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**CREDITORS' RIGHTS IN BUSINESS RESCUE  
PROCEEDINGS IN TERMS OF SOUTH AFRICA'S  
COMPANIES ACT 71 OF 2008**

**BY**

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**A thesis submitted in fulfilment of the academic requirements for the degree of Doctor  
of Philosophy in the School of Law,  
University of KwaZulu-Natal, Pietermaritzburg**

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August 2017**

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## **DEDICATION**

This work is dedicated to my Dad and Mum.

## ABSTRACT

The focus of this study is the protection of creditors' rights in South Africa's statutory business rescue regime provided for in Chapter 6 of the Companies Act 71 of 2008. In this analysis, three issues in particular are addressed in depth.

The first is the creditors' power to initiate the business rescue process. The second is the position of creditors between the commencement and the termination of the business rescue process. The third issue is to suggest (on the basis of experience drawn from reported case law and academic criticism of the current business rescue statutory provisions) an improved model that will more effectively safeguard creditors' rights in South Africa's business rescue regime.

In exploring these issues, I give a critical review of pertinent literature. With respect to the first issue, I conclude that the legislative provisions granting creditors the right to seek a court order initiating the business rescue process are open to criticism. By contrast, a resolution of the board of directors for the commencement of business rescue is a simpler route.

With regard to the second issue I conclude that the company's creditors have considerable influence in the business rescue process. Overall, the current statutory business rescue regime is intended to give a voice to all major stakeholders in the company's continued solvent existence. In the event of certain irresolvable disputes in the course of that process, the judiciary has the final say. A substantial number of judicial decisions have provided interpretations of the statutory provisions, and the trend has been to try to restore financial ailing companies to solvency and viability where there is a reasonable prospect for success in this regard.

In my conclusion, I propose a legislative model that seeks to strike an optimum balance between the competing and sometimes conflicting interests of the various interested parties and I suggest reforms directed at enhancing the protection of creditors' rights.

This thesis takes account of South African legislation and legislative amendments as at 31 December 2016 and of decisions of the South African courts up to and including those handed down during April 2017 and reported in the *saflii* on-line law reports. Since a substantial part of this thesis was written from outside South Africa, the author relied heavily on the *saflii* data

base of judgments of the South African courts, rather than on hard copy law reports which take time to reach their destination by post.

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## CHAPTER ONE INTRODUCTION

### 1.1 Background to the Study

South Africa's Companies Act 71 of 2008 (hereinafter the 2008 Act) came into force on 1 May 2011.<sup>1</sup> Chapter 6 of the Act introduced a statutory 'business rescue' regime as a means of restoring financially distressed companies to solvency and viability where there is a reasonable prospect of success in this regard. The statutory business rescue regime marked a significant evolution from the previous and now-repealed judicial management process.<sup>2</sup> In *Richter v Absa Bank Limited*,<sup>3</sup> the Supreme Court of Appeal gave a short history of South Africa's corporate rescue mechanism as follows:

“A review of the background to the introduction of the business rescue process into our law gives an insight as to the intention of the legislature in introducing the procedure. Our business rescue regime is adapted from similar concepts in other jurisdictions such as the United States and Great Britain. In South Africa it was introduced against the background of general acceptance that the judicial management process provided for under chapter XV of the 1973 Act was failing the local economy because only few, if any, judicial management orders resulted in the saving of companies experiencing financial difficulties.”

*Section 128 (1) (b)* of the 2008 Act now defines 'business rescue' as follows:

“Business rescue means proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for:

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<sup>1</sup> This legislation was driven inter alia by the need to overhaul South Africa's corporate law to bring it into harmony with certain global trends. This was articulated by the then Minister of Trade and Industries in the foreword to *South African Company Law for the 21<sup>st</sup> Century, Guideline for Corporate Law Reform*, GN 1183 GG 26493 of 23 June 2004 page 3, available at <http://www.gov.za/documents/download.php?f=169430> accessed in 1.06.2014

<sup>2</sup> The concept and objective of 'judicial management' was expressed thus in Section 427 of the Companies Act 61 of 1973:

“When any company by reason of mismanagement or for any other cause, is unable to pay its debts or is probably unable to meet its obligations; and has not become or is prevented from becoming a successful concern, and there is a reasonable probability that, if it is placed under judicial management, it will be enabled to pay its debts or to meet its obligations and become successful concern, the Court may, if it appears just and equitable, grant a judicial management order in respect of that company.”

