company, may allow, the company must–
>
> (a) publish a notice of the resolution, and its effective date, in the prescribed manner to every affected person, including with the notice a sworn statement of the facts relevant to the grounds on which the board resolution was founded; and
> (b) appoint a business rescue practitioner who satisfies the requirements of section 138, and who has consented in writing to accept the appointment.
>
> (4) After appointing a practitioner as required by subsection (3)(b), a company must –
>
> (a) file a notice of the appointment of a practitioner within two business days after making the appointment; and
> (b) publish a copy of the notice of appointment to each affected person within five business days after the notice was filed."

2.2.2. Compulsory commencement of business rescue (ordered by court)

Any affected person possesses the legal entitlement to apply to court for an order to initiate business rescue proceedings, thereby subjecting the company to supervised restructuring.[56] For clarity, affected persons include – shareholders, creditors, and employees (represented and unrepresented).[57]

[56] Section 131(1).
[57] Section 128(1)(a)(i)–(iii).

Upon the submission of an application to the court, the court may, at its discretion, issue an order for the company to be placed under supervision and to initiate business rescue proceedings.[58] Additionally, it is imperative for the court to ascertain that the company is indeed facing genuine financial distress.[59] Furthermore, the court may grant such an order if the company is required to make payments under a public regulation or employment contract and has failed to fulfil this obligation.[60] Finally, the court is empowered to issue the order when it is deemed just and fair for financial reasons and when there exists a reasonable prospect for rescuing the company.[61]

A noteworthy statement made by MML Maya (Judge of Appeal) in *Newcity Group (Pty) Limited v Allan David Pellow N.O*[62] was that

> "it is plain from the wording of these provisions that a court may not grant an application for business rescue unless there is a reasonable prospect for rescuing the company ie facilitating its rehabilitation so that it continues on a solvent basis or, if that is not possible, yields a better return for its creditors and shareholders that what they would receive through liquidation."

When the court grants an order for compulsory supervision and business rescue, the court may, in addition, appoint an interim business rescue practitioner nominated by the affected person.[63] However, the appointment of the aforementioned practitioner is subject to confirmation by a majority of independent creditors' voting rights at the initial meeting of creditors.[64]

2.2.3. The duration and conclusion of the business rescue proceedings

Section 132 of the Companies Act[65] provides comprehensive guidelines pertaining to the duration and conclusion of business rescue proceedings. The aforementioned section determines the following:

[58] Section 131(4)(a).
[59] Section 131(4)(a)(i).
[60] Section 131(4)(a)(ii).
[61] Section 131(4)(a)(iii).
[62] [2014] ZASCA 162 par 15.
[63] Section 131(5).
[64] Section 131(5).
[65] Section 132.

"(1) Business rescue proceedings begin when –

(a) the company –

(i) files a resolution to place itself under supervision in terms of section of section 129(3); or

(ii) applies to the court for consent to file a resolution in terms of section 129(5)(b);

(b) an affected person applies to the court for an order placing the company under supervision in terms of section 131(1); or

(c) a court makes an order placing a company under supervision during the course of liquidation proceedings, or proceedings to enforce a security interest, as contemplated in section 131(7).

(2) Business rescue proceedings end when –

(a) the court –

(i) sets aside the resolution or order that began those proceedings; or

(ii) has converted the proceedings to liquidation proceedings;

(b) the practitioner has filed with the Commission a notice of the termination of business rescue proceedings; or

(c) a business rescue plan has been –

(i) proposed and rejected in terms of Part D of this Chapter, and no affected person has acted to extend the proceedings in any manner contemplated in section 153; or

(ii) adopted in terms of Part D of this Chapter, and the practitioner has subsequently filed a notice of substantial implementation of that plan.

(3) If a company's business rescue proceedings have not ended within three months after the start of those proceedings, or such longer time as the court, on application by the practitioner, may allow, the practitioner must –

(a) prepare a report on the progress of the business rescue proceedings, and update it at the end of each subsequent month until the end of those proceedings; and

(b) deliver the report and each update in the prescribed manner to each affected person, and to the –

(i) court, if the proceedings have been the subject of a court order; or

(ii) Commission, in any other case."

2.4 Exploring the impact of business rescue proceedings

Upon careful review of section 133(1) of the Companies Act, it is clear that no legal proceedings, inclusive of the enforcement of actions, may be instigated against a company or its assets during the course of business rescue proceedings without obtaining consent from the business rescue practitioner or obtaining necessary leave from a court. This safeguard serves to provide the company with a reprieve from legal challenges, thereby enabling it to focus on the process of restructuring and financial recovery without the encumbrance of ongoing legal disputes.[66]

It is noteworthy that the temporary moratorium holds particular significance as it constitutes one of the fundamental components and essential key pillars within the business rescue framework.[67] The temporary moratorium operates in conjunction with the temporary supervision of the business rescue practitioner and the formulation and implementation of the business rescue plan.[68]

The moratorium comes into effect from the initiation of the business rescue procedure and remains as such throughout the duration of the business rescue proceedings until the business rescue is completed.

Section 133 specifically deals with the moratorium relating to legal proceedings against the company as follows:

> "(1) During business rescue proceedings, no legal proceedings, including enforcement action, against the company, or in relation to any property belonging to the company, or lawfully in its possession, may be commenced or proceeded with in any forum, except –
>
> (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;

[66] Hockly's par 26.1.1.
[67] Hockly's par 26.1.1.
[68] Hockly's par 26.1.1.

(c) as a set-off against any claim made by the company in any legal proceedings, irrespective of whether those proceedings commenced before or after the business rescue proceedings began;
(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
(g) written notification to the business rescue practitioner.

(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.
(3) If any right to commence proceedings or otherwise assert a claim against a company is subject to a time limit, the measurement of that time must be suspended during the company's business rescue proceedings."

Furthermore, section 134 of the Companies Act is designed to safeguard the interest of creditors and shareholders to ensure that no assets can be disposed without the consent of a business rescue practitioner. In fact, section 134 states specifically:

"(1) Subject to subsections (2) and (3), during a company's business rescue proceedings–

(a) the company may dispose, or agree to dispose, of property only –
(i) in the ordinary course of its business;
(ii) in a bona fide transaction at arm's length for fair value approved in advance and in writing by the practitioner; or
(iii) in a transaction contemplated within, and undertaken as part of the implementation of, a business rescue plan that has been approved in terms of section 152".

2.3. Considering the interests and perspectives of all stakeholders involved in the context of business rescue

The significance of section 7(k) of the Companies Act and its stated purpose must be reiterated: " …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 …".

In this discussion, an analysis of the interests and roles of employees (along with a focus on employment contracts), directors, shareholders, and creditors will be undertaken.

2.3.1. Employees of the company in business rescue

An employee of a company is considered an "affected person" as defined in Chapter 6 of the Companies Act.[69] Employees who were employed by the company prior to the commencement of business rescue proceedings will retain their employment under the existing terms and conditions, unless modifications occur due to natural attrition or by mutual agreement between the employees and the company, in compliance with South African labour laws.[70] If the business rescue plan includes provisions for employee retrenchment, the process will be subject to relevant sections of the applicable employment legislation to ensure fairness and safeguard the rights and interests of the employees involved.[71]

Section 144 of the Act delineates the rights of employees in the context of business rescue proceedings. This specific section stipulates that employees are entitled to partake in court proceedings related to the business rescue procedures. Employees have the right to be actively involved in the development of the business rescue plan.[72] They are entitled to make submissions.[73] and have a voting interest on the proposed

[69] Section 128(1)(a)(iii).
[70] Section 136(1)(a)(i) and (ii).
[71] Section 136(1)(b).
[72] Section 144(3)(b).
[73] Section 144(3)(e).

business rescue plan.[74] Additionally, employees have the right to vote for the approval or rejection of a proposed business rescue plan.[75]

Therefore, employees have a substantial degree of influence in the company while in business rescue proceedings. Section 135(1)(3)(a) stipulates that employees have a priority claim for remuneration over creditors.

2.3.2. Directors

In the context of business rescue proceedings, the incumbent directors of the company retain their positions, albeit with a transfer of their powers and duties to the business rescue practitioner. Consequently, the business rescue practitioner assumes control over the company's management and assumes all the responsibilities customarily held by the directors.[76]

During the period of business rescue, the company's director(s) are required to fulfil their responsibilities under the authorization of the business rescue practitioner.[77] The directors are obligated to execute all management functions in accordance with the instructions provided by the business rescue practitioner, to the extent that it is deemed reasonable.[78] Furthermore, the directors must comply with instructions given by the business rescue practitioner during the business rescue process.[79]

2.3.3. Shareholders

In accordance with Chapter 6 of the Companies Act, shareholders are also recognized as "affected persons". Subject to sections 129 and 130 of the Companies Act[80] shareholders have the right to receive all pertinent notifications regarding any legal proceedings and business rescue-related matters. This involves taking part in hearings related to the business rescue process.[81]

[74] Section 144(3)(e).
[75] Section 144(3)(f).
[76] Hockly's par 26.6.
[77] Section 137(2)(a).
[78] Section 137(2)(b).
[79] Section 137(3).
[80] Sections 129 and 130.
[81] Sections 129 and 130.

