A Comparative Assessment of Employee Rights within South African, United Kingdom and Australian Corporate Rescue Legislation

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TABLE OF CONTENTS

SUMMARY

Many countries, including South Africa, have begun implementing legislative measures which encourage the rescue and recovery of financially distressed companies, rather than bringing the company's existence to a close in a liquidation process. The underlying logic of business rescue is that a company experiencing financial difficulty can be turned around, and in the long run save jobs and be worth more as a going concern, as opposed to simply chopping it up and distributing the remaining assets to the creditors.

In the short run however, the company's lack of financial resources ensures that business rescue plays itself out in a context of tension between the competing interests of employees, employers and creditors, with the process intersecting matters of labour law, company law and insolvency law.

Shifting societal attitudes around issues of fairness and ethics have led internationally and locally to enhanced employee protections in labour, corporate and insolvency law. The focus of this study is to assess and compare South African employee rights in the business rescue regime with similar regimes in the United Kingdom and Australia, along with making recommendations for improvement in a number of key areas.

CHAPTER 1
INTRODUCTION

1.1 Background

1.1.1 Ethical Corporate Governance

The concept of limited liability has been the bedrock of modern capitalism, protecting company owners and investors from personal liability for any company debts, and limiting their risk to the amount invested in the company. However, widespread abuse by multinational companies such as the Bank of Credit and Commerce International and Enron resulted in governments finally clamping down on companies, regulating their activities through stricter accounting requirements, stronger corporate governance measures and enhanced laws relating to director's duties.

The Cadbury Report[1] in the United Kingdom[2] took note of these problems, and recommended the introduction of voluntary corporate governance measures in the UK.[3] The report "laid the groundwork for the development of international standards of corporate governance",[4] with its principles subsequently adopted in a 1999 report by the

[1] The report was a private sector initiative commissioned by the London Stock Exchange, the Financial Reporting Council and the UK accounting profession in 1992, chaired by Sir Adrian Cadbury.
[2] Hereafter referred to as UK.
[3] These measures have been updated on numerous occasions, most recently in the September 2012 amendments by the Financial Reporting Council to the UK Corporate Governance Code. The Code derives its authority ultimately from the Financial Services and Markets Act 2000.
[4] Jordan 10.

influential Organisation for Economic Cooperation and Development.[5] The United States followed suit with the Sarbanes Oxley legislation,[6] whilst the King Reports[7] set the tone for a code of ethical corporate governance in South Africa.[8]

Sir Cadbury wrote that the essence of a good corporate governance system is that it must allow companies to "be free to drive their companies forward, but (to) exercise that freedom within a framework of effective accountability".[9] His analysis is still relevant today, with the net effect of the corporate governance changes making companies far more accountable to their various stakeholders, including employees, shareholders, the communities in which the business operates and broader society.[10] The 2006 UK Companies Act[11] continues to reflect this thinking, with directors being required to have regard to stakeholder interests, including employees, the community and the environment.[12] Judge King eloquently puts the issue in perspective with his remarks that

> "it is estimated that of the 100 largest economies in the world by gross revenue, 51 are multinational companies and only 49 are governments. The impact that these great multinational companies have on the earth is huge. Companies are far greater agents for change than governments, if for no other reason that there are millions of companies in the world and only a few hundred governments. They have a duty to their stakeholders to act and to be seen to be acting as good corporate citizens. Governance of companies has consequently become of critical importance in the twenty-first century".[13]

Strong pressure has thus been placed on companies to accept that profit maximization for shareholders is not their sole raison d'etre, with a 2004 policy paper issued by the South African government[14] maintaining the need for improved levels of corporate governance

[5] Hereafter referred to as OECD. The OECD is an international organisation of 34 countries founded in 1961 to stimulate economic development and international trade. The organisation has a working relationship with South Africa as a non-member country.
[6] Sarbanes–Oxley Act of 2002.
[7] The King Reports on Corporate Governance were issued in 1994 (King I), 2002 (King II), and 2009 (King III).
[8] The principles of the King Code are not legally binding except, to a certain extent, in the case of JSE listed companies.
[9] Cadbury Report 10.
[10] Stein 5.
[11] Companies Act 2006, hereafter referred to as UK Companies Act.
[12] S 172(1) of the UK Companies Act.
[13] King 449.
[14] Department of Trade and Industry *South African Company Law for the 21st Century: Guidelines for*

and ethics and greater linkage between companies and the communities in which they operate.[15] The South African courts have followed the international trend, holding that good corporate governance should be underpinned by the philosophy of ubuntu,[16] "based on a clear code of ethical behaviour".[17]

1.1.2 Debate as to the Nature of Insolvency Law

The notion of taking the interests of all stakeholders into account, including greater society, has in turn impacted upon a jurisprudential debate around what the nature of insolvency law should be. Authors such as Professor Thomas Jackson hold that characterizing a modern insolvency system as a collective debt-collection procedure creates the best possible option for creditors, and simultaneously contributes positively to broader economic and financial stability. In contrast to a situation whereby individual creditors would be forced to collect separately on their debt, Jackson argues that a collective and compulsory system not only saves time and money for each creditor, but also maximizes the value of all the assets.[18]

In contrast to Jackson's "creditors bargain model", authors such as Senator Elizabeth Warren, previously a Harvard Law School professor specializing in bankruptcy law, argue that creditor interests need to be balanced against a wider range of interests. Thus, she maintains that viewing insolvency issues solely from an economic debtor – creditor perspective is too narrow, and that broader community interests should also be taken into account in assessing the overall fairness of an insolvency regime. Thus for example, the shutting down of a company can cause not only sudden unemployment, but can also create a negative effect amongst surrounding businesses and the community. Averch sums it up best by stating that "what motivates and justifies the interests of the debtor and its creditors may be far different from the interests of the community".[19] Thus, instead of dismantling the company in a liquidation procedure and automatically terminating the

Corporate Law Reform (2004).
[15] Department of Trade and Industry 13.
[16] Ubuntu is a Nguni Bantu term meaning human kindness, which has been used in the democratization process of African countries, including South Africa.
[17] *SA Broadcasting Corporation Ltd v Mpofu* (2009) 4 All SA 169 (GSJ), at 64.
[18] Averch 32.
[19] Averch 32.

employees' contracts, proponents of the social model of insolvency hold that rehabilitation of the financially distressed company is a preferable long term approach not only for creditor interests, but also serves a broader social and political interest by protecting employees and also giving debtors a second chance.[20]

1.1.3 Business Rescue Culture

Senator Warren's views have held sway, with numerous countries adopting legislative measures which encourage the proactive rescue of financially struggling companies, on the basis that a company experiencing financial difficulty can be worth more as a going concern rather than simply chopping it up in a liquidation exercise and distributing the remaining assets to the creditors.[21] In promoting the development of the South African economy by encouraging high standards of corporate governance,[22] the South African Companies Act of 2008[23] has similarly adopted a business rescue system, making provision for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders.[24]

1.1.4 Intersection of Labour Law, Company Law and Insolvency Law

Employees have not been forced, as stakeholders, to rely purely on the largesse of ethical corporate governance standards for their labour rights, and have been afforded statutory protection to varying degrees around the world in the areas of employment conditions, health and safety, collective bargaining, unfair dismissal, and business transfers. Labour law protections have in the process broken down the traditional common-law principles of contract, which entitled employers to terminate employment contracts by simply complying with contractual termination clauses, without the need to have a fair reason.[25]

[20] International Monetary Fund 9.
[21] Cassim 459.
[22] S 7(b)(iii) of the Companies Act 71 of 2008, hereafter referred to as Companies Act.
[23] As amended by the Companies Amendment Act 3 of 2011, and the Companies Regulations 2011.
[24] S 7(k) of the Companies Act.
[25] Van Eck & Lombard 22.

The common law approach has been widely criticized as ignoring the "inequitable distribution of wealth and power in society",[26] with Wedderburn commenting that it "is hostile to workers' combinations and collective action".[27] Sir Otto Kahn-Freund famously described the employer-employee relationship as being "between a bearer of power and one who is not a bearer of power. In its inception it is an act of submission, in its operation it is a condition of subordination".[28] The resulting demise of the common law approach has led to enhanced labour protections internationally,[29] with legislation in South Africa such as the Labour Relations Act[30] and the Basic Conditions of Employment Act[31] creating a minimum base of rights for South African employees.[32]

Workers' rights in South Africa have been strengthened further by the inclusion of section 23 in the Bill of Rights,[33] granting everyone the right to fair labour practices as a human right,[34] binding the State along with natural and juristic persons to protect and respect the rights in the Bill of Rights,[35] in a vertical and horizontal application of the Bill of Rights.[36] The court described fair labour practices in *National Entitled Workers Union v CCMA*[37] as a concept that "recognises the rightful place of equity and fairness in the workplace".[38] Whilst the concept is not defined in the Constitution, it has nevertheless "crept into the heart of our labour law jurisprudence and it may be expected that it will continue to grow, by conventional and unconventional means, as long as lawful, unilateral action is regarded by the courts … as unfair and inequitable".[39]

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[26] Hepple 6.
[27] Wedderburn 261.
[28] Davies & Freedland 18.
[29] UK employees benefit from legislation such as the Employment Rights Act 1996, Transfer of Undertakings (Protection of Employment) Regulations 2006, Health and Safety at Work Act 1974, and the Trade Union and Labour Relations (Consolidation) Act 1992. Likewise, Australian employees receive protection from the Fair Work Act of 2009 and the Fair Entitlements Guarantee Act of 2012.
[30] Labour Relations Act 66 of 1995, hereafter referred to as LRA.
[31] Basic Conditions of Employment Act 75 of 1997, hereafter referred to as BCEA.
[32] Van Eck & Lombard 23.
[33] Constitution of the Republic of South Africa Act 108 of 1996, hereafter referred to as Constitution.
[34] Liebenberg 22.
[35] S 7(2) and S 8(2) of the Constitution.
[36] Currie & De Waal 43. A Bill of Rights traditionally regulates the "vertical" relationship between individuals and the State, but S 8(2) of the Constitution also ensures regulation of a "horizontal" application of rights between individuals, including juristic persons.
[37] *National Entitled Workers Union v CCMA* Labour Court Case JR 685/02.
[38] At 5.
[39] Landman 812.

The concept of a fair labour practice has impacted significantly within South African law, with Van Eck *et al* noting that a number of reforms to the Insolvency Act,[40] LRA and BCEA in 2002 and 2003 all originate in the constitutional right to fair labour practices, with "the labour movement, and not the needs of insolvency practice, (being) the engine which drove the insolvency law reform processes that have taken place so far".[41] The practice of labour law, including fair labour practices, has been further characterized as

> "a complex and intertwined body of law drawn from a number of diverse legal concepts, (with) contract, delict, criminal law, administrative law, company law, constitutional law, and international law all areas of law with which labour law to a greater or lesser degree intersect".[42]

1.2 Research Question

In a globalised world, courts facing issues can learn from each other's outlook to similar problems.[43] In this vein, the Constitution and LRA both make reference to international law as a means for South African courts to interpret legislation,[44] with the Supreme Court of Appeal having referred to Australian case law in the matter of *Oakdene Square Properties v Farm Bothasfontein*.[45] South Africa and Australia share similar company law and corporate rescue legislation.[46] With both countries also sharing comparable common law backgrounds with the UK arising out of their British colonial days, along with similar procedures in UK corporate rescue legislation,[47] the focus of this study is to assess and compare South African employee rights in the business rescue regime, along with recommending improvements in a number of key areas.

1.3 Significance of the Study

The South African Institute of Race Relations reported that there are more people in the country receiving welfare benefits than are employed,[48] and echoed the South African National Planning Commission's warning that an insufficient taxpayer base could result

[40] Insolvency Act 24 of 1936.
[41] Van Eck *et al* 906.
[42] Van Niekerk *et al* 3.
[43] Lefler 166.
[44] S 39(1) of the Constitution and S 3(c) of the LRA.
[45] *Oakdene Square Properties v Farm Bothasfontein (Kyalami)* (609/2012) [2013] ZASCA 68.
[46] Anderson 1.
[47] Loubser LLD ii.
[48] SAIRR 1.

in a destructive cycle of "economic decline, falling living standards, rising competition for resources and social tension".[49] Preservation and creation of jobs is critical for South Africa's economic and social stability, and it is within the context of business rescue that the country's labour, company and insolvency laws are at centre stage in trying to strike a balance between the competing interests of employers and employees.

Corporate rescue has attracted much professional, academic and legislative focus around the world. With business rescue still in its infancy in South Africa, and with South Africa's company laws having much in common with the UK and Australian systems, a comparative study of employee rights involving the corporate rescue systems in the three countries is of academic and practical benefit.

1.4 Research Methodology

The approach to this study is a combination of describing corporate rescue law in the three jurisdictions, comparing employee rights, and placing them analytically within jurisprudential debate around insolvency, company and labour law issues and the nature of substantive rights. The study utilizes library-based research, relying on a mix of legislation, case law, and academic, professional and government publications.

1.5 Terminology

For practical purposes, the masculine gender is used, and includes the feminine gender. In addition, the terms "business rescue" and "corporate rescue" are both used.

1.6 Structure

This study follows with discussion of corporate rescue systems and related employee issues, first with that of South Africa in Chapter Two, followed by the UK and Australian systems in Chapter Three. The position of employees within the three systems is compared and evaluated in Chapter Four, along with recommendations for improvement in the South African system. The study closes in Chapter Five with a number of concluding comments.

[49] National Development Plan 4.

CHAPTER 2
SOUTH AFRICA

2.1 Introduction

Taking note of international moves towards creating business rescue systems, along with changes in corporate governance trends, the South African Department of Trade and Industry published a policy document in 2004 dealing with guidelines for corporate law reform.[50] Along with the long term failure of judicial management as a corporate rescue mechanism, and changes in substantive rights given to workers in the Constitution, LRA,

[50] Department of Trade and Industry *South African Company Law for the 21st Century: Guidelines for Corporate Law Reform* (2004) Notice 1183 of 2004 in *Government Gazette* No 26493 of 23 June 2004.

and the BCEA, the report recommended introduction of a business rescue regime as an alternative to liquidation.