<sup>3</sup> (20181/2014) [2015] ZASCA 100, para 13.

- (i) the temporary supervision of the company, and of the management of its affairs, business and property;
- (ii) a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and
- (iii) the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company."<sup>4</sup>

In addition to defining business rescue and laying down the process to be followed in an attempted rescue, the 2008 Act explicitly recognises and affirms the role of companies in providing economic and social benefits.<sup>5</sup> The legislation seeks to encourage the efficient rescue and recovery of financially distressed companies in a manner that balances the rights and interests of all relevant stakeholders.<sup>6</sup> The need for the equal treatment of “affected persons”<sup>7</sup> in the business rescue process is implicitly acknowledged, as is the need to recognise the rights of the company's creditors before and during the corporate rescue process.<sup>8</sup>

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<sup>4</sup> This definition is referred to and commented on in numerous judgments including *Industrial Development Corporation of SA Limited and Another v Schroeder NO and Others* (1958/2015) [2015] ZAECMHC 65 para 20; *Welman v Marcelle Props 193 CC and Another* (33958/2011) [2012] ZAGPJHC 32, para 11; *Griessel and Another v Lizemore and Others* (2015/24751) [2015] ZAGPJHC 189; [2015] 4 All SA 433 (GJ) para 75 n 77; *Ex parte: Target Shelf 284 CC; Commissioner, South African Revenue Service and Another v Cawood NO and Others* (21955/14; 34775/14) [2015] ZAGPPHC 740 para 26; *Absa Bank Limited v Caine NO and Another, In Re; Absa Bank Limited v Caine N.O. and Another* (3813/2013, 3915/2013) [2014] ZAFSHC 46, para 19; *AG Petzetakis International Holdings Ltd V Petzetakis Africa (Pty) Ltd And Others (Marley Pipe Systems (Pty) Ltd And Another Intervening)* 2012 (5) SA 515 (GSJ), para 10; *Redpath Mining South Africa (Pty) Ltd v Marsden NO and Others* (18486/2013) [2013] ZAGPJHC 148 para 43.

<sup>5</sup>Section 7 (d) of the 2008 Act.

<sup>6</sup>Section 7 (k) of the 2008 Act.

<sup>7</sup> Section 128 (1) (a) of the 2008 Act defines an “affected person” as:

- (i) a shareholder or creditor of the company;
- (ii) any registered trade union representing employees of the company; and
- (iii) if any of the employees of the company are not represented by a registered trade union, each of those employees or their respective representatives.

<sup>8</sup> The 2008 Act does not define the term ‘creditor’. But *Section 1* of the National Credit Act 34 of 2005 defines ‘creditor’, when used as a noun to mean:

- (a) a deferral of payment of money owed to a person, or a promise to defer such a payment; or
- (b) a promise to advance or pay money to or at the direction of another person;

Section 130 (1) (c) of the Companies Bill 2007 defined the term “creditor” to mean:

“a person to whom a company owes money under any arrangement immediately before the beginning of the company's business rescue proceedings, and for greater certainty, does not include a person who provides post-commencement finance to the company, as contemplated in section

In the South African statutory business rescue regime, two particular issues impact directly on the company's creditors. The first is the process for submitting their claims against the company and the second is the acceptance or rejection of those claims.<sup>9</sup> Submission of claims is in the hands of the creditor; acceptance or rejection is a decision for the business rescue practitioner or, in the event of a dispute, a court of law. If a creditor has an interest in any of the company's assets and wishes to dispose of or repossess the asset, an appropriate request must be made to the business rescue practitioner and, if the latter's decision is negative,<sup>10</sup> the creditor can apply to court for an order<sup>11</sup> affirming or rejecting the creditors' decision. If the business rescue practitioner or the court takes the view that sale or repossession of the assets by the creditor will jeopardise the prospects for the successful rescue of the company, then rejection is inevitable.