In the event that a company is placed under supervision, it is strictly prohibited to change the classification or status of any securities issued by the company under any circumstances.[82] Any alterations made without the approval of the court or outside of a business rescue plan are considered invalid and not legally binding.[83]

2.3.4. Creditors

Section 145 of the Companies Act focuses on the rights and active participation of creditors in the processes and decisions involved in business rescue proceedings. This specifically pertains to their entitlements, responsibilities and securities.[84]

Throughout the business rescue proceedings, the company maintains its regular day-to-day operations as it did prior to being placed under supervision.[85] The company and its creditors still have a mutual responsibility to fulfil their obligations towards each other.[86] However, this responsibility may be altered if the business rescue plan allows for changes to their original agreement.[87] It should further be kept in mind that in the course of business rescue proceedings, the business rescue practitioner retains the authority to fully, partially, or conditionally suspend any agreement or provision to which the company was a party.[88]

Creditors play a pivotal role in shaping the business rescue plan as they are actively involved in its formulation, approval and rejection thereof. It is apparent that creditors hold a significant amount of influence in the process. Therefore section 145(1) outlines the precise entitlements of creditors in these proceedings and stipulates that creditors are entitled to receive notice of all court and legal proceedings, decision making, and all relevant meetings pertaining to business rescue proceedings.[89]

[82] Section 137(1)(a) and (b).
[83] Section 137(1).
[84] Section 145.
[85] Hockly's par 26.4.
[86] Hockly's par 26.4.
[87] Hockly's par 26.4.
[88] Section 136(1)(a).
[89] Section 145(1)(a).

Additionally, creditors are entitled to take part in court proceedings and the company's business rescue proceedings.[90] Creditors have a further right to submit proposals regarding the business rescue plan to the business rescue practitioner.[91] In addition, creditors further have the power to approve, reject or propose alterations of the business rescue plan. Creditors have the option to acquire the rights of other creditors, at an independently determined value, who vote against the business rescue plan.[92]

Section 145(4)(a) explains that the voting rights of creditors pertaining to the proposed business rescue plan are predominantly influenced by the value of their claims. When it comes to secured and unsecured creditors, their voting rights will be equivalent to the worth of the outstanding amount owed.[93] In plain text – their voting power will be determined by the value of the debt which is owed to them.

However, the ranking and interests of creditors shift the moment when post-commencement finance creditors enter the plan of action to rescue a company in distress.

2.4. The *Wescoal* matter

In the case of Wescoal, the court was confronted with a critical legal question concerning the eligibility of a post-commencement creditor, specifically Mashwayi, to participate in the voting process at a meeting in accordance with section 151 of the Act.[94] During the business rescue proceedings, and more particularly at the section 151 meeting, Mashwayi chose to cast a vote against the proposed business rescue plan.[95] If Mashwayi's dissenting vote was taken into account, the plan would consequently be rejected. Conversely, if Mashwayi were deemed ineligible to vote, the plan would have been accepted.[96]

[90] Section 145(1)(b)(c).
[91] Section 145(1)(d).
[92] Section 153(1)(b)(ii).
[93] Section 145(4)(a).
[94] *Wescoal* paras 11 and 12.
[95] *Wescoal* par 39.
[96] *Wescoal* paras 11 and 39.

Judge Wilson J made a ruling regarding Mashwayi's dissenting vote, stating that it should not be considered because post-commencement claims do not possess voting rights.[97] His decision was based on an interpretation of the term “creditor” in sections 151 and 152 of the Companies Act. He concluded that this term is applicable only to individuals or entities holding claims that arose before the initiation of business rescue proceedings.[98] By affirming that only pre-commencement creditors are allowed to participate in the voting process, Judge Wilson ultimately determined that the plan was properly approved and adopted.[99]

The current case revolves around a dispute concerning the legitimacy of a business rescue plan for Arnot, the coal mining company. In reaching his judgment, Judge Wilson J had to address several key factors:

1. Identifying who qualifies as a creditor, along with differentiating between pre-commencement and post-commencement creditors.[100]

2. Assessing the voting rights specifically pertaining to post-commencement creditors.

3. Evaluating the validity of the meeting held on 28 July, particularly in terms of compliance with notice requirements and voting rights associated with Mashwayi.[101]

The court was responsible for clarifying whether the Act permits only the company's existing creditors at the commencement of business rescue proceedings to participate in voting at a meeting convened under section 152, or if creditors that arise after the commencement of these proceedings, known as post-commencement creditors, also have the right to vote on the proposed business rescue plan.

Upon reviewing sections 128, 135, 145, 150, and 152 of the applicable Act, the court determined that the right to vote on the adoption of the business rescue plan is

[97] *Wescoal* paras 14 and 39.
[98] *Wescoal* par 20.
[99] *Wescoal* par 40.2.
[100] *Wescoal* par 16.
[101] *Wescoal* par 28

exclusively granted to creditors who were present at the commencement of the business rescue process.[102]

The court determined that Mashwayi was ineligible to vote during the section 152 meeting, classifying him as a post-commencement creditor. The ruling highlighted that section 135, which pertains to post-commencement financing, treats these creditors distinctly and includes specific provisions designed to protect their interests.

2.5. Conclusion

In conclusion, the intricate dynamic of business rescue proceedings under South African law, as outlined in the Companies Act, underscores the significant role creditors play in shaping the outcomes during times of corporate distress. In addition, this chapter established the critical role of business rescue as a mechanism for providing financially distressed companies with an opportunity to restructure and recover, thus avoiding liquidation.

The procedure consists of several important phases, starting with the initiation of proceedings, followed by the selection of a business rescue practitioner and the formulation of a detailed business rescue plan designed to rejuvenate the company's financial and operation status. During this process, different stakeholders, including employees, creditors, directors and shareholders, are crucial to the effectiveness of the business rescue initiatives.

The chapter highlights important legal protections, such as the temporary moratorium on legal actions against the company. this allows the distressed company the flexibility it needs to effectively address financial difficulties.

Additionally, it explores the complexities and legal nuances associated with business rescue, particularly the role of post-commencement creditors and the importance of their voting rights, as exemplified in the Wescoal case.

[102] *Wescoal* paras 16 and 27.

The Wescoal case highlights critical distinctions between pre-commencement and post-commencement creditors, particularly in the context of voting rights and participation in the decision-making processes. Judge Wilson J's ruling reinforces the notion that only those creditors who claim preceded the initiation of business rescue have the authority to influence the approval of business rescue plans.

As companies navigate their challenges, adherence to statutory provisions and the active involvement of creditors remain paramount, ensuring a fair and structured approach to business recovery that ultimately seeks to balance the interests of all stakeholders involved.

Chapter 3: Post-commencement finance

3.1. Introduction

Post-commencement finance is a critical success factor in the turnaround of a company under business rescue – therefore, securing post-commencement finance is essential for the successful rehabilitation of a company in business rescue.[103] Recent research suggests that the lack of post-commencement finance is one of five main reasons why business rescues in South Africa fail.[104]

Securing financing after a company has initiated business rescue or liquidation proceedings poses practical challenges. This is due to the impact of such proceedings on the company's existing creditor relationships and its ability to obtain additional credit.[105] For a company in business rescue to sustain its regular business operations, it becomes imperative to secure funding to meet its financial obligations incurred in the course of conducting business. This basically means paying suppliers, employees and various other operational expenses. If the company fails to secure post-

[103] Calitz and Freebody "Is post-commencement finance proving to be the thorn in the side of business rescue proceedings under the 2008 Companies Act" 2016 *De Jure* 266.
[104] Pretorius and Du Preez "Constraints on decision making regarding post-commencement finance in Business rescue" 2013 *Southern African Journal of Entrepreneurship and Small Business Management* 168 at 168
[105] Van der Linde "Chapter 4 Priority Issues in Post-Commencement financing: A View from South Africa" (2009) in Wessels and Omar (eds) *The Intersection of Insolvency and Company Laws – Papers from the INSOL Europe Academic Forum Annual conference Barcelona, Spain* (2008) 41.

commencement financing, its chances of survival become increasingly slim. As a result, the business rescue proceedings may be converted to liquidation proceedings, leading to the final winding up of the company.