2.2 Overview

The new Companies Act duly obliged, with Chapter 6 of the Act providing for a business rescue procedure to facilitate the rehabilitation of companies that are financially distressed.[51] The system is characterized, in brief, by three broad areas providing for the temporary supervision and management of the company by an independent business rescue practitioner, a temporary moratorium on the rights of claimants against the company or property in its possession; and the development and implementation (if approved) of a business rescue plan to rescue the company.[52] "Affected persons" are given a range of rights by the business rescue legislation, and include not only the company shareholders and creditors, but significantly also registered trade unions and even individual employees, if not represented by a trade union.[53]

Chapter 6 of the Act provides financially distressed companies with "escape routes from commercial death",[54] offering them "a structured 'intensive care regime' to give an opportunity to be nursed back to health and avoid final liquidation".[55] Whilst profit companies are defined as being incorporated for the purpose of financial gain for shareholders,[56] it is clear that in the board's decision-making process, the inclusive approach to governance adopted in King needs to prevail. Thus, in fulfilling their duty to act in the best interests of a company,[57] directors are required to take into account not just shareholder interests, but also those of other stakeholders, including employees. As such, when the company starts getting into financial trouble, the directors will need to be acutely aware of the business rescue provisions in Chapter 6 of the Act.

[51] S 128(1)(b) of the Companies Act. The Financial Services Laws General Amendment Act 45 of 2013 in addition provides for business rescue of entities such as pension funds, insurers, and financial service providers.
[52] S 128(1)(b) of the Companies Act.
[53] S 128(1)(a) of the Companies Act.
[54] Bradstreet (2011) 352.
[55] Katz 53.
[56] S 1 of the Companies Act.
[57] S 76(3)(b) of the Companies Act.

Joubert *et al* point out that the Act was introduced "in a constitutional setting that South African corporate and insolvency lawyers may not previously have been used to. It is a milieu with a new social and democratic order in South Africa, and one that is much more sensitive to the rights of employees".[58] Whilst company law is traditionally concerned with shareholder interests, and insolvency law focuses on matters such as the shutting down of a business and the division of its assets amongst creditors,[59] labour law protects employee interests through enhancing job security and employment continuity.[60]

The basis of these employee rights originate in the Constitution, ensuring the right to fair labour practices, to trade union representation, and to strike,[61] with statutes such as the LRA and the BCEA giving effect to the constitutional right to fair labour practices.[62] Significantly, whilst the drafters of the Companies Act prefer for its provisions to be interpreted concurrently as much as possible with other legislation,[63] they nonetheless stipulated that the provisions and principles of the LRA will apply in the event of a conflict between the two,[64] reflecting the pre-existing LRA position.[65] Chapter 6 of the Companies Act thus grants extensive employee rights and powers, forming the chief subject-matter and focus of this chapter.[66]

2.3 Initiation of Business Rescue Process

2.3.1 Initiation by the Company

The board of directors may initiate business rescue proceedings, resolving that the company voluntarily begin business rescue proceedings, provided liquidation proceedings have not already been initiated against it.[67] The resolution must declare that the company is in financial trouble, and must also appoint a qualified independent

[58] Joubert *et al* 65.
[59] Van Eck *et al* 907.
[60] Van Eck & Lombard 23.
[61] S 23(1)-(5) of the Constitution.
[62] S 1(a) of the LRA, and S 2(a) of the BCEA.
[63] S 5(4)(a) of the Companies Act.
[64] S 5(4)(b)(i)(bb) of the Companies Act.
[65] S 210 of the LRA.
[66] Other turnaround mechanisms, including compromise with creditors dealt with in s 155 of the Companies Act, are thus not broached in this study.
[67] S 129(2)(a) of the Companies Act.

business rescue practitioner.[68] Within five business days of adopting it, and filing the resolution with the Companies and Intellectual Property Commission,[69] the company must notify every affected person of the resolution, in the prescribed manner, including a sworn statement of the facts on which the resolution was founded.[70] If a company fails to comply with the procedural requirements, the resolution lapses and the company cannot file another similar resolution for a period of three months.[71] If the company has commenced business recue proceedings, it may not begin liquidation proceedings unless the resolution has lapsed or the business rescue proceedings have ended.[72]

The rationale for granting the board power to initiate the procedure lies in the fact that the company itself is best placed to determine whether it is financially distressed, and is designed to encourage directors to proactively get assistance early instead of waiting until it is too late.[73] Stein points out that this voluntary process represents an important shift in policy away from court supervision, enabling small companies to implement business rescue as a viable alternative to liquidation.[74] However, he concedes that the system does have potential for abuse by unscrupulous directors, and argues that the practitioner should thus be independent and properly skilled in order to protect stakeholders.[75]

Employees benefit significantly from provisions in the Companies Act outlining directors' duties, and are thus not solely reliant on the practitioner for their protection. Whilst a Board failure to comply with section 129(7) of the Act[76] does not itself carry any sanctions for non-compliance, directors can be held liable for civil damages to any other person for contravention of a provision of the Act.[77] In addition, failure to comply with section 129(7) can also open directors to charges of reckless trading, involving gross

[68] S 129(3)(b) of the Companies Act.
[69] Hereinafter referred to as the Commission.
[70] S 129(3)(a) of the Companies Act.
[71] S 129(5)(a)-(b) of the Companies Act.
[72] S 129(6) of the Companies Act.
[73] Cassim 462.
[74] Stein 41.
[75] Stein 41.
[76] Requiring companies which do not initiate rescue proceedings to notify all affected persons that it is financially distressed, together with reasons for not adopting a resolution.
[77] S 218(2) of the Companies Act.

negligence, intent to defraud any person, or for any fraudulent purpose,[78] on the basis that they went along with the company continuing to conduct business despite knowing that it was in violation of the Act.[79] Struggling companies thus find themselves in a difficult situation, as whilst compliance can amount to commercial suicide,[80] non compliance may lead to personal liability for directors,[81] or to the company being issued with a compliance notice by the Companies and Intellectual Property Commission requiring it to cease carrying on its business or trading.[82] With employees strategically placed to capitalize on any breaches on their part, directors will need to tread carefully in the exercise of their duties, including with regard to initiation of business rescue procedures.

Affected persons, including employees, also have the opportunity to object to adoption of the Board resolution. The objection may occur by applying to court for the resolution to be set aside, on the grounds that the company is not financially distressed, that there is no reasonable prospect for rescuing the company, or that the company has not complied with the procedural requirements.[83] An affected person may also apply to court to set aside the appointment of the practitioner if the practitioner is not independent of the company or its management, or not sufficiently skilled for the job,[84] or requires the practitioner to provide security to secure the interests of the company and any affected persons.[85] The fact that the practitioner is in charge of the company assets is important for all the stakeholders, including the employees. Loubser thus argues that, although the Act does not require the practitioner to furnish security, it should be a precondition for his appointment, [86] in line with the King recommendations.[87]

[78] S 22(1)(a) of the Companies Act.
[79] Kotze 43.
[80] Kotze 43.
[81] S 77(3)(b) of the Companies Act. See also *Philotex (Pty) Ltd v Snyman and Others* 1998 (2) SA 138 SCA, in which the court held under section 424 of the previous Companies Act 61 of 1973 that directors can be held personally liable for company debts if they trade recklessly.
[82] S 22(3) of the Companies Act.
[83] S 130(1)(a)(i)-(iii) of the Companies Act.
[84] S 130(1)(b) of the Companies Act.
[85] S 130(1)(c) of the Companies Act.
[86] Loubser (2010-1) 509.
[87] King III Principle 2.15.

2.3.2 Initiation by an Affected Person

Affected persons, including employees, may apply to court for business rescue order.[88] The applicant must serve a copy of the application on the company and the Commission; and notify all other affected persons of the application.[89] Each affected person has a right to participate in the hearing of the application,[90] along with the right to participate in the hearing of an application for the setting aside of the business rescue resolution.[91]

The courts have taken the approach that affected persons do not require leave of the court to intervene in order to participate in the legal proceedings, although both Rogers AJ in *Cape Point Vineyards v Pinnacle Point Group*[92] and the court in *Engen Petroleum v Multi Waste*[93] suggested that, in order to ensure fairness to all parties, the courts would need to regulate the procedure to be followed, where for example affected parties wanted to file affidavits relevant to the application.[94]

The ability of employees to initiate rescue proceedings has been given significant muscle, with section 31(3) of the Companies Act requiring trade unions to be given access to company financial statements for purposes of initiating a rescue process,[95] giving effect in the process to section 32 of the Constitution.[96] It is worth noting that information relating to directors' remuneration and benefits must be included.[97] In addition, company documents given to employees are required to be drafted in plain language.[98]

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[88] S 131(1) of the Companies Act.
[89] S 131(2)(a)-(b) of the Companies Act.
[90] S 131(3) of the Companies Act.
[91] S 130(4) of the Companies Act.
[92] *Cape Point Vineyards v Pinnacle Point Group* 2011 (5) SA 600 (WCC).
[93] *Engen Petroleum v Multi Waste* 33410/11 (GSJ): 23 September 2011.
[94] Meskin *et al* 11.
[95] S 1 of the Companies Act defines "financial statements" as including annual financial statements and provisional annual financial statements; interim or preliminary reports; group and consolidated financial statements in the case of a group of companies; and financial information in a circular, prospectus or provisional announcement of results, that an actual or prospective creditor or holder of the company's securities, or the commission, panel or other regulatory authority, may reasonably be expected to rely on.
[96] S 32 of the Constitution gives everyone the right of access to information held by another person, which is required for the exercise or protection of any rights. The Promotion of Access to Information Act 2 of 2000 can also be of use to employees and trade unions.
[97] S 30(4)-(6) of the Companies Act.
[98] S 6(4)(b) and S 6(5) of the Companies Act. Shareholders, investors, and creditors also benefit from this provision, which has been inserted in the Companies Act, along with similar provisions in the National Credit Act 34 of 2005 and Consumer Protection Act 68 of 2008, as part of a growing trend towards

Whilst employees welcome their ability to initiate the procedure, Bradstreet cautions that the procedure is open to possible abuse as a bargaining tool for trade union wage negotiation.[99] Loubser warns further that trade unions will have "no limit on how often this demand may be made and no liability for abuse of the right, in spite of the fact that the reputation and creditworthiness of a company can be seriously damaged if it becomes known that such a demand has been made".[100] Wiese points out however, that the aim of the procedure is essentially to avoid liquidations and job losses,[101] and ultimately I would side with Cassim's view that, as a court application, "frivolous or malicious applications intended to harass the company or other forms of abuse of process are deterred".[102]

2.4 Requirements

2.4.1 Financial Distress

Business rescue applicants must show that the company is financially distressed, with a "probable failure in the near future of the business".[103] The court will accept this on the facts if it, within the next six months, it is reasonably unlikely that the company will be able to pay its debts, or reasonably likely that it will become insolvent.[104]

2.4.2 Reasonable Prospect of Rescuing Company

Initiation by either the company or affected persons can be performed as long as there is a reasonable prospect of rescuing the company.[105] Whilst the Act does not define the term "reasonable prospect", its meaning has been the subject of considerable judicial debate, going to the heart of the underlying issues surrounding business rescue.

usage of plain language in South African legal documents.
[99] Bradstreet (2011) 358.
[100] Loubser LLD 54.
[101] Wiese 2474.
[102] Cassim 467.
[103] Cassim 460.
[104] S 128(1)(f) of the Companies Act.
[105] S 129(1)(b) and S 131(4)(a) of the Companies Act.

The courts initially adopted a strict approach, with Eloff J holding in *Southern Palace Investments v Midnight Storm Investments*[106] that "one would expect, at least, to be given some concrete and objectively ascertainable details going beyond mere speculation in the case of a trading or prospective trading company".[107] Meskin *et al* are critical of this approach however, submitting that whilst it would be correct for the stage at which the business rescue practitioner develops a plan to rescue the company, it is inappropriate to expect applicants such as employees, creditors or shareholders to be in a position to provide information to this level. If the strict requirements prevail, they warn that it will probably "sound the death knell for business rescue in South Africa and lead to the procedure becoming as ineffective as its predecessor, judicial management".[108]

Whilst the courts did not immediately accept these criticisms,[109] judicial views started shifting, with Van der Merwe J commenting in *Propspec Investments v Pacific Coasts Investment*s[110] that "with respect to my learned colleagues, I believe that they place the bar too high",[111] and going on to hold that "in my judgment it is not appropriate to attempt to set out general minimum particulars of what would constitute a reasonable prospect in this regard".[112] The issue reached the Supreme Court of Appeal in the May 2013 judgement of *Oakdene Square Properties v Farm Bothasfontein (Kyalami),*[113] involving a proposed business rescue of Oakdene Square Properties, owner of the Kyalami racetrack. Whilst rejecting the business rescue application on the facts, the court sided with the *Propspec* approach, ruling that applicants do not require a detailed plan.

Although employee rights were not a factor in the case due to the fact that the company did not have any employees,[114] CJ Claassen J noted broadly that the legislation

[106] *Southern Palace Investments v Midnight Storm Investments* 2012 (2) SA 423 (WCC).
[107] At paragraph 24 of *Southern Palace Investments v Midnight Storm Investments*.
[108] Meskin *et al* 465.
[109] *Koen v Wedgewood Village Golf & Country Estate* 2012 (2) SA 378 (WCC) followed the strict requirements laid down in the *Southern Palace* case.
[110] *Propspec Investments v Pacific Coasts Investments* 2013 (1) SA 542 (FB).
[111] At paragraph 11 of *Propspec Investments v Pacific Coasts Investments*.
[112] At paragraph 15 of *Propspec Investments v Pacific Coasts Investments*.
[113] *Oakdene Square Properties v Farm Bothasfontein (Kyalami)* (609/2012) [2013] ZASCA 68.
[114] Bradstreet (2013) 45.

"encapsulates a shift from creditors' interests to a broader range of interests",[115] with employees standing "to gain substantial benefits from business rescue proceedings which precede a liquidation".[116] As such, the lenient approach adopted by the court towards the term "reasonable prospect" is of particular pertinence for employees, with the *Oakdene* approach putting them in a significantly better position to initiate rescue proceedings.

In the only employee-initiated application thus far, employees who lived and worked on their employer's farm instituted a business rescue application as affected persons in *Employees of Solar Spectrum Trading v Afgri Operations.*[117] In the matter, the court noted that a large majority of the employees had dependants, and that their employer's liquidation would likely result in them losing not only their jobs, but also their accommodation on the farm. Holding that the rights of all the stakeholders must be balanced fairly, the court decided that a reasonable prospect existed for the rescue of the farming business, and thus authorized the appointment of a business rescue practitioner.