Creditors may suffer a significant loss if an attempt at business rescue fails to achieve its primary objective, namely, to restore a financially distressed company to viability or to achieve its secondary objective of securing a greater return for shareholders and creditors than would have been achieved by immediate liquidation. The failure of an attempted business rescue may leave the creditors in a worse financial position than before the process started.<sup>12</sup> Indeed, it has

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138, except to the extent that such a person was a creditor of the company before providing that post-commencement finance;"

However, this definition was omitted in the enacted version of the Companies Act 71 of 2008. The omission may have been because the definition was too narrow or because it failed to treat post-commencement financiers as creditors. The omission also implied that employees who had no prior claims against the company were not creditors of the company. Arguably, the legislation should have provided a different definition, given the importance of creditors in the process.

See further, Lundgren, K., 'Liability of a Creditor in a Control Relationship with its Debtor,' (1984), 67, Marq. L. Rev., 523 who defines 'creditor' to mean:

"Any person to whom a debt is owed, whether through a loan of money, sale of goods or otherwise and who, by virtue of the relationship, is in a position to exert control over the business affairs of a borrower"

<sup>9</sup> See Sections 133 and 134 of the 2008 Act. These two provisions deal with limiting of the enforcement of a creditor's claims; the court and the business rescue practitioner are given power to accept or reject the creditor's assertions.

<sup>10</sup>Section 133 (1) (a) of the 2008 Act. Section 134 (2) gives the business rescue practitioner the right to reject a request by a creditor to exercise a right against property after taking into consideration the purpose of Chapter 6 or the circumstances of the company or the nature of the property in question.

<sup>11</sup>Section 133 (1) (b) of the 2008 Act.

<sup>12</sup> In *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd and Others (GNP)* [2013] ZAGPPHC 259, para 46, in regard to the constitutionality of a binding offer proposed to the dissenting creditor, Kathree-Setiloane, J. stated:

"...Therefore, a party whose claim is taken over by a binding offer, contemplated in s 153(1)(b)(ii) of the Act, would be in no worse a situation than had the company been liquidated. In fact, in most circumstances such a person would be in a better situation than those creditors who go through the

been said that the business rescue process not only adds costs that are ultimately borne by creditors, but that the process lends itself to abuse on the part of directors and shareholders aimed at delaying, defeating or reducing the claims of creditors.<sup>13</sup> Internationally, business rescue processes tend to leave creditors more vulnerable than other participants in the process.<sup>14</sup>

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business rescue proceedings, *only to find that the company cannot be rehabilitated and is then liquidated, at which point the dividend payable to creditors is substantially less...*" [Emphasis supplied].

In these circumstances concurrent creditors may receive nothing after liquidation costs are paid; see section 135 (4) of the Act 2008.

<sup>13</sup>*Swart v Beagles Run Investments 25 (Pty) Ltd (Four Creditors Intervening)* 2011 (5) SA 422 (GNP) paras 27 and 42. In this case, it was held that the applicant for business rescue had intended to abuse the process for the purpose of preventing the sale of corporate assets and stalling the winding-up procedure that had already been initiated against the company. The shareholders had engaged in this malpractice knowing that the company had neither a reasonable prospect of being revived, nor an prospect of enhancing the creditors' returns on liquidation. In *Cohen v Newcity Group (Pty) Ltd and Another* [2012] ZAGPJHC 144, the business rescue resolution initiated by the board of directors was found to have had the intention of delaying the payment of creditors' claims rather than achieving either of the goals of the rescue process.

See further. Michael, 'The Insolvency Bill 2000: Rescue Culture in the new Millennium', (2000), 15 J. Int'l Banking L., 62; A.Loubser, 'The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions (Part 1)', (2010), 3 J. S. Afr. L., 505; and Delport, P., *Henochsberg on the Companies Act 71 of 2008* (2012) page 446.