In addition to the above, and to deepen our understanding of the subject matter, it is imperative to examine a relevant case study and article written by Ray Mahlaka in the Daily Maverick, that highlights the business rescue initiatives undertaken by the South African Post Office.[106] This case provides significant insights into the complexities involved in securing additional funding during the business rescue phase, which could critically prevent the company from entering liquidation. The South African Post Office's business rescue practitioners have requested an additional R3.8 billion from the government to support ongoing operations during a critical financial restructuring phase. The outcome of this business rescue process is uncertain — without this essential funding, the organization risks facing liquidation, which would result in the closure of its 657 branches nationwide. Such a scenario would significantly impact the livelihoods of over 6,200 employees, who could potentially lose their jobs as a direct consequence.[107]

Earlier this year, the Post Office received a substantial allocation of R2.4 billion in funding to address its ongoing financial challenges. This funding was part of a series of measures that included significant cutbacks, such as the retrenchment of approximately 4,875 employees and the closure of 366 branches. Despite these efforts and a remarkable R12.7 billion in government bailouts over the past nine years, the organization has continued to face difficulties. As a result, it has yet to achieve the financial sustainability necessary for viable operation.[108]

The practitioners plan to leverage the new funding to address outstanding creditor obligations and restructure the organization effectively. The focus will be on improving

[106] https://www.dailymaverick.co.za/article/2024-09-05-sa-post-office-business-rescue-practitioners-ask-treasury-for-r3-8bn-bailout/ (23-11-2024)
[107] https://www.dailymaverick.co.za/article/2024-09-05-sa-post-office-business-rescue-practitioners-ask-treasury-for-r3-8bn-bailout/ (23-11-2024)
[108] https://www.dailymaverick.co.za/article/2024-09-05-sa-post-office-business-rescue-practitioners-ask-treasury-for-r3-8bn-bailout/ (23-11-2024)

services related to motor vehicle licensing and e-commerce logistics. Additionally, efforts are being made to explore potential partnerships with the private sector to enhance operational capabilities. Meanwhile, the government is in the process of preparing its Medium-Term Budget Policy Statement, during which the Finance Minister may announce further support for the struggling state-owned enterprise.[109]

Therefore, the business rescue proceedings may be converted to liquidation proceedings, leading to the final winding up of the company. Securing post-commencement finance is frequently the final recourse, simply put – the last lifeline available – to save a company from plunging into complete insolvency.[110] The inability to secure such funding stands as a primary factor of unsuccessful business rescue efforts.[111]

This chapter will provide an in-depth exploration of the structure of post-commencement finance while shedding light on the challenges in practice. Additionally, the discussion will emphasize the significant role that this type of financing plays in the recovery and revitalization of distressed companies. Exploring how it influences the overall success of business rescue efforts, we will highlight how post-commencement finance serves as a lifeline as the availability of such finance allows the business to stabilize and fulfil urgent financial obligations, as can be seen from the article mentioned above, and to further implement the rescue strategy.

3.2. The legal and economic framework for post-commencement finance

Section 135 of the Companies Act sets out the framework for post-commencement finance:

[109] https://www.dailymaverick.co.za/article/2024-09-05-sa-post-office-business-rescue-practitioners-ask-treasury-for-r3-8bn-bailout/ (23-11-2024)
[110] Katlego, Pretorius and De Abreu "Enhancing creditor decision-making in South African business rescue proceedings: a comprehensive analysis of information requirements in business rescue plans" DOI 10.1108/IJLMA-10-2023-0234 at 2.3.2
[111] Du Preez *The status of post-commencement finance for business rescue in South Africa* (2012, MBA dissertation, University of Pretoria) at par 1.2.4 page 6.

"135. Post-commencement finance

(1) To the extent that any remuneration, reimbursement for expenses or other amount of money relating to employment becomes due and payable by a company to an employee during the company's business rescue proceedings, but is not paid to the employee –
  (a) the money is regarded to be post-commencement financing; and
  (b) will be paid in the order of preference set out in subsection (3)(a).

(2) During its business rescue proceedings, the company may obtain financing other than as contemplated is subsection (1), and any such financing –
  (a) may be secured to the lender by utilising any asset of the company to the extent that it is not otherwise encumbered; and
  (b) will be paid in the order of preference set out in subsection (3)(b).

(3) After payment of the practitioner's remuneration and expenses referred to in section 143, and other claims arising out of the costs of the business rescue proceedings, all claims contemplated –
  (a) in subsection (1) will be treated equally, but will have preference over –
    (i) all claims contemplated in subsection (2), irrespective of whether or not they are secured; and
    (ii) all unsecured claims against the company; or
  (b) in subsection (2) will have preference in the order in which they were incurred over all unsecured claims against the company.

(4) If business rescue proceedings are superseded by a liquidation order, the preference conferred in terms of this section will remain in force, except to the extent of any claims arising out of the costs of liquidation."

Post-commencement financing denotes the funding extended to a company after the onset of business rescue proceedings. This funding is intended to facilitate and support the company's ongoing operation during the business rescue phase.

Financing can be provided by lenders or investors. Undoubtedly, the distressed company will urgently seek funding and capital to meet its ongoing financial obligations.[112] In addition, obtaining this financing allows the company to restructure

[112] Meskin par 18.8.1.

its operations, negotiate with creditors, and eventually be able to emerge from the business rescue process as a financially viable entity.

It must be kept in mind that the mere occurrence of a business entering business rescue proceedings adversely impacts its creditworthiness. In turn, this creates a high level of uncertainty for the company as well as for any potential third-party investors or creditors who may consider taking a risk and providing further funding.[113] It is evident that a company in distress will face considerable challenges in securing financing, as creditors will understandably be apprehensive about the prospects of repayment. Borrowing funding from creditors in the distress phase will be complicated.[114]

In the absence of legal provisions that grant preferential claims for post-commencement financing, it is highly improbable that any entity would be willing to provide finance to a financially distressed company under supervision.[115] The legislation is designed to aid companies in navigating these challenging circumstances by establishing a legal framework that allows for super-priority financing.[116] In my view, this framework places an emphasis on transparency and prioritizes various forms of financing over existing creditors, thereby affording lenders increased security when disbursing funds. With the South African economy facing challenges, it's essential to promote investments during this crucial period of financial uncertainty.

After the commencement of business rescue proceedings, it is pivotal to seek additional financing from either new creditors or existing creditors who are willing to extend further credit under these challenging circumstances.[117] Creditors employ this funding with the anticipation that their financial assistance will assist in facilitating the distressed company's recovery, thereby increasing the likelihood of recovering a greater or the full value of their claims.[118] In my opinion, this strategy demonstrates a

[113] Burdette "Some Initial thoughts on the development of a modern and effective business rescue model for South Africa" (Part 2) 2004 *South African Mercantile Law Journal* 409 at 422.
[114] Davis *et al Companies and Other Business Structures in South Africa* (2009) 170.
[115] Delport *et al Henochsberg on the Companies Act 71 of 2008* (2013) 478(10).
[116] Cassim *et al Contemporary Company Law* (2012) 882.
[117] Van der Linde *INSOL Europe Academic Forum* 42.
[118] Van der Linde *INSOL Europe Academic Forum* 42.

deliberate choice to support the debtor's ability to recover, even though it involves certain risks.

In practice, entities that offer post-commencement financing are commonly banks, third-party creditors (investors), and shareholders.[119] In addition to the aforementioned points, Levenstein[120] identified several categories of typical post-commencement financiers. These include those who seek to protect and improve their investments, such as shareholders.[121] Bankers provide financial services and capital, and trade creditors extend credit for the provision of goods and services.[122] Development finance institutions are committed to advancing economic development by providing essential financial support.[123] Finally, private equity firms are well-known for investing in companies that show significant potential for value growth.[124] Each of these financial entities plays a significant role in sustaining businesses during critical junctures following the commencement of financial reorganization or distress.