Whilst the Companies Act appears to include a "reasonable prospect of rescue" as a requirement for both company and affected person initiations, Bradstret points out that the punctuation used in the legislation suggests that this requirement is only applicable for company initiated business rescue procedures, or for court orders granted on the basis of being just and equitable for financial reasons.[118] As such, he argues that affected persons applying for business rescue orders on the other specified legislative grounds "would only need to show that the company is financially distressed".[119] Whilst Bradstreet's approach appears to be sensible from an employee perspective, the issue will nonetheless remain a moot point until pronounced upon by the courts in the future.

[115] At paragraph 12 of *Oakdene Square Properties v Farm Bothasfontein (Kyalami).*
[116] At paragraph 15 of *Oakdene Square Properties v Farm Bothasfontein (Kyalami).*
[117] *Employees of Solar Spectrum Trading v Afgri Operation*s Case No 6418/2011 High Court Pretoria 8 May 2012 [37].
[118] Bradstreet (2013) 48.
[119] Bradstreet (2013) 48.

2.4.3 Company Failure to Pay Employment-Related Contractual Amounts

The court is notably empowered in considering the application to also take into account other factors, including a company failure to pay over contractual amounts with respect to employment-related matters.[120] In situations where trade unions will not always have concrete information as to whether a company is financially distressed,[121] Meskin *et al* contend that "this clause can only have been included in order to assist registered trade unions in bringing applications for compulsory business rescue proceedings".[122] They caution further that if a rescue application has been brought by affected persons, and the company turns out in fact to not be financially distressed, then the business rescue practitioner would need to take steps immediately to terminate the rescue procedure.[123]

2.4.4 Just and Equitable

A further provision allowing courts to make business rescue orders if it is "otherwise just and equitable to do so for financial reasons"[124] has also attracted considerable criticism, with the court criticizing the phrase as being "extremely vague" in *Oakdene Square Properties v Farm Bothasfontein (Kyalami).*[125] Loubser warns further that the phrase could be used in support of employee applications for reasons of company financial difficulties that are not dealt with in the definition of financial distress, such as businesses that may become insolvent or unable to pay their debts over a longer time than stipulated in the Act.[126] Saunders similarly suggests that it may offer employees an alternative strategy to dealing with company retrenchments, contending that trade unions could utilize the procedure in a situation such as a foreign parent company wanting to cease its operation in South Africa and looking to thus terminate its South African subsidiary.[127]

[120] S 131(4)(a)(ii) of the Companies Act.
[121] The LRA entitles employees access to certain information in situations of retrenchments and transfer of employment contracts, although in practice they can struggle to obtain the information.
[122] Meskin *et al* 462.
[123] Meskin *et al* 492.
[124] S 131(4)(a)(iii) of the Companies Act.
[125] At paragraph 17 of *Oakdene Square Properties v Farm Bothasfontein (Kyalami).*
[126] Loubser (2010-1) 510.
[127] Saunders 1.

In considering the issue, Meskin *et al* raise the issue that "financial reasons" could relate to a host of stakeholders, including creditors, shareholders and employees,[128] which will thus need to be considered by a court when applying this provision.[129] Nonetheless, they submit that although no guidance is provided as to the meaning of "just and equitable" in the Act, applicants bringing an application on this ground will still have to show that there is a reasonable prospect of rescuing the company.[130]

2.5 Consequences of Business Rescue Process

2.5.1 Notification of All Affected Persons

Should the court order in favour of business rescue, the company must notify all affected persons within five business days.[131] Should the application be dismissed, the court may make an alternative order, including one placing the company under liquidation.[132] A court order suspends existing liquidation proceedings until the rescue proceedings end,[133] and the company may also not adopt a resolution placing itself in liquidation until the rescue proceedings have ended.[134] The Act specifies that proceedings end by either the court setting aside the resolution or order that initiated the proceedings, or converting the proceedings into liquidation proceedings, the practitioner filing a notice of termination, or the implementation or rejection of a business rescue plan.[135] The intention is that the proceedings not take unduly long, with the practitioner required to make a progress report to each affected person, the court or the Commission if proceedings take longer than three months.[136] The rationale behind the strict time limit is that "the quicker the process, the less the prejudice to creditors and employees and other third parties".[137]

[128] Meskin *et al* exclude companies, which can't apply to court as they are not affected persons.
[129] Meskin *et al* 463.
[130] Meskin *et al* 462.
[131] S 131(8)(b) of the Companies Act.
[132] S 131(4)(b) of the Companies Act.
[133] S 131(6) of the Companies Act.
[134] S 131(8)(a) of the Companies Act.
[135] S 132(2) of the Companies Act.
[136] S 132(3) of the Companies Act.
[137] Cassim 470.

2.5.2 Business Rescue Practitioner Powers

2.5.2.1 General Powers of Practitioner

As part of the process, a practitioner is tasked with investigating the company's affairs and making an independent assessment as to its rehabilitation prospects.[138] If he decides that the prospects are reasonable, a business rescue plan is developed for consideration by affected persons, and implemented if approved.[139] Although provision has been made for the practitioner to apply to court for an extension of the three month period,[140] he clearly needs to get cracking from the outset, and is given wide powers to perform his functions, both as an officer of the court and with the responsibilities, duties and liabilities of a director, as set out in sections 75 to 77 of the Act.[141]

In order to investigate the company's affairs, the practitioner is given full management control of the company, with directors required to cooperate fully with the practitioner,[142] and subject to the authority of the practitioner.[143] In this vein, the directors must provide the practitioner with any information about the company's affairs as may reasonably be required,[144] including company financial and operating information such as books and records,[145] along with information pertaining to the number of employees, and any collective agreements or other agreements relating to the rights of employees.[146]

The practitioner is required to be independent of the company or its management,[147] and not have a relationship with the company that could be interpreted as lacking in integrity, impartiality or objectivity.[148] Such a situation, along with a host of other grounds would provide grounds for his removal by the court either upon application by an affected person, including employees, or on its own initiative.[149]

[138] S 141(1) of the Companies Act.
[139] S 140(1)(d)(i)-(ii) of the Companies Act.
[140] S 132(3) of the Companies Act.
[141] S 140(3)(a)-(b) of the Companies Act.
[142] S 137(2) of the Companies Act.
[143] S 137(2)(a) of the Companies Act.
[144] S 137(3) of the Companies Act.
[145] S 142(1) of the Companies Act.
[146] S 142(3)(d) of the Companies Act.
[147] S 130(1)(b)(ii) of the Companies Act.
[148] S 138(1)(d) of the Companies Act.

The broad powers granted to practitioners include the ability to remove any person from office who forms part of the pre-existing management of the company,[150] including directors, by applying to court on a number of specified grounds[151]. However, directors are also employees, and Meskin *et al* submit thus that the practitioner is required to comply with employment-related legislation when removing a director, a process which could end up taking longer than the business rescue procedure.[152]

2.5.2.2 Suspension of Contracts

The practitioner has in addition been given the power to suspend (entirely, partially or conditionally) for the duration of the rescue proceedings agreements to which the company is a party.[153] In addition, the practitioner is also authorized to apply urgently to court to cancel any agreement to which the company is party (entirely, partially or conditionally), on any terms that are just and reasonable in the circumstances.[154]

The intention behind this provision is to allow the company to free itself from onerous contractual provisions that could prevent it from getting back on its feet, with the other party to the contract being limited to a claim for damages, excluding claims for specific performance.[155] Whilst employment contracts are excluded from this provision, and employees thus expected to continue working on the same terms and conditions, the provision has nonetheless attracted severe censure, with critics arguing that it ignores the legal principle of sanctity of contract, to the detriment of creditors.[156]

2.5.3 Moratorium

The net effect of entering the rescue process is that no legal proceedings, except for criminal proceedings against the company or directors,[157] can be commenced or

[149] S 139 of the Companies Act.
[150] S 140(1)(c)(i) of the Companies Act.
[151] S 137(5)(a)-(b) of the Companies Act.
[152] Meskin *et al* 481.
[153] S 136(2) of the Companies Act.
[154] S 136(2) of the Companies Act.
[155] S 136(3) of the Companies Act.
[156] Stein 42.
[157] Cassim 472.

proceeded with against the company in any forum, unless agreed to by the business rescue practitioner or the court.[158] This moratorium is viewed as being crucial for the success of corporate rescue procedures, with similar procedures in the USA, United Kingdom and Australia viewed as creating breathing space for the process.[159]

It is still early days for the business rescue process, and the courts have thus not yet had an opportunity to interpret many of the procedure's provisions. One possible area of contention may be whether the moratorium on legal proceedings against the company "in any forum"[160] will prevent employees from referring unfair dismissal or other disputes to the Commission for Conciliation, Mediation and Arbitration[161] in terms of the LRA,[162] without having to first obtain the practitioner's consent or leave of the court.

Saunders suggests that employee exclusion from the CCMA is most likely the applicable situation,[163] raising the issue as to whether the CCMA would then accept compliance with the moratorium as a reason to grant condonation for failure to refer the case within the prescribed time limits.[164] In addition, if the company is subsequently liquidated as a result of the business rescue failing, Saunders raises the further problem of the employees not having had the opportunity to obtain an award against the company, effectively blocking them from then lodging a claim with the liquidator.[165]

2.5.4 Business Rescue Plan

The rescue process is centered around the business rescue plan, which the practitioner is required to prepare after consulting with the creditors, management of the company, and other affected persons, including employees,[166] for consideration at a meeting. The plan is required to contain all information reasonably required by affected persons to decide

[158] S 133(1) of the Companies Act.
[159] Levenstein 6.
[160] S 133(1) of the Companies Act.
[161] A dispute resolution body established in terms of the LRA, hereinafter CCMA.
[162] S 191(1) of the LRA.
[163] Saunders 2.
[164] S 191(1)-(2) of the LRA.
[165] Saunders 2.
[166] S 140(1)(d)(i) of the Companies Act.

whether or not to accept or reject the plan,[167] including the benefits for creditors of adopting the business rescue plan as opposed to the benefits that would be received if the company were to be placed in liquidation, and the effect of the plan on the holders of each class of the company's issued securities.[168]

2.6 Participation in the Process

2.6.1 Employee Participation in the Process

Employees are given a host of rights during the process, and may elect to exercise them collectively through their representative trade union, or directly or by proxy through an employee organisation or representative if not represented by a trade union.[169] Employees are entitled to notice of and participation in each court proceeding, decision, meeting or other relevant event, to participate in any court proceedings arising during the business rescue proceedings, and to form a committee of employees' representatives.[170] The committee may be formed by the employee representatives at their first meeting, which must be convened and presided over by the practitioner within ten business days of being appointed.[171] In convening the meeting, the practitioner is required to give notice setting out the date, time, place and agenda of the meeting to each registered trade union representing employees, and to all individual employees not represented by a registered trade union, or their representatives,[172] which can include attorneys.[173]

At the first meeting, the practitioner is required to inform the employee representatives whether he believes that there is a reasonable prospect of rescuing the company.[174] The committee of employees may consult with the practitioner during the course of the business rescue proceedings about any matter relating to the proceedings, but is not permitted to direct or instruct the practitioner. The committee may receive and consider reports relating to the rescue proceedings on behalf of its members, and is required to act

[167] S 150(1)-(2) of the Companies Act.
[168] S 150(2)(b)(vi)-(vii) of the Companies Act.
[169] S 144(1) of the Companies Act.
[170] S 144(3) of the Companies Act.
[171] S 148(1) of the Companies Act.
[172] S 148(2) of the Companies Act.
[173] S 149(2)(b) of the Companies Act.
[174] S 148(1)(a) of the Companies Act.

independently of the practitioner in order to ensure fair and unbiased representation of its members' interests.[175] The employees must be given sufficient opportunity to review any finalized business rescue plan,[176] which must contain all the information reasonably required to allow affected persons to decide whether to accept or reject it.[177]

Within ten business days of finalizing and publishing the business rescue plan,[178] the practitioner is required to convene and preside over a meeting of creditors and any other holders of a voting interest for purposes of considering the plan.[179] The practitioner must deliver a notice of the meeting to all affected persons at least five business days before the meeting, setting out the date, time, place and agenda of the meeting, along with a summary of the rights of affected persons to participate in and vote at the meeting.[180]

Although not allowed to vote as employees at the meeting, the employees must nonetheless be afforded an opportunity to prepare and present a submission at the meeting before a vote is taken on any proposed business rescue plan by the holders of voting interests,[181] giving them an opportunity to express their views and try influence the vote on the proposed rescue plan. To the extent that the employees are creditors, they may vote with the creditors on a motion to approve a proposed business plan.[182] However, notwithstanding all the rights and job security given to employees, the lack of an employee vote on the rescue plan illustrates that they are treated as less important stakeholders than creditors within the overall process .[183]

The court in *Commissioner of SA Revenue Services v Beginsel*[184] has clarified the manner in which concurrent creditors, which can include employees, will vote in rescue

[175] S 149(1)(a)-(c) of the Companies Act.
[176] S 144(3)(d) of the Companies Act.
[177] S 150(2) of the Companies Act.
[178] S 150 of the Companies Act contains the prescribed structure of the business rescue plan.
[179] S 151(1) of the Companies Act.
[180] S 151(2)(a)-(c) of the Companies Act.
[181] S 144(3)(d)-(e) of the Companies Act.
[182] S 144(3)(f) of the Companies Act.
[183] Wiese 2474.
[184] *Commissioner of SA Revenue Services v Beginsel and Others* (15080/12) [2012] ZAWCHC 194; 2013 (1) SA 307 (WCC) (31 October 2012).

proceedings, holding that the Companies Act does not create statutory preferences as set out in the Insolvency Act, and that SARS is thus not a preferential creditor in business rescue as it would be in a liquidation proceeding. The net result is that concurrent creditors stand alongside secured creditors and have the opportunity to have their say, namely, to vote in accordance with the value of their claim against the company, either for the approval or rejection of the plan.[185]

As the matter now stands, SARS is less likely to vote in favour of business rescue plans. Nonetheless, proposed rescue plans will be adopted if supported by creditors holding more than 75% of the creditors' voting interests that voted, and at least 50% of the independent creditors' voting interests,[186] and does not alter the rights of any class of shareholders.[187] Once adopted, the plan binds all creditors, with a cramdown[188] applicable to all creditors whether or not they were present at the meeting or how they voted, along with the company, and every holder of the company's securities.[189] The company, under the practitioner's direction, must then take all necessary steps to implement the plan,[190] after which he must file a notice of substantial implementation of the rescue plan.[191]

If the proposed plan is rejected, the practitioner may seek a vote of approval from the holders of voting interests to prepare a revised plan, or advise the meeting that the company will apply to court to set aside the vote on the grounds that it was inappropriate.[192] If the practitioner does not do this, then both employees and creditors are entitled as a last-ditch measure to propose the development of an alternative plan, by either calling at the meeting for a vote of approval from the holders of voting interests requiring the practitioner to prepare a revised plan, or applying to court to set aside the result of the vote on the grounds once again, that it was inappropriate.[193] Loubser

[185] Torrington 1.
[186] S 152(2)(a)-(b) of the Companies Act.
[187] S 152(3)(b) of the Companies Act.
[188] Cassim 491. The binding of dissenting creditors is referred to as a "cramdown".
[189] S 152(4) of the Companies Act.
[190] S 152(5) of the Companies Act.
[191] S 152(8) of the Companies Act.
[192] S 153(1)(a) of the Companies Act.
[193] S 153(1)(b)(i)(aa)-(bb) of the Companies Act.

criticizes this provision as granting employee rights illicitly, warning that it will not only effectively give employees more rights than shareholders, but that rescue plans could be obstructed by uncooperative employees and trade unions.[194]

Employees and creditors are also entitled to making a binding offer to purchase the voting interests of those who opposed the rescue plan,[195] at a value independently and expertly determined to be a reasonable estimate of the return to that person if the business were to be liquidated,[196] failing which the practitioner may file a notice of termination of the rescue proceedings.[197] The logic of this provision is that employees, creditors and shareholders who continue to support the rescue plan are given the option to purchase the other voting interests and then approve the rescue plan.[198] Rushworth characterizes the provision as a "novel concept",[199] whilst Loubser criticizes it as "one of the most disturbing provisions regulating business rescue provisions".[200] She warns that a share in a drowning company is worthless upon liquidation,[201] and that the words "binding offer", in addition, could be interpreted to mean that offerees are bound to accept the offer, effectively being forced in the process to give their shares away.