<sup>14</sup>There is a debate as to whose interests the company's management should serve where the company has embarked on a financial restructuring process. At common law the managers of a company owe the company a duty of loyalty and care; see *Percival v Wright [1902] 2 Ch. 421 and Multinational Gas Petrochemical Services Ltd [1983] Ch. 258 and Brady v Brady (1987) 3 B.C.C. 535 (C.M.)*. It is clear that, where the company is solvent, the directors should act to maximize the shareholders' returns as they are, in economic terms, the owners of the company; see Cieri, R.M. and others, 'The Fiduciary Duties of Directors of Financially Troubled Companies,' (1994), 3 Journal of Bankruptcy Law and Practice, page 146 and *Ngurli v McCann (1953) 90 CLR 425, 238*. Other writers have put forward the contrary view that creditors' interests should be considered at all times during the company's operations, regardless of its solvency; see Keay, A., 'The Director's Duty to Take into Account the Interests of the Company Creditors: When is it Triggered?', (2001), 25, Melbourne University Law Review, pages 334-338; McConvill, J., *Directors' Duties Towards Creditors in Australia after Spies v The Queen (2002) 20 Company and Securities Law Journal, 4*; McConvill, J., 'Geneva Finance and the Duty of Directors to Creditors: Imperfect Obligation and other Imperfections' (2003) 11 Insolvency Law Journal 7; Davies, P., 'Directors' - Regarding Duties in Respect of Trading Decisions Taken in the Vicinity of Insolvency, (2006), 7, EBOR, page 301; and Adler, B., 'A Re-Examination of Near-Bankruptcy Investment Incentives' (1995), 62 U Ch Law Review, page 575. Other writers have proposed that the interests of creditors should come first where a company is in the process of business rescue or is undergoing any other insolvency procedures; see Asian Development Bank, *Insolvency Law Reforms in the Asian and Pacific Region: Report of the office of the General Counsel on TA 5795-Reg: Insolvency Law Reforms, Law and Policy Reform at the Asian Development Bank, 1, 2000, page 43*. To the same effect, see Keay, A., 'Formulating a Framework for Directors' Duties to Creditors: An Entity Maximisation Approach,' (2005), 64 (3), Cambridge Law Journal, pages 617-620; in Tomasic, R., 'Creditors Participation in Insolvency Proceedings-Towards the Adoption of International Standards,' (2006), 14, Insolvency Law Journal, page 179 it is argued that creditors' interests in a company during financial crisis surpasses the interests of other parties and that their interests should prevail. There is judicial precedent that favours the supremacy of the interests of creditors during the insolvency of a company; see for example *Liquidator of West Mercia Safetywear v Dodd (1988) 4 B.C.C. 30*; *Re MDA Investment Management Ltd [2004] 1 B.C.L.C. 217, 245*; *Kinsela v Russell Kinsela Pty Ltd. (1986) 4 A.C.L.C. 215*; *Gwyer v London Wharf (Limehouse) Ltd. [2003] 2 B.C.L.C. 153, 178*; *Re Pantone 485 Ltd. [2002] 1 B.C.L.C. 266, 285*. In United States of America, some decisions have taken the same approach as in *Geyer v Ingersoll Publications Co. 621 A 2d 784 (1992) (Delaware)*; see also *Jones v Gun [1997] 2 ILRM 245* in Ireland. In *The Bell Group Ltd. v Westpac Banking Corporation (No 9) [2008] WASC 239* and in *Walker v Wimborne (1976) 137 CLR 1* the Australian courts took the same view with regard to the creditors' interests during times of financial crisis.

Before a modern business rescue process became available under the 2008 Act, South Africa's companies legislation offered a far inferior process that went by the name of *judicial management*.<sup>15</sup> The latter process was characterised by the replacement of the company's board of directors by a court-appointed judicial manager; by contrast, in business rescue under the 2008 Act, the board remains in office, but must work with and under the business rescue practitioner.<sup>16</sup> The outcome of judicial management was seldom positive.<sup>17</sup> The legislation did not bar suppliers and other creditors from enforcing their claims against the company unless the court imposed a moratorium on such claims.<sup>18</sup> Consequently, judicial management did not create a substantive opportunity for the company to recover financially and resume operations on a solvent basis. In *Le Roux Hotel Management (Pty) Ltd v E Rand (Pty) Ltd* judicial management was described as a precursor to liquidation.<sup>19</sup> Judicial management can be described as a creditor-friendly regime. Another business rescue process that was available before the 2008 Act was a "scheme of arrangement" which could take the form of a compromise with creditors, an amalgamation, or a take-over.<sup>20</sup>