Prior to providing post-commencement financing, these lenders typically undertake a comprehensive evaluation of the company's financial stability and operational potential.[125] This assessment involves a review of multiple elements, such as the company's present financial reports, future cash flow estimations, and market conditions.[126] Additionally, through the analysis of these factors, the investors aim to determine whether the company has a viable opportunity for recovery and stability from their perspective.[127] Therefore, the investigations and due diligence process are essential for addressing risks and making well-informed decisions regarding the potential investment in the company in distress.[128]

Given the prevailing condition of the South African economy, it is important to note that obtaining post-commencement finance is exceptionally restricted. The role of

[119] Du Preez 84-88.
[120] Levenstein *An appraisal of the new South African business rescue procedure* (2017) 9-108.
[121] Levenstein *An appraisal of the new South African business rescue procedure* 9-108.
[122] Levenstein *An appraisal of the new South African business rescue procedure* 9-108.
[123] Levenstein *An appraisal of the new South African business rescue procedure* 9-108.
[124] Levenstein *An appraisal of the new South African business rescue procedure* 9-108.
[125] Pretorius and Du Preez 2013 *SAJESBM* 168.
[126] Pretorius and Du Preez 2013 *SAJESBM* 187.
[127] Pretorius and Du Preez 2013 *SAJESBM* 168.
[128] Pretorius and Du Preez 2013 *SAJESBM* 168.

post-commencement finance in contributing to the success and turnaround of a company during business rescue proceedings is a widely discussed topic.[129] As a result of the nascent stage of business rescue proceedings in South Africa, this factor contributes to the level of uncertainty among financiers when considering investing in financially distressed companies.[130]

The absence of post-commencement finance can be attributed to several factors. Primarily, these include the failure to request post-commencement finance from financial institutions, the absence of unencumbered assets or residual value within the business, and financiers' reluctance to risk investing in a financially distressed company.[131]

Throughout the course of business rescue proceedings, a fundamental objective is to ensure the safeguarding of the rights and priorities of the existing creditors to the extent that it is reasonably practicable.[132] It is crucial to uphold equilibrium in addressing the entitlements of creditors with pre-commencement and post-commencement financial claims – this is the aim of section 135 of the Act. Hence, when viewed from the perspective of a post-commencement financier, awarding preferential treatment to post-commencement financiers encourages them to assume the augmented risk associated with extending credit to a financially distressed company.[133]

3.3. Ranking of claims in business rescue

Section 135(3) of the Companies Act delineates the order of claims. Consequently, the claims of post-commencement financiers are settled subsequent to the remuneration and expenses of the business rescue practitioner, as well as the claims of employees. Additionally, in situations involving multiple claims from various post-commencement financiers, these claims will be addressed and settled in the order in which they are incurred, relative to all unsecured claims. Additionally, section 135(3)(b)

[129] Pretorius and Du Preez 2013 *SAJESBM* 168.
[130] Pretorius and Du Preez 2013 *SAJESBM* 168.
[131] Du Preez 79.
[132] Cassim *et al Contemporary Company Law* 883.
[133] Van der Linde *INSOL Europe Academic Forum* 42.

does not distinguish between secured and unsecured claims; rather, it solely addresses the order in which claims were incurred. It is crucial that the applicable laws in the jurisdiction clearly establish that any post-commencement financing provided to a distressed borrower will hold a priority status over the claims of secured creditors. If the post-commencement financing is required to rank subordinate to the secured creditors, the legal framework should ensure that it incorporates specific provisions for preferential treatment. This arrangement could include enhanced recovery rights or other financial incentives that would protect the interests of the lenders extending such financing, thus fostering a more favourable environment for investment and support during the reorganization process.[134] In addition, Cassim argues that the justification for this approach is that "pre-commencement unsecured creditors must submit to the preferential treatment of post-commencement creditors in order to facilitate the raising of finance for the company in the hope of full repayment of their claims in the event of a successful business rescue."[135]

In the matter of *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company Ltd*,[136] Kgomo J confirmed the hierarchy of claims among creditors and clearly delineated the order of preference as follows:

> "1. The practitioner, for remuneration and expenses, and other persons (including legal and other professionals) for costs of business rescue proceedings.
> 2. Employees for any remuneration which became due and payable after business rescue proceedings began.
> 3. Secured lenders or other creditors for any loan or supply made after business rescue proceedings began, i.e. post-commencement finance.
> 4. Unsecured lenders or other creditors for any loan or supply made after business rescue proceedings began, i.e. post-commencement finance.
> 5. Secured lenders or other creditors for any loan or supply made before business rescue proceedings began.

[134] INSOL International Small Practice Special Report - *Financing the Rescue Process – A Comparative Analysis of the Financing Regimes in Australia, Canada, South Africa, United Kingdom and United States of America* par 1.4 page 3.
[135] Cassim *et al Contemporary Company Law* (2000) 866.
[136] 2013 JDR 1019 (GSJ). Hereafter referred to as "*Merchant West*".

6. Employees for any remuneration which became due and payable before business rescue proceedings began.
7. Unsecured lenders or other creditors for any loan or supply made before business rescue proceedings began."[137]

It has been observed that the judgment rendered by Kgomo J is not devoid of criticism. Delport argued that Kgomo J's decision in *Merchant West* does not truly reflect the position of creditors under section 135(3) of the Companies Act.[138]

In the absence of legal provisions that grant preferential claims for post-commencement financing, it is highly improbable that any entity would be willing to provide finance to a financially distressed company under supervision[139]

Judge Kgomo J, who oversaw and made decisions in the case of *Redpath Mining South Africa (Pty) Ltd v Marsden NO*,[140] evaluated the ranking of claims during a business rescue process and upheld the ranking previously established by Merchant West.

In the matter of Redpath Mining, the applicant has initiated an urgent application to nullify a business rescue plan.[141] This request raises substantial legal issues pertaining to the treatment of secured creditors in accordance with Chapter 6 of the Companies Act.[142] The applicant asserted that the proposed business rescue plan effectively undermined its security by requiring a concession of 15% of its secured claim in favour of other creditors, particularly post-commencement financiers. It was posited that such a deprivation contravened the provisions of the Companies Act, thereby constituting an unconstitutional and arbitrary infringement of the applicant's property rights.[143]

[137] *Merchant West* par 21.
[138] *Henochsberg* 482.
[139] Delport *et al Henochsberg on the Companies Act 71 of 2008* (2013) 478(10).
[140] 2013 JDR 1410 (GSJ).
[141] Redpath par 1.3.
[142] Redpath par 24.1.
[143] Redpath par 24.1.

The applicant contended that the Companies Act does not grant the business rescue practitioner the authority to modify the rights of secured creditors without their explicit consent. Chapter 6 explicitly acknowledges the rights of secured creditors, indicating that the execution of the business rescue plan in its current form could potentially undermine these rights.[144]

Judge Kgomo J reaffirmed his prior rulings concerning the priority order for creditor claims within the business rescue process. He delineated a hierarchy, specifying that the sequence of payments must adhere to the following protocol:[145]

1. The practitioner, along with any other individuals (including legal and other professionals) for expenses related to business rescue proceedings, will be compensated for their services.[146]

2. Employees will receive payment for any remuneration that became due after the initiation of business rescue proceedings.[147]

3. Secured lenders or other creditors are entitled to repayment for any loans or supplies provided after the commencement of business rescue proceedings, known as post-commencement finance.[148]

4. Unsecured lenders or other creditors can claim repayment for any loans or supplies given after the business rescue process began, specifically post-commencement finance.[149]

5. Secured lenders or other creditors have the right to payment for any loans or supplies released prior to the onset of business rescue proceedings.[150]

[144] Redpath par 25.
[145] Redpath par 60.
[146] Redpath par 61.1.
[147] Redpath par 61.2.
[148] Redpath par 60.3
[149] Redpath par 60.4
[150] Redpath par 60.5

6. Employees are owed remuneration that became due before the business rescue proceedings started.[151]

7. Unsecured lenders or other creditors can seek payment for any loans or supplies provided before the business rescue proceedings commenced.[152]

Judge Kgomo J highlighted section 134(3) of the Companies Act, indicating that in the context of business rescue, secured creditors are positioned on equal footing with other creditors throughout the process. The primary objective is to ensure that all creditors receive full compensation for their claims, which differs from the results typically seen in liquidation or judicial management scenarios.[153]

Judge Kgomo J underscored that in circumstances where a business rescue plan faces insurmountable challenges, leading to the necessity of asset liquidation, Section 134(3) functions as a protective mechanism for the rights of secured creditors. He ultimately concluded that there was nothing inherently unconstitutional regarding the business rescue plan.[154] Justice Kgomo emphasized the importance of its prompt implementation to facilitate the rehabilitation of the financially distressed company, thereby benefiting all pertinent creditors and stakeholders involved.[155]

3.4. The ***Wescoal*** **matter**

In the case of Wescoal, the court was confronted with a critical legal question concerning the eligibility of a post-commencement creditor, specifically Mashwayi, to participate in the voting process at a meeting in accordance with section 151 of the Act.[156] During the business rescue proceedings, and more particularly at the section 151 meeting, Mashwayi chose to cast a vote against the proposed business rescue plan.[157] If Mashwayi's dissenting vote was taken into account, the plan would

[151] Redpath par 60.6
[152] Redpath par 60.7
[153] Redpath par 66
[154] Redpath par 83
[155] Redpath par 84
[156] *Wescoal* par 11 and 12.
[157] *Wescoal* par 39.

consequently be rejected. Conversely, if Mashwayi were deemed ineligible to vote, the plan would have been accepted.[158]

Judge Wilson J made a ruling regarding Mashwayi's dissenting vote, stating that it should not be considered because post-commencement claims do not possess voting rights. His decision was based on an interpretation of the term “creditor” in sections 151 and 152 of the Companies Act.[159] He concluded that this term is applicable only to individuals or entities holding claims that arose before the initiation of business rescue proceedings.[160] By affirming that only pre-commencement creditors are allowed to participate in the voting process, Judge Wilson ultimately determined that the plan was properly approved and adopted.[161]

However, the business rescue practitioner and Mashwayi have been granted for leave to appeal to the Supreme Court of Appeal (SCA) and the was heard on the 30th of August 2024. At the date of writing the dissertation, judgment in the matter had not been given.