Loubser's worst fears were realized in the matter of *African Bank Corporation of Botswana Limited v Kariba Furniture Manufacturers (Pty) Ltd,*[202] with North Gauteng High Court Judge Kathree–Setiloane holding that the term "binding offer" is not an offer in the contractual sense but rather a set of statutory rights and obligations, with the result that the binding offer is binding on both the offeror and offeree. However, a conflicting judgment by Judge Trevor Gorven in the KwaZulu-Natal High Court matter of *DH Brothers Industries (Pty) Ltd vs Karl Johannes Gribnitz N.O. and Dowmont Snacks (Pty)*

[194] Loubser (2010-2) 696.
[195] S 144(3)(g)(i)-(ii) of the Companies Act for employees, and S 145(2)(a)-(b) of the Companies Act for creditors.
[196] S 153(1)(b)(ii) of the Companies Act.
[197] S 153(5) of the Companies Act.
[198] Rushworth 407.
[199] Rushworth 407.
[200] Loubser (2010-2) 697.
[201] Loubser (2010-2) 697.
[202] *African Bank Corporation of Botswana Limited v Kariba Furniture Manufacturers (Pty) Ltd* 2013 (6) SA 471 (GNP).

Limited[203] means that the issue will need to be finally resolved in either the Supreme Court of Appeal or the Constitutional Court.

2.6.2 Employee Participation as Creditors

Creditors are given similar rights as the employees, and are also entitled to participate in court proceedings and meetings, and to form a committee of creditor representatives. They also have the right, at the end of the process, to vote to approve, reject or amend a rescue plan at a meeting to determine the company's future.[204]

The issue of creditor rights is important for employees to take into account, since the Act regards employees as "preferred unsecured creditors" of the company in relation to any unpaid employment-related amounts owing from before the beginning of the company's business rescue proceedings,[205] thus giving them an opportunity to participate in the business rescue process to this extent as creditors. The Act does not place a limitation on the amount employees may claim as preferred unsecured creditors in the business rescue process, giving them a significantly better deal than if the company was engaged in a liquidation process through the Insolvency Act,[206] which limits employee claims to maximum amounts determined by the Minster of Justice from time to time in the Government Gazette.[207] In addition, an employee medical scheme, pension scheme or provident scheme is similarly regarded as an unsecured creditor in relation to any unpaid amounts owing by the company to the scheme trustees from before the rescue proceedings, or for the present value of a defined benefit scheme at the commencement of the rescue proceedings of any unfunded liability under that scheme.[208]

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[203] *DH Brothers Industries (Pty) Ltd vs Karl Johannes Gribnitz N.O. and Dowmont Snacks (Pty) Limited* 2014 (1) SA 103 (KZP).
[204] S 152 of the Companies Act.
[205] S 144(2) of the Companies Act.
[206] S 98A of the Insolvency Act 24 of 1936 permits employees to submit salary claims as preferential creditors.
[207] Goode (2011) 485.
[208] S 144(4)(a)-(b) of the Companies Act.

2.7 Retention of Employment

2.7.1 Same Terms and Conditions for Employees

Whilst common law principles of contract entitle employers to terminate employment contracts,[209] "it would be anathema to modern labour law for contracts of employment to terminate automatically upon the occurrence of a particular event".[210] Employees are however, clearly included as important stakeholders in the rescue process, with the business rescue plan ultimately required to assess the effect, if any, of the rescue process on the employees and their conditions of employment.[211] A crucial protection offered to employees right from the outset of the process is that the company is required to continue employing them on the same terms and conditions, except to the extent that changes occur in the ordinary course of attrition, or the employees agree to different terms and conditions with the company.[212]

Whilst this is a crucial protection for employees on the company's books, an inflated wage bill may be an important contributor in the first place to the company's financial woes. Rajak and Henning submit that the ability of a company to cut its wage bill is vital to save the business and jobs,[213] whilst Stein and Everingham point out however, that the provision limits the practitioner's ability to reduce costs.[214]

Whilst it is possible for practitioners to retrench employees within the rescue plan, the retrenchments may only take place within the parameters of the LRA.[215] With the LRA requiring consultation and joint consensus-seeking[216] on matters such as the number of employees to be affected, timing of retrenchments and fair selection criteria, the process can unfortunately end up being too lengthy and costly for the company to effectively survive. From the employee perspective, the retrenchment provisions are also subject to

[209] As discussed in Chapter 1.
[210] Van Eck *et al* 908.
[211] S 150(2)(c)(ii) of the Companies Act.
[212] S 136(1) of the Companies Act.
[213] Rajak & Henning 286.
[214] Stein & Everingham 421.
[215] Retrenchment of employees will be subject to the provisions of S 189 and S 189A, along with the Code of Good Practice on Dismissal Based on Operational Requirements, in the LRA.
[216] At paragraph 27 of *Johnson & Johnson Ltd v CIWU* (1998) 19 ILJ 89 (LAC).

criticism however, in that they do not make provision for any benefits in the form of employee retraining or compensation.[217]

2.7.2 Priority Payment for Employee Salaries

Employee salaries owing from after the commencement of the rescue proceedings need to continue being paid by the company, with the Act treating employees as a special category of creditors, classifying their claims as "post-commencement financing".[218] The concept of post-commencement finance relates to funding that the company receives after the rescue proceedings commence, which enable it to continue trading. The lenders receive preferential payment for these loans, with the hope that they will be prepared to continue financing distressed companies.

The net result of this is the altering of creditors' rankings in terms of the Insolvency Act, with the business rescue provisions creating a special order of preference for employee claims, preferring employees even over secured creditors for claims arising during the business rescue process. Thus, employee claims will be paid out immediately after payment of the business rescue practitioner's remuneration and expenses, followed only thereafter by other post-commencement financing regardless of whether or not they are secured.[219] Once again, the Companies Act business rescue provisions can be seen as giving employees a far better deal than under the Insolvency Act, with Meskin *et al* cautioning that "it remains to be seen whether this misalignment of the two Acts will lead to any attempted abuse of the business rescue procedure in future".[220]

Meskin *et al* raise an interesting issue relating to the order of preference in which monies must be paid out by the practitioner, speculating whether employees would be able to consent to "non-payment of their pre- or post-commencement claims as part of a business rescue plan that would keep them employed after the implementation of the plan".[221] They do not believe that the position in this regard is clear, although it could be argued

[217] Rajak & Henning 286.
[218] S 135(1)(a) of the Companies Act.
[219] S 135(3) of the Companies Act.
[220] Meskin *et al* 478(3).
[221] Meskin *et al* 519.

that such an agreement could be acceptable as long as it does not offend applicable labour laws,[222] especially since economic development and job preservation are vital aspects of both the Companies Act[223] and the LRA.[224]

Whilst the employee priority will naturally be welcomed by trade unions, it has been criticized as undermining the interests of creditors, with the end result that it may ultimately not work to the advantage of employees, and could possibly also be the subject of a constitutional challenge for being in violation of the property rights of secured creditors.[225] The business rescue legislation is creating opportunities that are certainly of interest to financiers of distressed debt, with the Southern African Turnaround Management Association noting for example that "business rescue cannot happen without a cheque book".[226] However, the fact that creditors rank behind employees for payment of debt could act as a strong disincentive to provide the distressed company with a much-needed financial boost. This could be exacerbated by the employee preferential claims remaining in force for subsequent liquidation proceedings should the business rescue fail, although they will be subject to the liquidation costs first being covered.[227]

2.8 Transfer of Business

A business purchaser is not obligated under common law to employ its workers.[228] However, the LRA protects employees in businesses transfer situations, stipulating that employees must be employed on the same terms and conditions by the new employer, and that wrongdoings committed by the old employer, such as unfair dismissals, are transferred to the new employer.[229] Section 197 complies with the European Union Business Transfers Directive,[230] which stipulates that in EU business transfers, all

[222] S 136(1)(a)(ii) of the Companies Act.
[223] S 7 of the Companies Act.
[224] S 1 of the LRA.
[225] S 25 of the Constitution. However, s 36(1) of the Constitution allows for limitation of constitutional rights if it is regarded as reasonable and justifiable.
[226] Van der Walt 11.
[227] S 135(4) of the Companies Act.
[228] Van Eck *et al* 919.
[229] S 197 and S 197A of the LRA.
[230] Transfers of Undertakings Directive 2001/23/EC, hereafter referred to as EU Directive.

employment contracts are transferred,[231] employees are protected from dismissal by both the old or new employer,[232] and employees are consulted about the impending transfer.[233]

2.9 Liquidation

Section 197A was added to the LRA in 2002, protecting employees in insolvent transfer situations, although certain provisions were relaxed in an effort to encourage buyers to purchase struggling businesses. Thus, whilst the employees still have the right to be transferred, section 197A followed Article 5 of the EU Directive, which holds that the Directive does not apply to transfers of insolvent businesses or analogous proceedings.[234] As such, South African employee claims for unpaid salary and unpaid leave do not transfer to the new employer.

Prior to 1 January 2003, all contracts of employment were automatically terminated upon the insolvency of an employer. However, with the 2003 amendment of section 38 of the Insolvency Act, employment contracts since then may be suspended for a period of forty five days without remuneration, during which the liquidator may opt to retrench the employees, subject to LRA requirements.[235] Alternatively, liquidators who do not wish to undertake the legal risks associated with dismissing employees will most likely allow the employment contracts to terminate automatically after the 45 day period runs out.[236] Notwithstanding the contractual suspension and termination provisions of section 38 of the Insolvency Act, Van Eck *et al* submit that inclusion of the wording "despite the Insolvency Act"[237] means that if the business is sold, the employment contracts will nonetheless revive and be transferred to the new employer, a situation that they describe as untenable.[238] In any event, with continuation of paid employment given greater certainty under the business rescue provisions of the Companies Act, I would submit that

[231] Art 3(1) of the EU Directive.
[232] Art 4 of the EU Directive.
[233] Art 7 of the EU Directive.
[234] Art 5(1) of the EU Directive.
[235] Whilst the liquidator is not required to pay the suspended employees, the employees may claim unemployment benefits up to a maximum of 34 weeks from the Unemployment Insurance Fund, in terms of S 13(3) of the Unemployment Insurance Act 63 of 2001.
[236] Van Eck & Boraine 277.
[237] S 197A(2) of the LRA.
[238] Van Eck *et al* 921.

employees would once again prefer to find themselves in a business rescue process compared to a liquidation process.

Instruments such as International Labour Organisation[239] Convention number 173[240] regulate employee claims against insolvent employers, whilst also recognizing the importance of rehabilitating insolvent enterprises and safeguarding employment.[241] South Africa has not ratified the Convention, and its insolvency provisions thus do not provide for independent guarantee institutions that pay arrear employee claims in place of the insolvent employer.[242] However, South Africa does nonetheless comply with Part II of the Convention, which grants employee protection in the form of a privilege, allowing them to be paid out for wage and entitlement claims from the insolvent employer's assets before non-privileged creditors.[243]

Employees are thus permitted to submit arrear salary claims when a company is liquidated as preferential creditors.[244] However, the claims are restricted by the legislation to a maximum period of three months, up to an amount of R12,000. The claim will be paid out after the higher-ranked secured creditors first receive payment on their claims, with the balance of any employee claim being able to be submitted as a lowest-ranking concurrent claim. Employees subject to company liquidations are also entitled to claim severance pay equal to at least one weeks remuneration for each completed year of continuous service with the employer.[245]

[239] Hereafter referred to as ILO.
[240] ILO Protection of Workers' Claims (Employer's Insolvency) Convention 173, 1992, hereafter referred to as ILO C 173.
[241] Preamble to ILO C 173.
[242] As provided for in Part III of ILO C 173.
[243] Art 6 of ILO C 173.
[244] S 98A of the Insolvency Act 24 of 1936.
[245] S 41(2) of the BCEA.

CHAPTER THREE

UNITED KINGDOM AND AUSTRALIA

3.1 United Kingdom

3.1.1 Introduction

Recognising the adverse societal consequences of too many UK companies failing which could otherwise be rehabilitated, the Cork Report[246] in 1982 advocated the introduction of a rescue culture for UK business. The report highlighted that

> "a concern for the livelihood and well-being of those dependent upon an enterprise which may well be the lifeblood of a whole town or even a region is a legitimate factor to which a modern law of insolvency must have regard. The chain reaction consequences upon any given failure can potentially be so disastrous to creditors, employees and the community that it must not be overlooked".[247]

[246] Report of the UK Insolvency Law Review Committee, hereafter referred to as the Cork Report.
[247] Paragraph 204 of the Cork Report.