## 1.2 Outline of the Research Problem

A statutory corporate rescue process can be essentially pro-creditor or pro-debtor. The former focuses on protecting the defaulting company's creditors throughout the process from its commencement to its termination. The respective legislation of the United Kingdom and of Germany are pro-creditor corporate rescue regimes. By contrast, a pro-debtor regime emphasises the protection of the financially struggling debtor company at all stages of the rescue process. This is inevitably achieved by limiting the rights of the company's creditors. The 'Chapter 11' process in the United States of America (introduced by the Bankruptcy

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<sup>15</sup>First introduced in South Africa by the Companies Act 46 of 1926 and thereafter in terms of Sections 427-440 of the Companies Act 61 of 1973.

<sup>16</sup>Section 137 (2) (b) of the 2008 Act.

<sup>17</sup>A Smith, 'Corporate Administration: A Proposed Mode I', (1999) *De Jure* 80.

<sup>18</sup>Section 428 (2) of the Companies Act 61 of 1973 allowed the parties to apply for the leave of the court if they wished to enforce their claims during judicial management; see for example *Lief NO v Western Credit (Africa) (Pty) Ltd* 1966 (3) SA 344 (W); and *Transkei Development Corporation Ltd v Oshkosh Africa (Pty) Ltd* 1986 (1) SA 150 (C).

<sup>19</sup>[2001] 1 All SA 233 (C), this decision provides a summary of problems in relation to judicial management proceedings in South Africa.

<sup>20</sup>See Section 331 of the Companies Act 1973.

Reform Act of 1978) and the business rescue provisions of French legislation are notable examples of corporate legislation which aim at salvaging a debtor company.<sup>21</sup>

However, the USA and France are currently amending their corporate rescue procedures and have started moving toward a creditor-friendly model. By contrast, some creditor-friendly business rescue jurisdictions are now leaning toward a pro-debtor model that protects the struggling company. For instance, the UK, a prime example of a pro-creditor corporate rescue jurisdiction, has enacted the Enterprise Act 2002 which makes significant amendments to the existing Administration Rescue Procedure by allowing companies that are viable but are facing financial difficulties to be salvaged before any distribution to its creditors.<sup>22</sup> By contrast, the USA's Chapter 11, a federal law that governs corporate reorganisation, has been progressively amended and has become an avenue for the sale of a company as going concern or for the sale of the company's assets, as distinct from saving the company from liquidation.<sup>23</sup>

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<sup>21</sup> These two countries offer minimum creditor protection according to the index provided in R La Porta, F Lopez-de-Silanes and RW Vishny. 'Law and Finance,' (1998) 106(6) *Journal of Political Economy* 1113-1155; and as also observed by M Hunter 'The Nature and Functions of a Rescue Culture', (1999) *JBL* 498.

<sup>22</sup> Nevertheless this legislation has failed to completely protect debtors after the inception of 'pre-packaging administration,' also called a 'pre-packaged sale'; this refers to an arrangement under which the sale of all or part of a company's business or assets is negotiated with a purchaser prior to the appointment of an insolvency practitioner as administrator. This is discussed in M Haywood 'Pre-pack Administrations', (2010) 23 (2), *Insolv.Int.*, 17-22; B Xie 'Regulating Pre-package Administration-Complete Agenda', (2011) 5 *JBL* 513; also V Finch *Corporate Insolvency Law*, (2009) page 452 and L Qi 'The Rise of Pre-Packaged Corporate Rescue on both sides of the Atlantic', (2007) 20 (9) *Insolv. Int.* 129, 131 referred to a pre-packaging administration as a mixture of formal and informal corporate rescue procedure. The change from a pro-creditor to a pro-debtor regime is also evident in the Netherlands' Insolvency law.