The term “creditor” is not explicitly defined in the Act, neither in relation to Chapter 6 nor in general context. Consequently, in the Wescoal case, the court had to interpret the meaning of “creditor” in a way that was contextually appropriate. In my view, the interpretation of the legislation should contribute meaningfully to its overall purpose and align with the intent of the Act.[162]

Additionally, when the court interprets the term “creditor” particularly with respect to Chapter 6 of the Act, it is important to acknowledge that Parliament did not provide a specific definition for the term as it appears in the statute. Therefore, one can assume that the Act did not contemplate any special definition to be assigned to the term, but instead intended for it to be understood in its standard meaning.[163] Judge Wilson, noted with regret that the term “creditor” is not defined in the Act.[164] The applicants in

[158] *Wescoal* par 11.
[159] *Wescoal* paras 14 and 39.
[160] *Wescoal* par 20.
[161] *Wescoal* par 40.2.
[162] See generally *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA).
[163] *Minister of Defence and Military Veterans v Thomas* 2016 (1) SA 103 (CC) par 20.
[164] *Wescoal* par 17.

the Wescoal matter contended that Mashwayi became a creditor after the commencement of the rescue proceedings. Consequently, they argued that he did not meet the criteria for a creditor as outlined in section 145 of the Act.

As a general principle, it is not appropriate to apply meanings assigned to terms in one statute as definitive interpretations in the context of a different statute.[165] When examining the term “creditor” within the context of business rescue, it is important to clearly distinguish its definition from that which is applicable in liquidation proceedings for an insolvent company.[166] In liquidation, a *concursus creditorum* is established as at the date of liquidation, with creditors’ rights strictly regulated by the Companies Act of 1973 and the relevant sections of the Insolvency Act of 1936.[167] In contrast, business rescue proceedings do not involve a *concursus*, and the rights of affected stakeholders, particularly creditors, are governed by Chapter 6. It is important to note that business rescue is fundamentally different from liquidation; it facilitates the continuation of business operations under unusual circumstances.

The term “creditor” is commonly defined as “a person or company to whom money is owing”[168] or “an individual or commercial entity that is owed money”.[169]

In accordance with section 145(1) of the Act, each creditor is granted the right to engage in the business rescue proceedings in formal and informal capacities. Furthermore, section 145(2)(a) of the Act grants each creditor the right to cast a vote on, accept, or reject, a proposed business rescue plan. Regrettably, Judge Wilson concluded that the rights conferred under section 145 of the Act, as well as the voting interest specified in section 152, are assigned exclusively to creditors at the commencement of business rescue proceedings.[170]

Judge Wilson noted that a fundamental aspect of the discussion is the definition of "affected persons" as delineated in section 128 of the Act. Furthermore, the ruling issued in the Wescoal case stipulates that only creditors, as specifically defined, are

[165] *Greater Johannesburg Transitional Metropolitan Council v Eskom* 2000 (1) SA 866 (SCA) par 24.
[166] IWIRC Southern Africa Network NPC – First Amicus curiae – Heads of Argument. Par 6.2.
[167] IWIRC Southern Africa Network NPC – First Amicus curiae – Heads of Argument. Par 6.2.
[168] IWIRC Southern Africa Network NPC – First Amicus curiae – Heads of Argument. Par 7.
[169] IWIRC Southern Africa Network NPC – First Amicus curiae – Heads of Argument. Par 7.
[170] *Wescoal* par 20.

entitled to participate in the voting process at the meeting convened under section 152. Judge Wilson further states that the "effect" of the statute must be determined by a consideration of the ordinary grammatical meaning of its text, the context in which it was formulated, and the intended purpose of the provision[171] – I respectfully disagree with the conclusion reached, and I believe that Judge Wilson may have misapplied his judgment in this matter.

Section 145(4)(a) of the Act stipulates that both secured and unsecured creditors hold a voting interest that corresponds to the total amount owed to them by the company. Consequently, in the absence of a *concursus*, as observed in cases of liquidation, one may question the rationale behind restricting the term "creditor" exclusively to pre-commencement creditors. The phrase "affected person" effectively includes individuals recognized as "creditor[s] of the company".[172] The legislation explicitly does not restrict the definition of a "creditor of the company" to those individuals or entities that held creditor status at the outset of the business rescue proceedings. This implies that the criteria for qualifying as a creditor might extend to a more diverse array of parties, potentially including individuals or entities that have become creditors after the proceedings began. In reference to Wescoal, I assert that the Appeal Court should reach the conclusion that the intent was for all creditors, defined as those to whom funds are owed, to possess a voting interest, regardless of the stage at which they engage in the proceedings. In reference to Wescoal, I respectfully contend that the Appeal Court should determine that the intention was to include all creditors, defined as those to whom funds are owed, to possess a voting interest, regardless of the stage at which they engage in the proceedings.

The principal objective of Chapter 6 of the Companies Act is to provide a clear framework that enables financially distressed companies to pursue business rescue strategies. This process aims to enhance the likelihood of the company maintaining successful and solvent operations. Alternatively, if this objective is not achievable, it seeks to deliver a more favourable outcome for creditors or shareholders compared

[171] *Wescoal* par 19.
[172] Section 128(1)(a) of the Act.

to an immediate liquidation scenario.[173] During business rescue proceedings, the company maintains its regular operations.

The Court effectively highlighted the distinctions between the two situations in *Diener NO v Minister of Justice and Others (South African Restructuring and Insolvency Association) (SARIPA) and Others as amici curiae*[174] where the following observations were documented:

> "… the starting point is the context and purpose of chapter 6. It is apparent, when regard is had to the central provisions of chapter 6, as I have done above, that it is intended to create an efficient, regulated and effective mechanism to facilitate the rescue of companies in financial distress – as long as they are capable of rescue – in a way that balances the rights and interests of the stakeholders.
>
> Although the Chapter makes provision for Business Rescue failing in some instances, and hence allows for conversion of Business Rescue proceedings into liquidation proceedings, its overwhelming focus is on business rescue and the mechanics of Business Rescue, rather than on liquidation."

It is important to approach the interpretation of section 145(4)(a) of the Act with a clear and systematic methodology in mind. This section provides that in respect of "any decision contemplated in this Chapter that requires the support of the holders of creditors' voting interests … a secured or unsecured creditor has a voting interest equal to the value of the amount owed to that creditor by the company".[175] The Act does not provide a comprehensive definition of the term "creditor". However, it does offer a definition for "independent creditor" in section 128(1)(g) of the Act, which is described as an individual or entity that "is a creditor of the company and is not related to the company".

Furthermore, the Act does not provide a definition for the term "stakeholders", and thus, the terminology should be interpreted in its conventional sense. A stakeholder is

[173] Section 128(b); Luan van Rhyn "Business Rescue in South Africa: A Lifeline for struggling Businesses" https://thrivecfo.co.za/business-rescue-in-south-africa/
[174] [2018] 1 All SA 317 (SCA) at paras 40 – 41.
[175] https://lnkd.in/d78c3HUh

generally defined as “a person with an interest or concern something, especially a business”.[176]

In Wescoal, Judge Wilson made references to section 150(2)(a)(ii) of the Act, which stipulates that a business rescue plan must include a list of creditors as of the commencement date of the business rescue proceedings.[177] Judge Wilson appears to interpret the exclusion of post-commencement creditors as indicative of legislative intent to categorically exclude them from classification as creditors.[178]

In my assessment, Judge Wilson's interpretation holds significant errors and lacks a proper direction of interpretation. Judge Wilson ruled that a post-commencement creditor is not allowed to vote on the adoption of the business rescue plan as per the words used in section 150(2)(a)(ii) of the Act, specifically, that a business rescue plan must at least include “a complete list of creditors of the company when the business rescue proceedings began…”.[179] I submit that the purpose of section 150 of the Act is to establish the minimum criteria for a business rescue plan, rather than to provide a comprehensive listing of its components. To illustrate a point and for the sake of simplification, an examination of the language used in section 150(2)(a) reveals that the inclusion of the phrase “at least” suggests that there is room for incorporating additional information. This indicates that additional information may and should be included.

This section shows that the law requires the plan to include a list of creditors that existed before the company started. This list provides important background information about the company for assessment purposes[180] – It is essential to refrain from drawing any further implications from section 150(2)(a)(ii) of the Act.