As a result, the committee recommended the introduction of insolvency procedures aimed at providing an alternative to liquidation proceedings for financially ailing but economically viable companies.

3.1.2 Overview

The administration procedure followed as the main business rescue mechanism in the UK. It is outlined in Schedule B1 of the Insolvency Act 1986,[248] and was later updated by the Enterprise Act 2002.[249] In brief, the procedure allows for an independent administrator to attempt to rescue the business under protection of a temporary moratorium against claims by creditors.

The administrator of the company is required to perform his functions with the aim of rescuing the company as a going concern, achieving a better result for the company's creditors as a whole than would be likely if the company were wound up, or realising property in order to make a distribution to one or more secured or preferential creditors.[250] In short, the main purpose within the three requirements is to obtain the best result for the company's creditors as a group.[251] Loubser refers to the third UK requirement (of realising property in order to make a distribution) as "window-dressing to appease ordinary creditors",[252] and views it as significant that the legislation effectively excludes the interests of employees or shareholders who would benefit far more from a rescue of the company.[253]

3.1.3 Initiation of Process

The administration of a company begins when a qualified administrator[254] is appointed to take over the company affairs.[255] The administrator may be appointed by the company or

[248] Insolvency Act 1986.
[249] Enterprise Act 2002.
[250] Paragraph 3(1) of Schedule B1 to the Insolvency Act 1986 inserted by the Enterprise Act 2002, hereafter referred to as Schedule B1. The provisions are referred to as "paragraphs" and not "sections" as they are contained in a Schedule to the Insolvency Act 1986.
[251] Goode (2011) 391.
[252] Loubser LLD 184, footnote 141.
[253] Loubser LLD 183.
[254] Paragraph 6 of Schedule B1.

its directors without having to obtain an order of court,[256] by the holder of a floating charge (secured creditor),[257] or by an administration order of court.[258] An administration order may only be appointed on condition that the company is or is likely to become unable to pay its debts,[259] and the administration is reasonably likely to achieve the purpose of administration,[260] as set out in Paragraph 3 of Schedule B1. Employees are excluded from the ambit of these initiation provisions, and are also not required to be given notice of the application,[261] although announcement of the administrator's appointment must be published generally, and also communicated specifically to all known creditors, as soon as is reasonably practicable.[262]

3.1.4 Consequences of Process

The administrator acts as an officer of the court (whether or not he is appointed by the court),[263] and in taking over the running of the company, acts also as its agent.[264] He is given extensive power over the company, to the extent that any management power may not be exercised without his consent.[265] He is authorized to do anything necessary or expedient for the management of the affairs, business and property of the company,[266] including the power to remove and appoint directors.[267]

3.1.5 Moratorium

During the course of the administration proceedings, a moratorium on insolvency and other legal proceedings kicks in,[268] acting as a "circuit breaker that provides a breathing

[255] Paragraph 1(2)(b) of Schedule B1.
[256] Paragraph 22 of Schedule B1.
[257] Paragraph 14 of Schedule B1.
[258] Paragraph 10 of Schedule B1.
[259] Paragraph 27(2)(a) of Schedule B1 applies for company and director appointments, and Paragraph 11(a) of Schedule B1 applies for court appointments.
[260] Paragraph 11(b) of Schedule B1.
[261] Paragraph 12(2) of Schedule B1 sets out the list of parties to whom notice should be given.
[262] Paragraph 46 of Schedule B1.
[263] Paragraph 5 of Schedule B1.
[264] Paragraph 69 of Schedule B1.
[265] Paragraph 64(1) of Schedule B1.
[266] Paragraph 59(1) of Schedule B1.
[267] Paragraph 61(a)-(b) of Schedule B1.
[268] Paragraphs 42 and 43 of Schedule B1.

space whilst consideration is given to the prospect of saving the company".[269] In addition, Schedule B1 makes provision for an interim moratorium, protecting the company from creditor claims in the period before the administrator is appointed.[270] Creditors will be adversely impacted for a period of up to one year,[271] after which the administrator's appointment automatically comes to an end.[272] From an employee perspective, it has been held in the UK that the moratorium does not only cover civil court proceedings, but also quasi judicial proceedings, including employment law tribunals.[273]

3.1.6 Investigation Process

Notwithstanding the twelve month time-period, the administrator is required to get the ball rolling quickly, and is given eight weeks to investigate the company's affairs and to send a statement setting out his proposals for achieving the purpose of administration to the Registrar of Companies and all known creditors and members of the company.[274] The proposals are based partly on information received from officers of the company and employees in a statement of the affairs of the company.[275]

The administrator's statement sets out how he proposes to achieve the purpose of administration, and must be accompanied by an invitation to a creditors' meeting (initial creditors' meeting),[276] which must take place within a period of ten weeks after the date on which the company entered administration.[277] At the meeting, the creditors may establish a creditors' committee to protect their interests for purposes of liaison and provision of information from the administrator.[278]

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[269] Anderson 17.
[270] Paragraph 44 of Schedule B1.
[271] Although Paragraph 43 of Schedule B1 states that the administrator or court are entitled to provide relief.
[272] Paragraph 76 of Schedule B1 states that the administrator's term can be extended by the consent of creditors for up to six months or by court order for a specified period.
[273] *Carr v British International Helicopters Ltd* [1994] 2 B.C.L.C. 474, cited in Goode (2011) 436, footnote 328.
[274] Paragraph 49(4)-(5) of Schedule B1.
[275] Paragraph 47 of Schedule B1.
[276] Paragraph 51(1) of Schedule B1.
[277] Paragraph 51(2)(b) of Schedule B1.
[278] Paragraph 57 of Schedule B1.

The administrator's proposals may be approved by the creditors with or without modifications at the initial meeting,[279] with further meetings being called by the administrator if revised proposals need to be later approved.[280] An approved proposal requires support from a majority in value of creditors present and voting at the meeting,[281] leading to its implementation by the administrator if approved.[282] Failure to approve the administrator's proposals effectively ends the administration, with the court able to make any order it deems appropriate.[283]

Communication requirements with the plethora of creditors have been eased for administrators with the introduction in 2010 of a provision allowing use of a website for provision of information and documentation.[284] Similarly, use of technology is permissible for purposes of meeting attendance, allowing for meeting participation and voting remotely by use of technology.[285]

However, whilst consultation rights for creditors appear to have been strengthened by the 2010 changes, the administrator has significant powers to frustrate those rights. For example, he is only required to call additional creditor meetings beyond the initial meeting if requested by creditors with claims totalling at least ten percent of the company's debts, or if directed to do so by a court.[286]

In addition, he is not required to call an initial meeting at all if he believes that the company has sufficient assets to pay all the creditors in full, insufficient assets to make any distribution at all to unsecured creditors, or that the administration process will not result in the company being rescued or creditors achieving a better result.[287] Thus, for example, no meetings[288] will be held in situations of pre-packaged sales,[289] involving the

[279] Paragraph 53(1) of Schedule B1.
[280] Paragraph 54 of Schedule B1.
[281] Loubser LLD 211.
[282] Paragraph 68(1) of Schedule B1.
[283] Paragraph 55 of Schedule B1.
[284] S 246B of the Insolvency Act 1986.
[285] S 246A of the Insolvency Act 1986.
[286] Paragraph 56(1) of Schedule B1.
[287] Paragraph 52(1) of Schedule B1.
[288] Statement of Insolvency Practice 16 was issued by the Association of Business Recovery Professionals

sale of the business before appointment of the administrator, often in the form of a management buyout, which is then formalized immediately after the administrator's appointment.[290] Thus, the court held in *Re Transbus International Ltd*[291] that the effect of these provisions is that the administrator is entitled to exercise any statutory powers available, including the power to sell company assets, without first calling a creditors' meeting or applying for directions from the court.[292] Creditor involvement in the administration process has been further diluted by a number of subsequent court decisions holding that the financial imperatives of a successful pre-pack sale take precedence over creditor interaction with the administrator.[293] Whilst employees are thus unable to rely on creditor protections in these situations, they nonetheless have a number of significant employee based statutory protections at their disposal.

3.1.7 Employee Creditor Claims

In terms of the legislation, administrators are given a 14 day period in which to "adopt"[294] employee contracts,[295] after which employee wages, salaries and pension contributions[296] are payable as an administration expense on a "super priority" basis out of company assets. This "super-priority status" does not extend however, to payments in lieu of notice

(known as R3) in January 2008 to alleviate the concerns of creditors by requiring disclosure of information by administrators regarding the sale immediately after the pre-pack agreement has been entered into.

[289] Hereafter referred to as pre-packs. Pre-packs are not explicitly authorized by the legislation, but were first approved by the court in *DKLL Solicitors v HM Revenue and Customs* [2007] EWHC 2067.

[290] Goode (2011) 412.

[291] *Re Transbus International Ltd* [2004] 2 All ER 911.

[292] Wellard & Walton 3.

[293] See *DKLL Solicitors v HMRC* [2008] 1 BCLC 112; *Re Kayley Vending Limited* [2009] BCC 578 and *Re Hellas Telecommunications (Luxembourg) II SCA (in administration)* [2009] EWHC 3199 (Ch), [2010] BCC 295.

[294] Paragraph 99 of Schedule B1.

[295] Uncertainty as to the meaning of "adopt" was settled by the court in *Powdrill v Watson* [1995] 2 A.C. 394, which held that a contract of employment "is inevitably adopted if the administrator causes the company to continue the employment for more than 14 days after his employment." (at 450). The court further held that the administrator may not "cherry pick" terms of the contract, and must either adopt it in full, or not at all. The issue was further clarified by *Re Antal International Ltd* [2003] EWHC 1339 where the court held that termination of employment contracts by the administrators 16 days after the commencement of administration was valid, since they had only just become aware of their existence, and took immediate steps to terminate the contracts.

[296] Paragraph 99(6) of Schedule B1 states that wages and salaries include pay, holiday pay, sick pay and occupational pension contributions.

or protective awards under employment legislation.[297] If employee's contracts are not adopted, they can in theory claim unpaid wages as ordinary creditors. However, owing to the slim chance in practice of recovering anything, the legislature entitles these employees to claim for unpaid wages from the National Insurance Fund,[298] complying in the process with Part III of ILO Convention 173, which provides for independent guarantee institutions to pay arrear employee claims in place of the insolvent employer.

3.1.8 Transfer of Employment

Pre-pack sales differ from the situation where the administrator concludes a sale of the business after having already traded in administration for a period of time subsequent to the administrator's appointment. Employees in such a situation who suddenly find themselves doing the same work for a new employer are not left in the lurch, and are protected by the Transfer of Undertakings Regulations 2006.[299]

TUPE is the UK's implementation of the European Union Business Transfers Directive.[300] TUPE complies with the EU Directive, ensuring that not only must UK employee representatives be informed and consulted regarding the impending transfer,[301] but that employment contract rights transfer to the new employer with the same terms and conditions,[302] and that dismissals effected solely by virtue of the transfer are thus regarded as unfair.[303]

The UK authorities recognized that the TUPE regulations could make it more difficult to find buyers for struggling businesses,[304] and in order to help preserve jobs thus created a number of exceptions for insolvent companies, including allowing employers and employee representatives to agree on lawful changes to employment contracts.[305] In

[297] Goode (2011) 458.
[298] S 182 of the Employment Rights Act 1996.
[299] Transfer of Undertakings (Protection of Employment) Regulations 2006, hereafter referred to as TUPE.
[300] Transfers of Undertakings Directive 2001/23/EC, hereafter referred to as EU Directive.
[301] Regulation 13 of TUPE.
[302] Regulation 4(1) of TUPE.
[303] Regulation 7(1) of TUPE.
[304] Goode (2007) 53.
[305] Regulation 9 of TUPE.

addition, new employers are not held liable for some of the old company's employment-related debts, with the National Insurance Fund instead meeting the obligation to pay amounts such as redundancy pay, payment in lieu of notice, holiday pay and so on.[306] The new employer is however responsible for ensuring that pension benefits of the new employees are transferred.[307]

Whilst the EU Directive does not apply to transfers of insolvent businesses or analogous proceedings,[308] and the TUPE regulations similarly are not applicable in situations of insolvency proceedings or any analogous proceedings,[309] the UK Court of Appeal held in *Key2Law v De'Antiquis*[310] that administration proceedings do not constitute "analogous insolvency proceedings" under Regulation 8(7) of TUPE. As a result, the UK courts now take the view that Section 218(2) of the Employment Rights Act 1996[311] does not limit continuity of employment in business transfer situations with reference to TUPE, with dismissals thus being automatically unfair if connected with a transfer of employment.[312]

Pre-packs have been widely used in the UK,[313] and thus praised for maintaining significant levels of company activity and jobs. However, moves by foreign companies to re-register as UK companies shortly before entering pre-pack administration has led to the UK being labeled as the "bankruptcy brothel of the world",[314] and to sustained criticism that the procedure lacks transparency and is abused by company management and secured creditors. As a result, the UK Insolvency Service launched a review in July 2013 into the use of pre-pack administrations as part of broader moves by the UK government to improve levels of corporate transparency and of economic growth and

[306] Regulation 8 of TUPE.
[307] Regulation 10 of TUPE.
[308] Art 5(1) of the EU Directive.
[309] Regulation 8(7) of TUPE.
[310] *Key2Law v De'Antiquis & Anor* [2011] EWCA Civ 1567, overturning the ruling in *Oakland v Wellswood (Yorkshire) Ltd* UKEAT/0395/08.
[311] Dealing with continuity of employment in business transfer situations.
[312] See *OTG Ltd v Barke and others* [2011] IRLR 272; *Key2Law v De'Antiquis & Anor* [2011] EWCA Civ 1567; *Spaceright Europe Limited v Baillavoine & Anor* [2011] EWCA Civ 1565.
[313] The UK Insolvency Service, the government regulator of the UK insolvency profession, estimated in its 2011 report that 25 per cent of the 2808 companies that entered administration in 2011 used the pre-pack procedure - The Insolvency Service *Annual Report on the Operation of Statement of Insolvency Practice 16, January to December 2011*.
[314] Wellard & Walton 1.

employment.[315] The pre-packs review is expected to release its findings in early 2014, and highlights the fact that the law is not static, and that employee rights fit within a greater societal and legal paradigm.