<sup>23</sup> This is discussed in DG Baird and RK Rasmussen 'The End of Bankruptcy', (2002) 55 *S.L.R* pages 786-788. This form of procedure as practised in Chapter 11 has been referred to as 'pre-pack reorganisation'. The amendments to the Bankruptcy Abuse Prevention and Consumer Protection Act 2005 which aimed at restoring responsibility and integrity to the bankruptcy system in the USA by curbing fraudulent, abusive, and opportunistic bankruptcy claims, is credited with this change. The legislation has made significant changes to the operation of Chapter 11, especially as regards small companies, as is observed in H Miller 'Chapter 11 in Transition - From Boom to Bust and Into the Future', (2007) 81 *Am. Bankr. L.J.* pages 387-388. This is also the view taken in T Whitaker 'Congressional Changes to Business Bankruptcy', (2006) 54 *USAB* page 28, where it is said that:

"Some small businesses will be forced into a procedurally more expedited, but flexible, plan process with mandatory disclosure requirements and increased oversight by the U.S. Trustee. *Clearly, some debtors will have greater difficulty in achieving a successful reorganization*". [Emphasis added.]

R Levin and A Ranney-Marinelli 'The Creeping Repeal of Chapter 11: The Significant Business Provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005,' (2005) 79 *Am. Bankr. L.J.* page 603 emphasise that:

"In general, these changes reflect active lobbying by *certain creditor groups to improve their positions in bankruptcy cases, particularly in Chapter 11, vis-a-vis debtors and other creditors and Congressional reaction (or overreaction) to the recent Enron, WorldCom, Adelphia and other scandals. Ironically, the increased burden placed on reorganizing debtors in favour of particular groups of creditors will likely reduce overall recoveries for all creditors, including the favoured groups.*" [Emphasis supplied].

Consequently, the amendments has made Chapter 11 to be dominated by creditors and to be regarded as a creditor-friendly rescue regime, as was observed by DA Skeel 'Creditors` Ball: The `New` New Corporate

Franken (2004) proposes some features for a business rescue regime to be regarded as pro-creditor, namely:<sup>24</sup>

- “(i) There should be a replacement of the management with a court-appointed trustee or creditor’s appointed rescue practitioner;
- (ii) It should not provide for a complete stay of the creditors’ enforcement rights, and also, permit senior secured creditors to enforce their claims against the debtor’s assets; and
- (iii) Its applicable distributive rule is the absolute priority rule which implies that the distribution to creditors and shareholders does not follow the priority ranking outside of bankruptcy.”

Franken sets out the attributes of a jurisdiction’s corporate rescue legislation that will categorise it as a pro-debtor regime:<sup>25</sup>

- “(i) Leaving the management of the company in place as the debtor-in-possession;
- (ii) Providing for complete stay of the creditors’ enforcement rights; and
- (iii) Sharing of loss among the parties, which means that creditors and shareholders (company owners) are allowed to agree on a distribution that deviates from the priority ranking outside of bankruptcy.”

The protection given to creditors in a pro-debtor corporate rehabilitation regime is limited, compared to that offered in a pro-creditor regime.<sup>26</sup> The corporate rescue process of a particular

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Governance in Chapter 11’, Research Paper NO.3-19, Institute of Law and Economics, University of Pennsylvania, (2003), pages 1-44; and ST Bharath et al, ‘The Changing Nature of Chapter 11’, Working Paper, Ohio State University, (2008), pages 1-46.

<sup>24</sup> S Franken ‘Creditor- and Debtor-Oriented Corporate Bankruptcy Regimes Revisited’,(2004) 5(4) *European Business Organization Law Review*, page 652; to the same effect, see J Qian and PE Straha ‘How Laws and Institutions Shape Financial Contracts: The Case of Banks Loans’, (2007) 62 (6) *The Journal of Finance* page 2804, which determined whether a country has strong creditor protection; the following were regarded as relevant characteristics in this regard: the corporate rescue legislation should not provide for an automatic bar on creditors’ enforcing their rights; a debtor should seek consent from creditors before applying for the restructuring procedure; also, the management of a distressed company should be removed once the proceedings start; lastly the secured creditors should be given priority in the distribution of the assets.

<sup>25</sup> Franken ‘Creditor- and Debtor-Oriented Corporate Bankruptcy Regimes Revisited’,(2004) 5(4) *European Business Organization Law Review* page 653.