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[176] The Oxford Dictionary, available at https://www.google.com/search?q=stakeholder+definition&rlz=1C1ONGR_enZA1079ZA1079&oq=stakeholder+definition&gs_lcrp=EgZjaHJvbWUyDggAEEUYORhGGPkBGIAEMgwIARAAGEMYgAQYigUyBwgCEAAYgAQyBwgDEAAYgAQyBwgEEAAYgAQyBwgFEAAYgAQyBwgGEAAYgAQyBggHEEUYPNIBCDYxNzNqMGo3qAIAsAIA&sourceid=chrome&ie=UTF-8
[177] *Wescoal* par 23.
[178] *Wescoal* par 23.
[179] *Wescoal* par 23.
[180] Section 150(2)(a)(ii).

A post-commencement creditor has a vested interest in a company during its business rescue proceedings. These creditors offer essential funding to a financially distressed company at a significant level of risk in doing so. A post-commencement creditor faces the risk of funding, as their chances of recovering their investment are closely tied to the fate of the struggling company. This aligns with the objectives of business rescue and supports the goals outlined in section 7(k) of the Act. Section 7(k) of the Act outlines that one of the Act's primary purposes 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”.

In light of the current economic conditions, it is challenging to substantiate the notion that a post-commencement creditor should possess fewer rights during the business rescue process compared to other creditors. This is particularly pertinent regarding voting on a plan that is likely to have been formulated with their financial support.

It is imperative to conduct a comprehensive assessment of the implications stemming from Judge Wilson’s interpretation that post-commencement financiers are not categorized as creditors under Chapter 6. Should this interpretation be upheld, individuals with post-commencement claims would forfeit the various rights granted to creditors under this chapter.

Participants will not receive notifications regarding court proceedings related to the company undergoing business rescue, nor will they be kept informed by the business rescue practitioner. Furthermore, they will be prohibited from attending creditor meetings and participating in votes on resolutions, including those pertaining to requests for extensions. They will also be deprived of the opportunity to consult with the business rescue practitioner during the formulation of the business rescue plan, and they will not have access to the plan, the ability to propose amendments, or the right to vote on it.

If the business rescue plan is rejected, post-commencement creditors will unequivocally lack the voting rights of creditors who oppose the plan, and they will not have the ability to seek court intervention to challenge a dissenting vote as improper. Post-commencement creditors would be entirely excluded from the business rescue process. A brief examination clearly demonstrates the impracticality of this approach.

This matter should not be solely addressed by the legislature. It is recommended that the Appeal Court consider overturning Judge Wilson's ruling to clarify that the term "creditor" in Chapter 6 of the Act encompasses all individuals or entities with claims against the company, regardless of when those claims were submitted. This provision would enable creditors who join subsequent to the commencement of the process to participate in the voting on the approval or rejection of a business rescue plan, contingent upon the business rescue practitioner's validation and accuracy of their claims.

3.5. Conclusion

In conclusion, the chapter on post-commencement finance represents a fundamental aspect of the business rescue process in South Africa. It acts as a vital mechanism aimed at enabling the turnaround of financially distressed companies. Numerous studies and analyses highlight the vital and complex role that access to financing after the commencement of restructuring plays in stabilizing businesses during this crucial period.

This financing option not only allows companies to sustain their operations while they navigate the complexities of reorganization but also serves as a crucial lifeline that supports the continuation of essential functions. Post-commencement finance is crucial for safeguarding jobs, protecting the intrinsic value of businesses, and enhancing confidence in the market. By supporting companies during challenging times, this financial lifeline not only stabilizes operations but also fosters a resilient economy where both employees and enterprises can thrive.

The South African business landscape illustrates that, notwithstanding a range of systemic challenges, post-commencement finance is essential for effective business rescue initiatives. The availability of post-commencement finance significantly affects the probability of successful recovery for struggling enterprises and has far-reaching implications for various stakeholders, including creditors, employees, and the broader community.

Therefore, establishing an environment conducive to timely and adequate access to post-commencement finance becomes paramount in fortifying the business rescue framework and enhancing the overall effectiveness of corporate recovery strategies within South Africa.

Continued research in this domain is crucial to comprehensively understand the evolving dynamics of post-commencement finance, particularly in the face of economic fluctuations and the continuously shifting business environment. Such inquiries should aim to ensure that the post-commencement finance mechanism remains resilient and adaptable, effectively addressing the needs of distressed companies across the country. By doing so, stakeholders can work towards optimizing the potential of post-commencement finance as a strategic tool for corporate recovery, thereby enhancing the sustainability and robustness of the South African economy.

Chapter 4: A comparative analysis of post-commencement financing in South Africa and the United States

4.1. Introduction

Insolvency law addresses the financial difficulties faced by individuals and businesses that are unable to fulfil their debt obligations. While fundamental principles of insolvency, such as liquidation, business restructuring and discharge of debt, are universally consistent, each country's insolvency framework is shaped by its unique legal and economic factors.

This comparison provides a comprehensive examination of the key aspects of insolvency law in South Africa and the United States. It delves into the fundamental principles, procedures and the legal structure which governs insolvency in both countries – highlighting notable similarities and differences, such as the treatment of creditors, the role of courts, and the financial options available to companies facing distress.

Insolvency in South Africa is primarily governed by the Insolvency Act 24 of 1936. In addition, the Companies Act of 2008 plays a significant role in guiding the insolvency proceedings, specifically for corporate entities. The insolvency framework in the United States operates under Title 11 of the United States Code, which is referred to as the Bankruptcy Code.[181] Chapter 7 of the Bankruptcy Code deals with liquidation matters, and Chapter 11 of the Bankruptcy Code deals with reorganisation.

4.2. Debtor-in-possession financing

The debtor-in-possession provisions outlined in Chapter 11 of the Bankruptcy Code[182] served as the foundational framework for the business rescue provisions established under Chapter 6 of South Africa's Companies Act. A comparative analysis of the two

[181] Bankruptcy Reform Act 11 USC 1978 hereinafter referred to as "the Bankruptcy Code".
[182] The Bankruptcy Reform Act of 1978.

systems is important for uncovering any gaps or opportunities for improvement of the South African legislation.

4.2.1. Chapter 11 reorganization under Title 11 - Bankruptcy

Bankruptcy proceedings in the United States (US) are overseen by the courts with the assistance of a specialized judiciary known as the Federal Bankruptcy Court. US bankruptcy proceedings are characterized as "debtor-friendly" and "soft," indicating that the legislation offers considerable protection to companies from creditors.[183] This approach maximizes the company's opportunity to restructure by allowing management to maintain control and providing sufficient time to develop a reorganization plan.[184]

Reorganization, which is applicable to both individual and corporate debtors, including partnerships, is governed by Chapter 11 of the Bankruptcy Code.[185] The primary objective of Chapter 11 bankruptcy is to provide debtors who are unable to meet their financial obligations, yet possess a viable opportunity for recovery, with a mechanism to reorganize their business affairs. This legal provision allows entities to restructure their debts and develop a systematic plan for repayment while continuing their operations.[186]

Chapter 11 appears to focus on providing benefits to various stakeholders, including employees, creditors, and shareholders, by ensuring the continuity of the business operations.[187] The existing management structure of the company is typically retained, allowing the current management to continue operating the business in the capacity

[183] Vernimmen *et al Corporate Finance: Theory and Practice* (2009) 933. See also Pretorius and Du Preez 2013 *SAJESBM* 172 – 174.
[184] Vernimmen *et al Corporate Finance: Theory and Practice* 933.
[185] Cambell *International Corporate Insolvency Law* (1992) 609.
[186] Gurule "Cash is King: Determining the extent of a secured lender's liens over revenues generated duringa bankruptcy case" *Business Law News* (Issue 2 2013).
[187] §1108. *"Authorization to operate business*
Unless the court, on request of a party in interest and after notice and a hearing, orders otherwise, the trustee may operate the debtor's business."

of “debtors in possession”.[188] In cases of fraud, dishonesty, or gross mismanagement, the court can appoint a trustee to replace the current management.[189]

Section 1101 of the Bankruptcy Code[190] provides a detailed definition of the term "debtor in possession" as follows:

“In this chapter -

(1) ‘debtor in possession’ refers to the debtor, unless a person qualified under section 322 of this title is serving as the trustee in the case.”

In the event that a company files for a Chapter 11 reorganisation, an automatic stay is triggered, ceasing all legal proceedings against the company. This provision also affords the debtor temporary protection from creditor actions.[191] Additionally, this enables the current management to make business decisions, update the company’s business plan, and negotiate the restructuring of its capital structure.[192]

While the business continues its operations, the debtor engages in collaboration with the creditors’ committee and the Bankruptcy Court to develop a comprehensive reorganization plan.[193] This plan must comply with various legal requirements to ensure compliance with legal requirements.[194] Upon approval of the plan, the debtor

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[188] Gaur “Post-petition financing in corporate insolvency proceedings: A comparative study across various jurisdictions” 2012 *Taxmann‘s SEBI & Corporate Laws Journal* 17 at 18.
[189] Franks and Torous “The costs of corporate bankruptcy: A U.S. – European comparison” in Bhandari and Weiss (eds) *Corporate Bankruptcy: Economic and Legal Perspectives* (1996) 471*;* Gaur 2012 *Taxmann‘s SEBI & Corporate Laws Journal* 18.