3.1.9 Liquidation

When a company is placed into administration or liquidation, employees made redundant have preferential claims for wages and pensions[316] among creditors,[317] and if this is depleted from the remaining company assets, may then claim on a limited basis[318] from the National Insurance Fund.[319]

3.2 Australia

3.2.1 Introduction

Following the recommendations for UK insolvency law reform by the Cork Report in 1982, the Australians followed suit, instructing its Law Reform Commission in 1983 to investigate the country's insolvency laws. Completed in 1988, the Harmer Report[320] held that the insolvency procedures available at that time for struggling companies were too conservative, and needed to be replaced with a voluntary system allowing for effective debt restructuring and continuation of the company. It was argued that such a system would benefit all stakeholders, enabling "employees to remain in employment, preserve synergies represented by the existing business and benefit creditors (particularly unsecured creditors) by saving them from the inevitable poor returns consequent on a creditors' winding up".[321] The Report thus concluded that a

[315] The UK Department for Business Innovation and Skills under Secretary of State Vince Cable published a comprehensive Discussion Paper in July 2013 entitled "Transparency & Trust: Enhancing The Transparency of UK Company Ownership and Increasing Trust in UK Business," making numerous recommendations to government for reform of UK company law.
[316] S 386 of the Insolvency Act 1986.
[317] Employees rank behind only secured creditors and administration / liquidation expenses.
[318] The National Insurance Fund allows employee claims for wages for a maximum period of 8 weeks, with a limit of 450 Pounds per week; notice pay in the amount of 1 week per each completed year of service, up to a maximum of 12 weeks; and holiday pay up to 6 weeks. Unpaid maternity pay, paternity pay or sick pay can be claimed from separate government departments.
[319] S 166 of the Employment Rights Act 1996.
[320] Officially known as the Australian Law Reform Commission General Insolvency Inquiry (Report No. 45, 1988),, chaired by Mr Ron Harmer, hereafter referred to as the Harmer Report.
[321] Fridman 331.

> "a constructive approach to corporate insolvency requires the preservation, if practical and possible, of the property and business of the company in the brief period before creditors are in a position to make an informed decision. This assists in an orderly and beneficial administration whether creditors decide to wind the company up or accept a compromise. An ordered form of administration of the affairs of an insolvent person is at the centre of insolvency law — whether, in the case of an insolvent company, that law offers the prospect of a winding-up or continuation of the corporate business. This approach is similar to that taken by insolvency law inquiry bodies in many overseas countries, such as the United States of America, Canada, the United Kingdom and some of the European nations".[322]

3.2.2 Overview

As a result of these recommendations, voluntary administration was introduced in 1992 as an insolvency procedure initially in the Corporate Law Reform Act,[323] and incorporated later in Part 5.3A of the Australian Corporations Act,[324] along with the more traditional insolvency procedures of liquidation and receivership.[325] Similarly to the UK legislation, the Australian system of voluntary administration makes provision for an independent voluntary administrator to take control and investigate the affairs of financially distressed companies in an attempt to rescue them, with the protection of a moratorium in place against creditor legal actions.

The aim of voluntary administration is to prevent viable companies from being placed in liquidation, where the risk of insolvency would otherwise result in creditors moving to wind the company up.[326] The stated object of the procedure is to allow the business, property and affairs of an insolvent company to be administered in such a way that (either) maximises the chances of the company, or as much as possible of its business, continuing in existence; or if it is not possible for the company or its business to continue

[322] Paragraph 53 of the Harmer Report.
[323] Corporate Law Reform Act 210 of 1992.
[324] Corporations Act 50 of 2001.
[325] Receivership of a company usually occurs through contractual means, when a receiver is appointed by a secured creditor holding security over company assets to sell some or all of the assets to repay the secured debt. Receivership may also occur by means of a court order in terms of S 233(1)(h) of the Corporations Act, with Part 5.2 of the Act governing the conduct of receivers.
[326] Blazic 4.

in existence, (then) results in a better return for the company's creditors and members than would result from an immediate winding up of the company.[327]

Whilst preservation of employment was mentioned by the Harmer Report, it was not incorporated within the final objects section of the legislation.[328] The objects clause is central to the philosophy of corporate rescue, and has been used by the Australian courts to interpret related issues in Part 5.3A of the Act.[329] Although corporate rescue is the preferred goal of the legislation, the court accepted in *Dallinger v Halcha Holdings*[330] that achievement of a better return for creditors would be an acceptable application of Part 5.3A.

Australian corporate rescue administration has been primarily "designed as a court-free insolvency procedure",[331] set up around the interests of creditors, with the court stating in *Hagenvale v Depela*[332] that "the intention was, as has been indicated in several cases, to provide a more expeditious and less expensive way of assisting those creditors and members than under the greater formality of a winding-up or of the entry into a scheme of arrangement".[333]

The procedure is effectively "a halfway house between solvency and insolvency, (giving) a company limited protection from creditors and the tools to try and trade its way out of trouble".[334] If the administrator is unable to negotiate a compromise with the company's creditors, the process transitions automatically to liquidation.[335] However, if the administrator's attempts are successful, the arrangement is recorded in a deed of company arrangement, defined by the Australian Securities & Investments

[327] S 435A of the Corporations Act 50 of 2001.
[328] Symes (2012) 2.
[329] See *Australasian Memory v Brien* (2000) 200 CLR 270 and *Kalon v Sydney Land Corp* [No 2] (1998) 26 ACSR 593, cited in Anderson 6.
[330] *Dallinger v Halcha Holdings* (1996) 14 ACLC 263.
[331] O'Flynn & Mainsbridge 3.
[332] *Hagenvale Pty Ltd v Depela Pty Ltd* (1995) 13 ACLC 885.
[333] At 890.
[334] Gettler 2.
[335] S 446A of the Corporations Act 50 of 2001.

Commission[336] as "a binding arrangement between a company and its creditors governing how the company's affairs will be dealt with, which may be agreed to as a result of the company entering voluntary administration".[337]

3.2.3 Initiation of Process

The administration of a company begins when a qualified[338] administrator is appointed to take over the company affairs.[339] The most common method of initiation is by the company itself, with the directors authorized to make the appointment if they believe that the company is insolvent or likely to become insolvent.[340] Less commonly, the administrator may be appointed by a liquidator,[341] or a secured creditor.[342]

No other parties, including employees, may initiate the procedure, and employee representatives are not required to approve the initiation of voluntary administration proceedings.[343] However, the lack of provision for others to make a court application in this regard is argued as being based on the "recognition that court based systems as adopted in jurisdictions such as the United States often led to delays and costly litigation that resulted in even smaller dividends for creditors".[344]

3.2.4 Consequences of Process

The administrator is given a series of wide-ranging powers over the company, including the power to control and manage the company's business, property and affairs.[345] The administrator acts as the company's agent,[346] and company officers may not exercise any of their usual powers except with the administrator's written approval.[347] Directors are

[336] Hereafter referred to as ASIC.
[337] ASIC Information Sheet 41 3.
[338] S 448B of the Corporations Act 50 of 2001.
[339] S 435C(1)(a) of the Corporations Act 50 of 2001.
[340] S 436A(1) of the Corporations Act 50 of 2001.
[341] S 436B of the Corporations Act 50 of 2001.
[342] S 436C of the Corporations Act 50 of 2001.
[343] Symes (2012) 8.
[344] Anderson 9.
[345] S 437A(1) of the Corporations Act 50 of 2001.
[346] S 437B of the Corporations Act 50 of 2001.
[347] S 437C of the Corporations Act 50 of 2001.

required to assist the administrator as reasonably required, including handing over all books and company information.[348]

3.2.5 Moratorium

A moratorium against creditor claims saves the administrator from incurring any unnecessary costs and time delays during the investigation process, providing the company with much-needed breathing space during the process.[349] Thus, amongst other provisions, the moratorium prevents the company from being wound up,[350] prohibits owners or lessors from recovering property that is in the possession of the company,[351] bars proceedings from being commenced or proceeded with against the company,[352] and prevents attempts to enforce court judgments.[353] The severity of the moratorium is mitigated however, by the short duration of the administration process, along with the fact that the administrator or court is entitled to provide relief.[354]

3.2.6 Investigation Process

Notwithstanding the moratorium, the Fair Work Commission[355] ruled in late 2012 that the moratorium against legal proceedings does not extend to its jurisdiction, and that an unfair dismissal matter against a company in voluntary administration could proceed.[356] Employees do not receive specific protection, but are entitled to participate in the process as creditors themselves of the company, for unpaid salary and entitlements.[357] Blazic asserts that this creditor participation "is not only important in ensuring fairness and confidence in the corporate rehabilitation system, but is also concerned with the rescue procedure ensuring justice is seen to be done".[358]

[348] S 438B of the Corporations Act 50 of 2001.
[349] The moratorium is subject to a number of exceptions listed in the Act.
[350] S 440A of the Corporations Act 50 of 2001.
[351] S 440B of the Corporations Act 50 of 2001.
[352] S 440D of the Corporations Act 50 of 2001.
[353] S 440F of the Corporations Act 50 of 2001.
[354] S 440B of the Corporations Act 50 of 2001.
[355] The Fair Work Commission (FWC), formerly known as Fair Work Australia, is the Australian industrial relations tribunal created by the Fair Work Act 2009.
[356] Fletcher *et al* 1.
[357] ASIC Information Sheet 74 1.
[358] Blazic 7.

Creditors generally are required to be kept informed during the course of the process, and the administrator is obliged to thus call a first meeting of creditors by written notice within eight business days of his appointment.[359] The creditors are entitled to form a committee of creditors to consult and liaise with the administrator about matters relating to the administration; and to consider reports received from the administrator. The committee is not authorized to give directions to the administrator, except as a reasonable request for information regarding the administration.[360] The employees will thus be entitled to receive information and notification about the process along with the other creditors, including having representation on the creditors committee.

The primary function of the administrator is to investigate the company's affairs and make recommendation to the creditors on whether to accept one of three options, namely whether to end the voluntary administration and return the company to its directors, wind up the company and appoint a liquidator, or enter a deed of company arrangement[361] in terms of the voluntary administration process.[362] The administrator is required thereafter[363] to call a second meeting of creditors to decide on the company's future.[364]

Employees are entitled to attend and vote at the meeting as creditors,[365] with one of the three options being adopted if it receives the support of a majority in both number and value at the meeting.[366] Sellars writes that the DOCA "is really what the voluntary administration scheme is all about – the rest of it is all about how to get to this point, and ensuring that it is reached quickly".[367] Thus, if the company has a fighting chance of survival, the DOCA will generally be adopted at the creditors meeting,[368] and will be binding on all unsecured creditors, even if they voted against the DOCA, and on all

[359] S 436E of the Corporations Act 50 of 2001.
[360] S 436F of the Corporations Act 50 of 2001.
[361] Hereafter referred to as a DOCA.
[362] S 438A of the Corporations Act 50 of 2001.
[363] In terms of S 439A(5) of the Corporations Act 50 of 2001, the investigation process is required to be completed within 20 business days, or 25 business days if over the Easter or Christmas period.
[364] S 439A of the Corporations Act 50 of 2001.
[365] *Brash Holdings Ltd v Katile (Pty)Ltd* (1994) 12 ACLC 472.
[366] Regulation 5.6.19–5.6.21 of the Australian Corporations Regulations 2001.
[367] Australian Treasury 6.
[368] S 444B of the Corporations Act 50 of 2001 states that the company must sign the DOCA within 15 business days of the creditors' meeting, failing which the company automatically goes into liquidation.

secured creditors if they voted in favour of it.[369] This provision was confirmed by the High Court of Australia in *Lehman Brothers Holdings Inc v City of Swan.*[370] The DOCA takes the company out of voluntary administration, and the relationship between the company and its unsecured creditors is then governed by the terms of the DOCA.[371]

3.2.7 Employee Creditor Claims

If the voluntary administrator continues to trade the business, he must pay out of the available assets ongoing wages for services provided and other employee entitlements that arise after the date of their appointment. These payments are treated as an expense of the voluntary administration.[372] Employees don't automatically lose their jobs when a business goes into voluntary administration. However, the administrator can effectively dismiss employees,[373] and thus, unless the voluntary administrator adopts the employment contracts or enters into new contracts of employment with the employees, they are not personally liable for any employee entitlements that arise during the voluntary administration.[374]

The DOCA sets out how the company's affairs will be dealt with going forward, including to what extent the company will be released from its debt obligations, and the nature and duration of any moratorium period.[375] Employee creditor claims must be treated with the same priority as in a liquidation, unless they agree by a majority in both number and value to vary the priority treatment.[376] Thus, unless varied by the employees, the Corporations Act gives a "distribution priority upon insolvency",[377] with the DOCA required to reflect employee claims prior to the administration as being payable in priority to other unsecured creditors,[378] and the employees, with the exception of

[369] S 444D(1)-(2) of the Corporations Act 50 of 2001.
[370] *Lehman Brothers Holdings Inc v City of Swan* [2010] HCA 11
[371] Harris 146.
[372] ASIC Information Sheet 75 2.
[373] *Green v Giljohann* (1995) 17 ACSR 518.
[374] *Green v Giljohann* (1995) 17 ACSR 518.
[375] S 444A(4) of the Corporations Act 50 of 2001.
[376] S 444DA(1)-(2) of the Corporations Act 50 of 2001.
[377] Symes (2003) 134.
[378] S 556(1)(e)(i) of the Corporations Act 50 of 2001.

directors, being paid immediately after the administration costs are settled.[379] Employee claims after the administration commences are payable by the administrator as an expense out of the company assets.

In addition, Australian directors have a statutory duty to not do anything with the intention of blocking or reducing the recovery of employee entitlements,[380] and may be held liable for the recovery of such amounts to the employees.[381] This provision was inserted to block directors from a practice in the 1990's of transferring employees to newly established labour broking companies, and then later liquidating it or appointing administrators in order to "free themselves of the demands of a unionized workforce and the obligations of paying their entitlements".[382]

3.2.8 Transfer of Employment

Employees who are employed to do similar work on similar terms and conditions at a new employer by virtue of the business being transferred are not entitled to claim payment in lieu of notice and redundancy pay entitlements under the FEG scheme.[383] However, more important from an employee perspective is that they receive statutory protection for employee entitlements and employment terms and conditions from the Fair Work Act[384] for business transfers.[385] Thus, in *Svitzer Australia v Maritime Union of Australia, The Northern New South Wales Branch*,[386] the court held that the new employer assumes all employee-related obligations of the old employer in transfer situations.[387]

[379] S 556(1A) of the Corporations Act 50 of 2001 limits priority claims of employee directors to $2,000.
[380] S 596AB of the Corporations Act 50 of 2001.
[381] S 596AC of the Corporations Act 50 of 2001.
[382] Symes (2003) 142.
[383] S 16(2) of the Fair Entitlements Guarantee Act 159 of 2012, hereafter referred to as the FEG Act.
[384] Fair Work Act 28 of 2009.
[385] Part 2-8 of the Fair Work Act.
[386] *Svitzer Australia Pty Ltd v Maritime Union of Australia, The Northern New South Wales Branch* [2011] FWAFB 7947.
[387] The court held further that transferring employees are not made redundant, and thus are not entitled to redundancy pay.