<sup>26</sup> The actual lending process is a private matter between two or more parties, but the statutory protection of their interests should not be overlooked; see The South Africa Department of Trade and Industries, ‘Making Credit Markets Work: A Policy Framework for Consumer Credit’, (2004), page 6, accessible at

jurisdiction cannot be categorised as either pro-debtor or pro-creditor only on the basis of statutory provisions.<sup>27</sup> Judicial decisions on corporate rescue in a particular jurisdiction are invaluable in determining the character of its business rescue regime. Moreover, the particular country's political, economic, historical and cultural character influences the nature of its corporate rescue regime, regardless of what its laws provide.

To determine the extent to which creditors' rights are protected in the South African business rescue regime, regard must be had to its pro-debtor and pro-creditor features. To this end, the present study analyses each stage of the business rescue proceedings. This study commences with an analysis of the rights of creditors at the initiation of the business rescue process, and then proceeds to examine the rights of creditors during the statutory moratorium on their claims against the company. Thereafter the process for appointing the rescue practitioner and the implications of the appointment are considered. The role and responsibilities of the company's management during the rescue period are critically examined, and a study is made of the overall influence of creditors in the attempted corporate rescue mechanism. The duties and responsibilities of rescue practitioners, particularly those that impact on the creditors' well-being are critically considered. Certain distinctive features of the business rescue process are critically evaluated, with particular regard for creditors' rights.<sup>28</sup>

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[http://www.ncr.org.za/documents/pages/background\\_documents/Credit%20Law%20Review.pdf](http://www.ncr.org.za/documents/pages/background_documents/Credit%20Law%20Review.pdf) , accessed on 11.05.2014. This policy document states as follows regarding the regulation of the credit industry:

"The credit market is not a risk-free arena. There is a considerable imbalance of power between consumers and credit providers, consumer education levels are frequently low, consumers are poorly informed about their rights and unable to enforce such rights through either negotiation or legal action."

South Africa's National Credit Act 31 of 2005 attempts to regulate the lending relationship between the credit provider and the consumer by promoting the social and economic welfare of the citizenry, promoting a fair, transparent, competitive, sustainable, responsible, efficient, effective and accessible credit market and protecting consumers. In *Sebola and Another v Standard Bank of South Africa Ltd and Another* [2012] ZACC 11; para 40 (which was a case involving the debtor and creditor relationship) the Supreme Court of Appeal expressed its interpretation of this legislation as follows:

"The statute sets out the means by which these purposes must be achieved, and it must be interpreted so as to give effect to them. The main objective is to protect consumers. But in doing so, the Act aims to secure a credit market that is 'competitive, sustainable, responsible [and] efficient'. And the means by which it seeks to do this embrace 'balancing the respective rights and responsibilities of credit providers and consumers'. These provisions signal strongly that the legislation must be interpreted without disregarding or minimising the interests of credit providers.... I...agree that 'whilst the main object of the Act is to protect consumers, the interests of creditors must also be safeguarded and should not be overlooked'". [Footnote omitted.]

This Act regulates the lending relationship prior to the commencement of a corporate restructuring process and aims at balancing and protecting the rights of these the parties.

<sup>27</sup> Franken 'Creditor- and Debtor-Oriented Corporate Bankruptcy Regimes Revisited', (2004) 5(4) *European Business Organization Law Review* page 672.

<sup>28</sup> The methodology adopted in this study is investigating the extent to which the South African corporate rescue legislation protects the rights of creditors has been influenced by the perspectives advanced in Franken 'Creditor- and Debtor-Oriented Corporate Bankruptcy Regimes Revisited', (2004) 5(4) *European Business*

Since modern legislation for business rescue is a new phenomenon in South Africa, and the judiciary has not yet authoritatively considered all its aspects, the position of creditors in the process, and issues of legislative interpretation in this regard are very important. In *Natal Joint Municipal Pension Fund v Endumeni Municipality*<sup>29</sup> the Supreme Court of Appeal said as follows in regard to the principles of statutory interpretation:

“Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production...A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document. . . . The inevitable point of departure is the language of the provision itself, read in context and having regard to the purpose of the provision and the background to the preparation and production of the document. [Footnotes omitted]”

This study puts forward an interpretation<sup>30</sup> which attempts to give effect to the objectives of the legislation<sup>31</sup> in harmony with those principles, and in which the language of the statutory

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*Organization Law Review*, pages 652 – 653 and by S Claessens, in LF Klapper ‘Bankruptcy Around the World: Explanations of its Relative Use,’ (2002), and in the World Bank Policy Research Working Paper 2865 Control and Corporate Rescue, page 2, accessible at <http://www.univie.ac.at/bwl/ieu/lehre/ss06/.../debtorinpossession.pdf> , accessed on 23.11.2013.