[190] Chapter 11: Reorganization. From Title 11 – Bankruptcy Section 1101.
[191] Franks and Torous *Corporate Bankruptcy: Economic and Legal Perspectives* 471*;* Gaur 2012 *Taxmann‘s SEBI & Corporate Laws Journal* 472.
[192] Du Preez 25.
[193] §1106. Duties of trustee and examiner - *“(5) as soon as practicable, file a plan under section 1121 of this title, file a report of why the trustee will not file a plan, or recommend conversion of the case to a case under chapter 7, 12, or 13 of this title or dismissal of the case;”*
§1121. Who may file a plan – *“(a) The debtor may file a plan with a petition commencing a voluntary case, or at any time in a voluntary case or an involuntary case.(b) Except as otherwise provided in this section, only the debtor may file a plan until after 120 days after the date of the order for relief under this chapter. (c) Any party in interest, including the debtor, the trustee, a creditors' committee, an equity security holders' committee, a creditor, an equity securityholder, or any indenture trustee, may file a plan if and only if— (1) a trustee has been appointed under this chapter; (2) the debtor has not filed a plan before 120 days after the date of the order for relief under this chapter; or (3) the debtor has not filed a plan that has been accepted, before 180 days after the date of the order for relief under this chapter, by each class of claims or interests that is impaired under the plan.”*
[194] Baird *Elements of Bankruptcy* (2006) 251

is authorized to recommence operations and fulfil its debt obligations in accordance with the established terms. If specific creditor groups oppose the plan, the debtor can still secure confirmation by using a process called a “cramdown”, as long as the plan meets the requirements set forth in section 1129(b) of the Bankruptcy Code. The Bankruptcy Code introduces the “absolute priority rule”, which ensures a structured order of payments during bankruptcy proceedings. This framework prioritizes the payment of senior creditors before junior creditors and guarantees that creditors are compensated ahead of shareholders. A cramdown makes the plan binding on all creditors, including dissenting creditors.[195]

Numerous distressed companies elect to pursue a pre-packaged bankruptcy plan, commonly referred to as a “pre-pack”. In this process, the reorganization plan is negotiated and finalized with creditors prior to the submission of the bankruptcy petition. This method works well for companies that face financial problems instead of operational issues and for those that have a low amount of trade debt.[196]

4.2.2. Understanding debtor-in-possession financing

According to Pretorius and Rosslyn-Smith, debtor-in-possession financing in the United States represents one of the most significant forms of post-commencement financing available to entities navigating bankruptcy proceedings.[197] Businesses rely on Chapter 11 of the US Bankruptcy Code to reorganize debt, liquidate assets, and/or raise capital to maintain operations as a going concern.[198]

Prior to initiating Chapter 11 proceedings, it is essential for the debtor to focus on securing financing to facilitate the process. Following the filing of Chapter 11, there exists an immediate requirement for capital in order to sustain ongoing business

[195] Baird *Elements of Bankruptcy*.
[196] Gilson “Institute Investing in Distressed Situations: A Market Survey” 1995 *Financial Analysts Journal* 8 at 10.
[197] Pretorius and Rosslyn-Smith “Expectations of a business rescue plan: International directives for Chapter 6 implementation” 2014 *Southern African Business Review* 108 at 116.
[198] Gilson "Coming through in a crisis: How Chapter 11 and the debt restructuring industry are helping to revive the U.S. economy" 2012 *Journal of Applied Corporate Finance* 23 at 27-28.

operations.[199] The debtor is required to secure court approval prior to accessing debtor-in-possession financing, commonly known as post-petition financing.[200]

DIP financing allows lenders to obtain security interests in assets that have not yet been pledged. A priming lien for newly acquired funds holds priority over administrative expenses and claims from unsecured creditors. Notwithstanding the additional collateral and the preferential treatment accorded to priming loans, these financing alternatives frequently entail interest rates that are higher than normal. This is primarily attributable to the borrower's status in bankruptcy.[201]

Although the debtor may have sufficient funds to meet immediate operational needs without taking on additional debt, any available assets are likely tied up with a prepetition lender. According to section 363 of the Bankruptcy Code, a debtor is permitted to utilize, sell, or lease property belonging to the estate as part of its normal business operations, provided it either obtain the approval of the secured party or secure a court order allowing the use of those assets.[202] Effective use of cash collateral can expand the financing options available to lenders and enhance the potential for a successful reorganization.

Lenders are typically very hesitant to provide loans to companies facing financial difficulties, particularly those undergoing bankruptcy proceedings.[203] To address this reluctance, section 364 allows a debtor in a bankruptcy case to secure credit by offering potential lenders a range of incentives to lend to a Chapter 11 debtor.[204] The US Bankruptcy Code permits a company to secure unsecured credit and accumulate unsecured debt in the normal course of business without requiring prior court approval,

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[199] Vedder Price Publication "Debtor in possession financing" 1.

[200] Chapter 11: Reorganization. From Title 11 – Bankruptcy Code Section 1101. Historical and Revision Notes – Legislative Statement – *"(c) Section 1125(f) prohibits the solicitation of acceptances of a plan of reorganization prior to court approval of such plan eventhough the solicitation complies with all applicable securities laws;"*

[201] Brewer, Kinsey and Mendenhall *Solyndra's Chapter 11 Bankrupcy* available at https://ir.law.utk.edu/cgi/viewcontent.cgi?article=1030&context=utk_studlawbankruptcy at 37.

[202] Section 363(c) of the US Bankruptcy Reform Act 1979.

[203] Dahiya *et al* "The Dynamics of Debtor-in-Possession Financing: Bankruptcy Resolution and the Role of Prior Lenders" September 2000, available at file:///C:/Users/shpla/Downloads/ssrn-247546.pdf

[204] Baisier and Epstein "Postpetition lending under section 364: Issues regarding the gap period and financing for prepackaged plans" 1992 *Wake Forest Law Review* 103 at 103.

thereby facilitating post-petition financing.[205] This type of unsecured debt is prioritized as an administrative expense, placing it above the claims of unsecured creditors with pre-petition debts.[206] Additionally, with the approval of the court and after discussions with creditors, a company can take on unsecured debt that falls outside its usual business operations, and this debt will also have administrative expense priority.[207] Section 364(e) ensures that lenders who have provided funds based on court orders approved under section 364 are safeguarded from changes or reversals during an appeal. If a court had the authority to revoke any order that grants a priority or lien under sections 364 (b), (c), or (d), it could lead to hesitance among creditors in offering financial support.[208]

The categorization of claims under the United States Bankruptcy Code is more comprehensive than the provisions outlined in Chapter 6 of the Companies Act. The order of claims under Chapter 11 is as follows:[209]

1. Claims by a creditor that are backed by a lien on property, which are recognized as valid under both state law and federal bankruptcy regulations;[210]
2. Unsecured claims and expenses that take precedence under the US Bankruptcy Code are categorized into three distinct groups:[211]
3. The super-priority claims associated with securing credit under post-petition financing;[212]
    3.1 the super-priority claims for secured creditors arise in the event that a company fails to provide sufficient protection for a creditor's secured interest during the reorganization process; and[213]

[205] Section 364(a) of the US Bankruptcy Reform Act 1979.
[206] Section 507(a) of the US Bankruptcy Reform Act 1979.
[207] Section 364(b) of the US Bankruptcy Reform Act 1979.
[208] House of Representatives 595 95th Cong 1st Sess 220 (1977) referred to in Prager “Financing the Chapter 11 Debtor: The Lenders' Perspective” 1990 *The Business Lawyer* 2141.
[209] Calitz and Freebody 2016 *De Jure* 265 at 278.
[210] Section 506 of the US Bankruptcy Code.
[211] Section 507(a) of the US Bankruptcy Code.
[212] Section 364(c) of the US Bankruptcy Code.
[213] Section 507(b) read with section 361 of the US Bankruptcy Code.