3.2.9 Liquidation

If the company fails to fulfill its obligations under the DOCA, or the creditors opt for liquidation at the second meeting, the company will then be placed into liquidation.[388] The court order for liquidation serves as a notice of dismissal for all employees,[389] although the liquidator can continue employing and paying the employees for a period of time. Employee claims will be treated in the same manner as discussed above, enjoying a statutory priority for payment. Employees unable to recover outstanding amounts from the liquidator are then entitled to claim amounts for various entitlements[390] under the government-funded, statutory Fair Entitlements Guarantee (FEG) scheme.[391] The FEG Act does not offer unlimited claim opportunities however, restricting for example, unpaid wage claims up to 13 weeks, with a maximum possible weekly wage of $2,451.[392] Nonetheless, it affords Australian employees important financial protection, complying similarly to the UK with Part III of ILO Convention 173.[393]

[388] S 446A(1) of the Corporations Act 50 of 2001.
[389] *Re General Rolling Stock Co* (1886) 1 Eq 346.
[390] The entitlements cover wages, annual leave, long service leave, payment in lieu of notice, and redundancy pay.
[391] Established under the FEG Act, replacing the General Employee Entitlements and Redundancy Scheme (GEERS), which continues to operate for claims arising before 5 December 2012.
[392] S 5 of the FEG Act.
[393] Part III of ILO Convention 173 provides for independent guarantee institutions to pay arrear employee claims in place of the insolvent employer.

CHAPTER FOUR

COMPARATIVE ASSESSMENT

4.1 Introduction

Globalisation of business has led to increased harmonization of international trading law, including in the areas of company law and insolvency law.[394] Effective corporate legal systems are crucial for the stability of financial and investment environments,[395] with insolvency systems giving certainty to market participants through the creation of efficient mechanisms for liquidating financially unviable businesses, and rehabilitating those that have potential to be rescued.

The United Nations[396] has played a crucial role in ensuring the alignment of national insolvency systems with international standards, with instruments such as International Labour Organisation[397] Convention number 173[398] recognising the importance of

[394] Stein 4.
[395] USAID 9.
[396] Hereafter referred to as UN.
[397] Hereafter referred to as ILO.
[398] ILO Protection of Workers' Claims (Employer's Insolvency) Convention 173, 1992, hereafter referred to as ILO C173.

rehabilitating insolvent enterprises and safeguarding employment.[399] Similarly, the UN Commission on International Trade Law[400] commissioned a comprehensive study on insolvency law in 1999. Published in 2005, the *Legislative Guide on Insolvency Law* has the stated aim of encouraging "the adoption of effective national corporate insolvency regimes",[401] including corporate rescue as an alternative to liquidation.[402]

4.2 Similarities between South Africa, UK and Australia

The end result of these moves towards international alignment has been the achievement of virtually identical characteristics in the corporate rescue legislation of the three countries surveyed. The South African, UK and Australian corporate rescue procedures all aim to preserve company value through maximizing the likelihood of it continuing to operate on a solvent basis, or if not possible, achieving a better return for its creditors or shareholders. In addition, all three systems make provision for an independent rescue practitioner to assume control of an investigation and supervision process over the company for a limited period of time, under the protection of a temporary moratorium in place against creditor claims, with the aim of implementing a plan to rescue the business. In situations of the employees being transferred to a new business, they receive protection with regard to continuation of their contractual terms and conditions.

4.3 Differences between South Africa, UK and Australia

If the employees are retrenched, or the company is liquidated, they receive various financial benefits in each of the three countries. However, the lack of an independent guarantee institution to pay arrear employee claims in place of the insolvent employer[403] places South African employees at a significant disadvantage compared to their UK and Australian counterparts in situations of job losses.

[399] Preamble to ILO C 173.
[400] A subsidiary body of the UN General Assembly, hereafter referred to as UNCITRAL.
[401] UNCITRAL iii.
[402] UNCITRAL 11.
[403] As provided for in Part III of ILO C 173.

South African employees are accorded significantly more rights in a business rescue situation compared to company liquidations.[404] The lack of a financial cushion to provide a softer landing when losing a job, coupled with the country's high unemployment rate, has thus led to concern that the business rescue process is open to considerable abuse, especially as a result of the substantial pecuniary benefit for employees to be gained by employees in the business rescue procedure compared to liquidation.[405]

The concern is based squarely on the notable difference in the level of employee rights and protections within the South African business rescue legislation compared to the UK and Australia. In contrast to their counterparts, South African employees and trade unions are entitled not only to formally initiate the business rescue proceedings, but are also given extensive rights to receive information and participate in the investigation process with the business rescue practitioner. Further, their employment contracts are required to be maintained during the rescue process, and they are also given a preferential claim for their salaries before other post commencement creditors.

4.3.1 Too Many Rights for South African Employees?

Cassim writes that the merits of a proper business rescue regime are no longer open to doubt, with the interests of various stakeholders, including employees, needing to be taken into account.[406] However, the basis of worker rights in South Africa contained in section 23 of the Constitution granting everyone the right to fair labour practices is nonetheless an unusual constitutional right, not found in other constitutions other than Malawi.[407] In addition, the Constitutional Court held in *NEHAWU v University of Cape Town & others*[408] that "everyone" includes not just employees, but also employers.

As such, in discussing whether the Companies Act succeeds in finding a suitable balance between employee rights and resuscitation of the company, Joubert *et al* ponder whether

[404] Employee contracts are suspended in a liquidation process, but maintained in a business rescue process, whilst in transfers of insolvent businesses, new employers are not held jointly liable with the old employer for any wrongdoings committed, such as unfair dismissals of employees.
[405] Loubser LLD 80.
[406] Cassim 458.
[407] Van Niekerk *et al* 36.
[408] *NEHAWU v University of Cape Town & others* (2003) 24 ILJ 95 (CC).

the legislation "has not gone too far in (its) quest to protect the interests of employees".[409] Loubser takes the view that employee rights within the business rescue process are "excessive, (with) no equivalent in any other comparable system",[410] and in a situation of competing rights of employees, employers and also creditors, the issue thus is to what extent they can and need to be balanced against each other.[411]

Van Eck *et al* point out further that the right to fair labour practices may be in conflict with other important insolvency law rights, such as the right of creditors to be treated equally, and the rights of secured creditors.[412] A number of key areas are examined and summed up in the following section, with the South African courts likely to have to decide in the future to what extent the various rights should be limited and balanced in terms of section 36 of the Constitution.

4.3.2 Recommendations for Improvement in SA Business Rescue Legislation

4.3.2.1 Initiation

With UK and Australian employees not afforded the right to initiate the rescue procedure, critics argue that South African employee rights need to be limited in the business rescue process. In assessing the issue, Loubser recognises that the involvement of the trade union movement in national government makes a legislative amendment removing the right of trade unions to apply unlikely. However, she argues that as a minimum, the right of individual employees to apply should be removed.[413] In addition, she recommends making it more difficult for a business rescue application to be initiated by amending the grounds upon which a court may grant the order.[414]

With regard to non-payment of employment related matters as grounds for a business rescue order,[415] Cassim describes it as "unduly harsh, with an element of overkill",[416]

[409] Joubert *et a*l 83.
[410] Loubser (2010-1) 509.
[411] Van Niekerk *et al* 10.
[412] Van Eck *et al* 902.
[413] Loubser LLD 337.
[414] S 131(4)(a) of the Companies Act.
[415] S 131(4)(a)(ii) of the Companies Act.
[416] Cassim 468.

with Loubser suggesting amendment of the Companies Act to indicate a period of at least three months of non-payment by the employer, "to avoid a company being placed under supervision as a result of missing one payment, accidentally or through no fault of its own".[417] She also submits that the ground of granting an order for "just and equitable" reasons[418] should be scrapped "because it is vague, unclear and will almost certainly lead to interpretational problems".[419]

Furthermore, she contends that trade union rights to initiate the proceedings should be curtailed, with right of access to company financial statements[420] limited as a result of the significant opportunity for abuse and the consequent risk to company reputation presented by this provision. She recommends that this risk should "at the very least be counterbalanced by a section providing that the court may issue an order for payment of damages to the company against an applicant for business rescue who abuses the procedure, or whose application is found to be malicious or vexatious".[421] She recommends further that the risk could be lessened by the amendment of section 31(3) to stipulate that only published financial company statements need to be supplied, or that only one request can be made in respect of a specific company per year.[422]

In spite of all the potential for abuse cited with regard to initiation of business rescue matters, I agree with Cassim's words of caution that a business rescue court application will ultimately not succeed if it is not brought in good faith, involves an abuse of process, or is lacking in merit.[423] In this light, a reasonable prospect must exist of rescuing the company, and the court in *Swart v Beagles Run Investments*[424] thus did not grant a business rescue application on the grounds that it constituted an abuse of process by the company to not pay its creditors, with no real prospect of financial rehabilitation.

[417] Loubser LLD 338.
[418] S 131(4)(a)(iii) of the Companies Act.
[419] Loubser LLD 338.
[420] S 31(3) of the Companies Act.
[421] Loubser LLD 55.
[422] Loubser LLD 337.
[423] Cassim 468, citing *Southern Palace Investments v Midnight Storm Investments* 2012 (2) SA 423 (WCC).
[424] *Swart v Beagles Run Investments 25 (Pty) Ltd and Others* 2011 (5) SA 422 (GNP).

4.3.2.2 Notification During Investigation Process

In assessing the plethora of notification requirements, Loubser proposes amendment of section 129 of the Companies Act by streamlining the plethora of procedural notification requirements to affected persons, through requiring only one notice after initiation of the rescue procedure informing affected persons of the resolution, and simultaneously giving notice to creditors and employees of their respective meetings.[425] I agree with her call for adoption of the recently streamlined UK practice of website usage for complying with notification requirements, instead of the current South African requirement to notify each affected person individually.[426] Similarly, in one of Australia's largest administrations, involving 16,000 employees, the court[427] consented to the employees being advised of meetings through notices in the national newspapers and via a website.[428]

4.3.2.3 Retention of Employment

Whilst the requirement to maintain South African employment contracts is welcomed by employees, Joubert *et al* raise the concern that the inflexibility of the provisions may ultimately not end up working in their favour. Although employee protection is important in business rescue provisions, they submit that insufficient emphasis is placed on the primary objective of actually saving the company, which ultimately "is in the best interests of employees, shareholders, creditors, and society at large".[429] COSATU counters the need for flexibility, submitting to the portfolio committee on trade and industry in Parliament in 2008 on the Companies Bill that a company emphasis on profit margins is ultimately to the detriment of socio-economic issues.[430]

Whilst the COSATU approach has merit, I would suggest that the hard-nosed reality facing employees in struggling companies is that a situation of some workers losing their jobs is preferable to all workers becoming unemployed. As noted earlier in this study, the requirement to maintain employment contracts constrains practitioners from cutting

[425] Loubser LLD 341.
[426] Loubser LLD 169.
[427] *In the matter of Ansett Australia Limited and Mentha* [2002] FCA 2.
[428] Symes (2012) 16.
[429] Joubert *et al* 83.
[430] Portfolio Committee 1.

company overheads as soon as possible, and is contrasted with the situation prevailing in the larger economies of the UK and Australia, where the rescue practitioners are given a discretion whether to adopt the employment contracts or not. As a result, I agree with the suggestion of Joubert *et al* that "more creative thought should have gone into providing some suppleness in respect of the substantive and procedural requirements that have to be met in terms of the LRA, and that go hand in hand with the reduction and/or restructuring of the workforce".[431]

4.3.2.4 Preferential Claim

As discussed in Chapter 2, the preferential claim given to South African employees for their salaries owing from after the commencement of the rescue proceedings has been criticized on the basis that it could deter financial institutions from making credit available to distressed companies, along with the fact that the employee preferential claims remaining in force for subsequent liquidation proceedings should the business rescue fail.[432]

Whilst UK and Australian employees enjoy similar preferential treatment, the difference lies in the foreign rescue practitioners being given flexibility with regard to the size of the workforce going forward, with the result that they are not unnecessarily burdened with an inflated wage bill in attempting to rescue the company. Sloan cautions further that a company "pregnant with employee entitlement obligations is a very unfavorable take-over target in a restructuring".[433] Similarly, the Federal Court of Australia has raised the concern that employee entitlements could prejudice the rehabilitation of struggling companies, leading to the disadvantage of all creditors, including employees.[434]

In addition, Symes warns that whilst entitlements make Australian employees "more important than ever before in corporate insolvency",[435] it is very difficult in practice to prosecute directors for deliberately blocking employee entitlements. A case in point is the

[431] Joubert *et al* 84.
[432] Although they will be subject to the liquidation costs first being covered.
[433] Sloan 10.
[434] *Fitzgerald; Re Advance Healthcare Group Ltd (admin apptd)* (2008) 68 ACSR 349.
[435] Symes (2003) 145.

Patrick Stevedores matter,[436] in which the High Court was not prepared to order the administrator, in one of Australia's biggest industrial relations disputes, to retain employees whilst the administration order was in place, in spite of the fact that it held the dismissal of 1400 employees from a labour broking company under voluntary administration to be in violation of the Workplace Relations Act of 1996.

Symes's warnings apply equally importantly for UK and South African employees. The *Patrick Stevedores* matter portrays the tension and inter-connection inherent in corporate rescue systems between insolvency law, company law and labour law, reflecting "the critical question whether corporate law would be cognitively open to the ethics of labour law or would remain normatively closed".[437]

4.3.2.5 Independent Guarantee Institution

Although the Insolvency Act makes provision for the establishment of an independent guarantee institution to pay arrear employee claims in place of the insolvent employer,[438] in line with Part III of ILO Convention 173, no scheme or fund has been set up yet in South Africa. Whilst COSATU[439] has called for the creation of such a fund to protect employees of companies that go into liquidation,[440] the provision is criticized on the basis of adverse South African economic realities, with the issue as to who would ultimately bear the cost of such a fund.

Van Eck *et al* submit that too high a price tag for government or employers alone could undermine the constitutionality of the fund, suggesting that a resulting situation of creditors having to accept a reduced dividend could lead to a constitutional challenge, on the basis of creditors' right to equality[441] being infringed by employees receiving differential treatment.[442] Such differentiation can of course be upheld in terms of the

[436] *Patrick Stevedores Operations No 2 Pty Ltd v Maritime Union of Australia* (1998) 195 CLR 1.
[437] Spender 52.
[438] S 98A(6)(b) of the Insolvency Act.
[439] The Congress of South African Trade Unions is the largest trade union federation in South Africa.
[440] COSATU Special Congress 1999.
[441] S 9 of the Constitution.
[442] Van Eck *et al* 919.

Constitution if it is regarded as reasonable and justifiable,[443] and it will be interesting to see if the government finally moves forward with proposals for broad insolvency law reform,[444] including the incorporation and implementation of a guarantee fund as in the UK and Australia. Such reforms, urges Calitz, will not only need "to be compatible and harmonious with international best practice in the field of law, but also incorporate the legal, economic and social context of a contemporary South Africa".[445] An important consideration to bear in mind is that implementation of a guarantee fund could possibly offset employee compromises in the areas of initiation of rescue applications and increased flexibility with regard to retention of employment during the rescue process.

4.3.2.6 Alternative Dispute Resolution

In attempting to balance the competing interests of employees, employers and creditors, dispute resolution institutions have a crucial role to play.[446] Recognising the need to make the rescue procedure cheaper and more accessible, and to eliminate recourse to overworked formal court processes as much as possible, a 2010 United States Agency for International Development[447] report on South African insolvency systems[448] recommended bypassing of the formal court structures through adoption of speedy and informal dispute resolution systems, such as the establishment of an accredited ADR[449] agency for business rescue matters.[450] In agreeing with this proposal, I would add that it is backed up by King III[451] and the Companies Act,[452] and is in line further with the mediation and arbitration provisions found within the South African labour dispute-resolution arena.

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[443] S 36(1) of the Constitution.
[444] The South African Law Reform Commission published a draft Insolvency Bill in 2000, and the Department of Justice completed an unofficial draft Insolvency and Business Recovery Bill in 2010.
[445] Calitz 306.
[446] Van Niekerk *et al* 10.
[447] A United States government agency responsible for administering civilian foreign aid and facilitating technical cooperation between countries, hereafter referred to as USAID.
[448] USAID Southern Africa *Insolvency Systems In South Africa: Strengthening The Regulatory Framework* (2010).
[449] Alternative Dispute Resolution.
[450] USAID 33.
[451] King III Principle 8.6.
[452] S 166 of the Companies Act.

4.3.3 Court Decisions

Whilst courts are not able to amend legislation, the manner in which they interpret existing provisions can have a vital impact on society. The UK and Australian corporate rescue legislation by and large excludes the interests of employees, other than making provision for protection of employee benefits. Whilst their legislation thus views the continuation of corporate economic activity as being more important than individual jobs, the courts have managed nonetheless to offer protection to employees in situations of transfers of employment contracts,[453] although also showing deference overall to the primary goal of corporate rescue over employee interests.[454]

It is still early days for court involvement in business rescue matters in South Africa, with Kgomo J noting in *Redpath Mining South Africa v Marsden*[455] that

> "there is still in my considered view, quite a long way before the organised profession completely musters all the nitty-gritties, explores all the nooks and crevices of the new Companies Act and lays or casts a well-travelled path that would engender and ensure consistency and sure-footedness in the implementation and interpretation of this new baby".[456]

Nonetheless, the Supreme Court of Appeal recently managed to settle a number of conflicting judgments in the *Oakdene* matter,[457] on the issue of what constitutes a reasonable prospect of rescuing the company. While the judgment significantly enhances the prospects of business rescue applications succeeding, a body of contentious issues arising out of the Companies Act remains to be resolved, including the conflicting decisions[458] in the past few months on the issue of what constitutes a binding offer to purchase the voting interests of persons who opposed the rescue plan.

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[453] *Key2Law v De'Antiquis & Anor* [2011] EWCA Civ 1567, and *Svitzer Australia Pty Ltd v Maritime Union of Australia, The Northern New South Wales Branch* [2011] FWAFB 7947.
[454] *Patrick Stevedores Operations No 2 Pty Ltd v Maritime Union of Australia* (1998) 195 CLR 1.
[455] *Redpath Mining South Africa (Pty) Ltd v Marsden NO*, Gauteng High Court Johannesburg Case No: 18486/2013 14 June 2013.
[456] At paragraph 40 of *Redpath Mining South Africa v Marsden*.
[457] *Oakdene Square Properties v Farm Bothasfontein (Kyalami)* (609/2012) [2013] ZASCA 68.
[458] *African Bank Corporation of Botswana Limited v Kariba Furniture Manufacturers (Pty) Ltd* 2013 (6) SA 471 (GNP) and *DH Brothers Industries (Pty) Ltd vs Karl Johannes Gribnitz N.O. and Dowmont Snacks (Pty) Limited* 2014 (1) SA 103 (KZP).

4.4 Conclusion

Writing in 1993, Wedderburn declared that UK employee interests "find little solace in our company law".[459] Things have changed from that traditional approach since then in the UK and around the world, impacted by shifting societal attitudes around issues of fairness and ethics, along with changes in jurisprudential thinking around stakeholder involvement in labour, corporate and insolvency law issues. It is within this context that employee rights have evolved to varying degrees in international business rescue systems, and are not in themselves a controversial topic any longer, having been incorporated within a range of international instruments and national legislative measures, including in the UK and Australia.

Similarly, it is not the existence of employee rights within the South African business rescue regime that is seen as problematic by some, but rather the extent of these rights, with Van Niekerk *et al* citing a 2006 World Bank study that employment rates in OECD countries with flexible labour laws are 2 to 2.5 percentage points higher.[460] A similar conclusion was reached again by the World Bank in 2010, with its report citing a study among 95 economies indicating that "more dynamic formal business creation occurs in economies that provide entrepreneurs with a stable legal and regulatory regime, …and more flexible employment regulations".[461]

Business rescue plays itself out in a context of tension between the competing interests of employees, employers and creditors. In contrast to the UK and Australian corporate rescue systems, South Africa's business rescue legislation accords its employees significant rights and protections. Whilst employee rights are a crucial aspect of inculcating fairness within our legal systems, I submit that the extent of the labour rights has the potential to undermine the successful rescue of the business, which ultimately would be to the detriment of socio-economic issues in this country. In this regard, employee ability to initiate the procedure has not in practice been embraced by the trade unions, and does not in my opinion add much value to the process of saving companies,

[459] Wedderburn 261.
[460] Van Niekerk *et al* 8.
[461] World Bank (2010) 24.

whilst holding significant potential for trade union abuse. In addition, particular legislative attention may need to be paid in the future to giving the rescue practitioner additional flexibility to cut costs by way of a streamlined retrenchment procedure. In order to balance things out fairly for employees, I would submit that greater usage of ADR processes would make the rescue procedure more accessible for employees, whilst future insolvency law reform should incorporate protection of arrear employee claims through an independent guarantee institution incorporating the business rescue process. The financing for such a project will of course be complex, but, in combination with the other suggested measures, would greatly enhance the viability of the rescue process

The fact that much dust remains to settle on the issues creates uncertainty in the short term for the corporate world. Nonetheless, short of employee rights being written out of the Companies Act, it will ultimately be up to the courts to provide clarity on the matters of competing rights arising out of the rescue process.

CHAPTER 5

CONCLUSION

In ancient Roman times, creditors were given the option of selling bankrupt debtors into slavery or cutting their body into pieces.[462] The law has fortunately evolved since then, developing to a point where legislative systems around the world attempt to keep debtor companies alive through corporate rescue systems. This study has assessed employee rights within the South African business rescue system by providing a comparative overview of the UK and Australian corporate rescue procedures, and making a number of recommendations for improved legislative provisions and practices.

The financial scandals worldwide over the past three decades have illustrated the need for a system of ethical corporate governance, leading in addition to a realization that the separation of corporate governance issues and labour law is not helpful to anyone.[463] Joubert *et al* comment in this vein that corporate rescue lies directly at the point of intersection between insolvency law, company law and labour law, clearly "giving rise to some interesting legal, social and moral questions".[464]

Whilst there is significant criticism of the extent of employee rights within the South African business rescue process compared to overseas jurisdictions, one needs to bear in mind that legal systems do not operate within a vacuum, and that employee protections have evolved in South Africa from a particular historical perspective. Professor Nathalie Martin writes that

> "insolvency systems profoundly reflect the legal, historical, political, and cultural context of the countries that have developed them. Thus, even countries that share a common legal tradition, such as the United States, England, Canada, and Australia, display marked differences in how they approach both business and personal bankruptcies".[465]

[462] Lamprecht 1.
[463] Mitchell *et al* 5.
[464] Joubert *et al* 66.
[465] Martin 4.

Model instruments such as the UNCITRAL *Legislative Guide on Insolvency Law* recognize that country approaches may vary with regard to application,[466] and South African employee rights within the business rescue process fit into this context. Based on principles of fairness in the Constitution, employee rights in both labour and company law legislation "endeavour to create a more equal balance between the strong and the weak",[467] founded ultimately on the recognition that the "common law contract of employment does not adequately regulate the unequal social and bargaining status between employers and employees".[468]

Whilst there is concern that the extent of employee rights may lead to abuse by employees and trade unions, this has not happened yet, and there is no guarantee that it will necessarily happen in the future. With the only case of employee-initiated business rescue occurring in the benign matter of *Solar Spectrum,*[469] it is still early days for the corporate rescue procedure in South Africa.

Insolvency figures compiled by Statistics South Africa reveal that liquidation levels are declining back to pre-recession levels before 2007.[470] The business rescue procedure has only been in operation since 1 May 2011, and has thus not greatly impacted the statistics yet, but it is hoped that it will further reduce the number of liquidations in the future, benefitting shareholders, creditors and employees alike, along with the rest of society.

Nonetheless, South Africa in the meantime has an alarmingly high unemployment rate,[471] with the OECD stating that "no progress toward income equality has been made since the end of apartheid".[472] Relying on South Africa's Gini coefficient of 0.70[473] as being

[466] UNCITRAL 10.
[467] Van Eck 408.
[468] Joubert *et a*l 66.
[469] *Employees of Solar Spectrum Trading v Afgri Operations* Case No 6418/2011 High Court Pretoria 8 May 2012 [37].
[470] Statistics South Africa Liquidations 6.
[471] Statistics South Africa Labour Force iv. The survey reported that South Africa's unemployment rate stood at 24.7% for the third quarter of 2013. The rate measures the number of people actively looking for a job as a percentage of the labour force, and excludes those who have given up looking, with the real rate of unemployment thus considerably higher.
[472] OECD (2013) 24.

"among the highest in the world",[474] the organisation maintains that the key solution lies in focusing on employment growth.[475] Whilst South Africa's National Development Plan agrees that the country urgently needs to move onto a new path of job-creating growth,[476] a 2013 World Bank report on South Africa indicates that the country has not created any changes in its labour laws over the past five years that had the effect of increasing labour market flexibility in order to assist entrepreneurial economic development.[477]

In spite of this, the big hope is that business rescue can play an important role in facilitating economic growth through preserving employment and alleviating inequality, with each rescued company ensuring that "creditors will receive payment, jobs will not be lost and the company will be able to pay taxes".[478]

The courts clearly have a significant role to play, with Nyman AJ commenting in *Cardinet v Wedgewood Golf and Country Estate*[479] that a successful business rescue contributes to job creation, complying in the process with "a primary objective of the Act of promoting economic development".[480] Nonetheless, they will also need to be cognizant of the need to not get in the way of strong economic growth in this country, with the decision in the matter of *African Bank Corporation of Botswana Limited v Kariba Furniture Manufacturers (Pty) Ltd*[481] not the best in this regard.

South Africa can learn much from the corporate rescue systems of developed countries such as the UK and Australia, which have been down historical paths which South Africa is yet to travel. However, South Africa as a developing country has different social and

[473] The Gini coefficient is a statistical measure of a country's income inequality, with a rating of zero illustrating maximum equality, and a rating of one indicating maximum inequality.
[474] OECD (2013) 24.
[475] OECD (2013) 27.
[476] National Development Plan 134.
[477] World Bank (2013) 99.
[478] Cassim 459.
[479] *Cardinet v Wedgewood Golf and Country Estate,* Case No: 19599/2012, Western Cape High Court.
[480] At 53.
[481] *African Bank Corporation of Botswana Limited v Kariba Furniture Manufacturers (Pty) Ltd* 2013 (6) SA 471 (GNP).

commercial conditions compared to that of the UK and Australia,[482] and an additional limiting factor is the fact that the business rescue procedure in South Africa only applies to the formal economic sector. Whilst this is not hugely significant for developed economies such as the UK and Australia, it is sobering, from a South African perspective, to take into account the statistic that up to 80% of economic activity in developing countries takes place in the informal sector.[483]

Employees are warned, as a result of these limiting factors, that the rights afforded to them "may regrettably boil down to very little in the face of financial realities".[484] However, it is important to bear in mind that South Africa has already come a long way politically, economically and socially in a relatively short period of time, with Liebenberg reminding us that "the Constitution and new laws have provided the government and society as a whole with a number of effective tools with which to meet the challenge ... to create a better life for all".[485]

South Africa's business rescue legislation contains positive and negative elements, but ultimately it presents itself as one of the tools to make a meaningful contribution to South Africa. In assessing employee-related business rescue issues as they come before it, the courts would do well to take into account the words of Nelson Mandela that

> "like slavery and apartheid, poverty is not natural. It is man-made and it can be overcome and eradicated by the actions of human beings. Overcoming poverty is not a gesture of charity. It is an act of justice. It is the protection of a fundamental human right, the right to dignity and a decent life. Sometimes it falls upon a generation to be great. You can be that great generation. Let your greatness blossom".[486]

[482] Anderson 1.
[483] World Bank (2010) 14.
[484] Van Eck *et al* 925.
[485] Liebenberg 43.
[486] Former State President of South Africa, Mr. Nelson Mandela, in an address on 3 February 2005 to 22,000 people in London's Trafalgar Square for the campaign to end poverty in the developing world.

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