3.2 all other administrative expenses shall be prioritized in accordance with the order delineated in the United States Bankruptcy Code. Specifically, employee remuneration ranks first in priority following the initiation of the reorganization process;[214]

4. General claims of unsecured creditors and subordinated claims.

The way employment contracts are handled under the U.S. Bankruptcy Code offers less protection than what is provided in Chapter 6 of the Companies Act. Section 135(1) of the Companies Act explicitly categorizes employee entitlements as post-commencement financing during business rescue proceedings. This designation provides enhanced protections compared to those outlined in the Insolvency Act.[215] Under the US Bankruptcy Code, employee contracts are categorized as "executory contracts" as outlined in section 365(a). This classification allows employers the discretion to terminate such contracts as deemed appropriate. It is important to note that the reorganization process in the United States does not place the same emphasis on the protection of employee rights compared to other legal frameworks.[216]

4.3. Comparison

Bankruptcy law recognizes that all parties involved have a mutual interest in assisting the debtor in achieving a successful reorganization. This includes creditors, as they could benefit if the debtor avoids liquidation. The US debtor-in-possession process illustrates that an approach focused on the debtor is not necessarily detrimental to creditors, and it is feasible to find a balance between various interests.[217]

Debtor-in-possession financing has been discussed in the context of potentially granting management increased control, while also reallocating value to privileged creditors, which may affect ordinary creditors and shareholders.[218]

[214] Section 503(b) of the US Bankruptcy Code.
[215] *Henochsberg* 482.
[216] Stoop and Hutchison "Post-commencement finance – Domiciled resident or uneasy foreign transplant" 2017 *Potchefstroom Electronic Law Journal* 1 at 14.
[217] Du Preez 27.
[218] Gaur 2012 *Taxmann's SEBI & Corporate Laws Journal* 25.

The regulations in the US regarding post-petition financing are more adaptable than our section 135. In the US, each financing case for a distressed company is evaluated on a case-by-case basis, enabling more customized solutions. As the importance of financing rises, so do the expectations and stipulations that the struggling company must fulfil to obtain that priority.

Furthermore, the interests of secured lenders are more effectively protected, as the debtor is required to demonstrate that the creditor whose lien is being primed is provided with adequate protection when a priming lien is granted. In contrast, the hierarchy of preferences established in the *Merchant West*[219] judgment does not impose similarly stringent protections.

Chapter 5: Conclusion

Post-commencement finance is a critical success factor in the turnaround of a company under business rescue – therefore, securing post-commencement finance is essential for the successful rehabilitation of a company in business rescue.[220] Recent research suggests that the lack of post-commencement finance is one of five main reasons why business rescues in South Africa fail.[221]

Securing financing after a company has initiated business rescue or liquidation proceedings poses practical challenges. This is due to the impact of such proceedings on the company's existing creditor relationships and its ability to obtain additional credit.[222] For a company in business rescue to sustain its regular business operations, it becomes imperative to secure funding to meet its financial obligations incurred in the course of conducting business.[223]

[219] *Merchant West* par 21.
[220] Calitz 2016 *De Jure* 266.
[221] Pretorius and Du Preez
2013 *Southern African Journal of Entrepreneurship and Small Business Management* 168.
[222] Van der Linde *INSOL Europe Academic Forum* 41.
[223] Du Preez 18.

In conclusion, the chapter on post-commencement finance represents a fundamental aspect of the business rescue process in South Africa. It acts as a vital mechanism aimed at enabling the turnaround of financially distressed companies.[224] Numerous studies and analyses highlight the vital and complex role that access to financing after the commencement of restructuring plays in stabilizing businesses during this crucial period. [225]

This financing option not only allows companies to sustain their operations while they navigate the complexities of reorganization but also serves as a crucial lifeline that supports the continuation of essential functions. Post-commencement finance is crucial for safeguarding jobs, protecting the intrinsic value of businesses, and enhancing confidence in the market. By supporting companies during challenging times, this financial lifeline not only stabilizes operations but also fosters a resilient economy where both employees and enterprises can thrive.

The South African business landscape illustrates that, notwithstanding a range of systemic challenges, post-commencement finance is essential for effective business rescue initiatives. The availability of post-commencement finance significantly affects the probability of successful recovery for struggling enterprises and has far-reaching implications for various stakeholders, including creditors, employees, and the broader community. Therefore, establishing an environment conducive to timely and adequate access to post-commencement finance becomes paramount in fortifying the business rescue framework and enhancing the overall effectiveness of corporate recovery strategies within South Africa.

Continued research in this domain is crucial to comprehensively understand the evolving dynamics of post-commencement finance, particularly in the face of economic fluctuations and the continuously shifting business environment. Such inquiries should aim to ensure that the post-commencement finance mechanism remains resilient and adaptable, effectively addressing the needs of distressed

[224] Section 128(b) of the Act.
[225] Geddes “Post-commencement finance: The key ingredient for a successful business rescue” available at https://geddescapital.co.za/post-commencement-finance/#post-commencement-finance-the-key-ingredient-for-a-successful-business-rescue.

companies across the country. By doing so, stakeholders can work towards optimizing the potential of post-commencement finance as a strategic tool for corporate recovery, thereby enhancing the sustainability and robustness of the South African economy.

The recent economic maturing and downturn has sparked a surge in corporate liquidations, making the need for effective corporate rescue more essential than ever.[226] As businesses face unprecedented challenges, the ability to navigate these waters and find pathways to recovery is becoming a critical focus in the corporate world. The introduction of the new business rescue procedure aims to give distressed companies an opportunity to avoid "corporate death" and continue their operations. Although South African courts have started interpreting this new framework, significant uncertainties remain, and there is still much to explore regarding the ambiguities of business rescue under the new Companies Act.

There are several interpretational challenges regarding Chapter 6, but the growing body of case law indicates a readiness to adapt to the new procedures. To make the most of this opportunity, obtaining turnaround funding is crucial. Access to this type of financing is vital for the effective restructuring of a business or, if restructuring is not feasible, for maximizing returns to creditors during liquidation.

In conclusion, post-commencement finance remains a complex and uncertain area of business rescue law, despite the Merchant West judgment. To resolve the confusion surrounding the ranking of secured pre-commencement creditors, it is essential that either the courts provide further clarity or the legislature amends the Companies Act to address these issues directly.

In summary, the appeal of Wescoal presents critical questions about how the term "creditor" is interpreted in the context of business rescue proceedings as outlined in Chapter 6 of the Companies Act 71 of 2008 ("the Act"). Two primary issues arise: first, whether post-commencement creditors, which include both post-commencement finance creditors and post-commencement trade creditors, should have the right to

[226] Kahn 2010 *Business Tax and Company Law Quarterly* 19; Loubser 3-4.

vote on the adoption of a business rescue plan; and second, whether there are any limitations on the cession of claims during the course of business rescue proceedings.

I respectfully submit that the judgment of the court a quo, which excludes post-commencement creditors from participating in the voting process regarding the business rescue plan, is not only legally untenable but also inconsistent with the fundamental purposes and objectives of business rescue as delineated in the Act. There is considerable rationale for allowing post-commencement creditors to exercise their voting rights, as there is no existing legislative framework that prohibits the cession of claims during business rescue proceedings.

Chapter 6 of the Companies Act does not provide a specific definition for the term "creditor", indicating that its interpretation should rely on the ordinary meaning of the word. A creditor is generally understood as an entity to whom money is owed. The Act's lack of distinction between pre- and post-commencement creditors implies that both categories have the right to engage in the business rescue process, which includes the ability to vote on the business rescue plan.

Section 145(4)(a) of the Act, which confers voting rights to creditors based on the amounts owed to them by the company, must be interpreted as applicable to both pre-commencement and post-commencement creditors. The term "creditor" in this context should not be restricted solely to pre-commencement creditors. Notably, when the legislature sought to impose specific limitations, it did so explicitly, as demonstrated by the wording in other sections of the Act. For example, section 150(2)(a)(ii) refers to creditors "when the business rescue proceedings commenced", which pertains to the company’s status at the initiation of the proceedings, rather than the voting rights of creditors concerning the adoption of the rescue plan. This provision emphasizes the company's background at the commencement of the business rescue process, rather than the operational aspects of decision-making throughout the course of that process.

The judgment of Wescoal misinterprets section 145(4)(a) by limiting voting rights to pre-commencement creditors. This ignores the primary goal of business rescue, which is to maximize the company's chance of ongoing solvency or provide better returns for creditors than liquidation. Excluding post-commencement creditors from voting would

undermine these objectives and contradict the legislation's intent to balance all stakeholders' interests in the rescue process.

The lack of a limitation in the statute suggests parliament intended to include post-commencement creditors in the voting process, unlike in other parts of the Act. Their inclusion aligns with fairness and equity, given their vital role in the company's rehabilitation.

Denying post-commencement creditors the right to vote could be considered unjust, particularly given that a company's success in business rescue frequently depends on the financial contributions these creditors make. As the company continues its operations, a post-commencement creditor's claim can change in value over time. Additionally, the risks and rewards associated with their involvement are inherently connected to the company's path to recovery.

Considering that the business rescue process is fluid and the debts owed to creditors may fluctuate throughout, it would be unfair to exclude post-commencement creditors from having a say in the company's future decisions. Additionally, the principle of equality before the law underscores that all creditors affected by the business rescue plan should be allowed to take part in the voting process. This ensures that the rights of every impacted party are acknowledged and that no group is unfairly excluded from decisions that will significantly influence their financial claims.

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