<sup>29</sup>[2012] ZASCA 13 para 18.

<sup>30</sup> The interpretation is in line with the decision in *Panamo Properties (Pty) & another v Nel & others NNO* [2015] ZASCA 76; 2015 (5) SA 63 (SCA) para 27 where the court was called on to determine whether procedural non-compliance with Section 129 (3) and (4) will result in the automatic termination of the business rescue proceedings.

<sup>31</sup> The proposed interpretation is in accord with the decision in *FirstRand Bank Ltd v KJ Foods CC (In business rescue)* (734/2015) [2015] ZASCA 50 where, in para 75, the Supreme Court of Appeal adopted such an interpretation. Section 5 (1) of the 2008 Act provides that in interpreting and applying the provisions of the Act account should be taken of the purposes set-out in Section 7, subsection (k) of which provides for the efficient rescue and recovery of financially distressed companies in a manner that balances the rights and interests of all relevant stakeholders. The Constitution Court has in numerous decisions declared that the constitution of South Africa requires a purposive approach to be applied in statutory interpretation, see *Du Toit v Minister for Safety and Security and Another* [2009] ZACC 22 paras 37 and 38, *Bertie van Zyl (Pty) Ltd and Another v Minister for Safety and Security and Others* [2009] ZACC 11 para 21; *African Christian Democratic Party v Electoral Commission and Others* [2006] ZACC 10 at paras 21, 25, 28 and *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Tourism and Others* [2004] ZACC 15 at para 91.

provisions is interpreted in accordance with commercial practice<sup>32</sup> and with appropriate regard to context.<sup>33</sup> This study also takes account of the history of and background materials in the interpretation of the business rescue provisions of the Act.<sup>34</sup> The Constitution<sup>35</sup> explicitly requires that the interpretation of legislation and the development of the common law and customary law must promote the spirit, purport and objects of the Bill of Rights.<sup>36</sup>

### 1.3 Rationale of the Study

In the business rescue process laid down in Chapter 6 of the Act, creditors are key players in any attempted rescue of a financially distressed company.<sup>37</sup> The following are particularly significant aspects of the structure of the legislative scheme:

- (i) A deliberate transition from the unsuccessful pro-creditor judicial management mechanism, to a significantly pro-debtor regime.<sup>38</sup> In *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd*<sup>39</sup> the court suggested that, as part of an application to enter the business rescue regime, the applicant should

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<sup>32</sup> In *Society of Lloyd's v Robinson* [1999] 1 All ER (Comm) 545, 551, an English court acknowledged the importance of contextual setting in interpreting commercial documents and held that the words should be construed as a reasonable commercial person would have done. This approach was later endorsed by the Justice Lord Clarke in *Rainy Sky SA and others v Kookmin Bank* [2011] UKSC 50 ([2012] Lloyds Rep 34 (SC)) para 21. In *Cool Ideas 1186 CC v Hubbard and Another* [2014] ZACC 16 at para 28 the Constitutional Court stated that giving the words of the legislation their ordinary grammatical meaning is a fundamental principle of statutory interpretation, unless doing so will lead to an illogical outcome. To the same effect, see *South African Airways (Pty) Ltd v Aviation Union of South Africa & others* 2011 (3) SA 148 (SCA) paras 25-30.

<sup>33</sup> See *Bato Star Fishing (Pty) Ltd v Minister of Environmental Affairs and Tourism and Others* [2004] ZACC 15 para 90..

<sup>34</sup> This includes Policy Documents, Parliament Bills and debates and Government-commissioned studies see De Waal, J. and Currie, I., *The Bill of Rights Handbook*, Juta Cape Town, (2013) 6<sup>th</sup> Edition, page 143.

<sup>35</sup> Section 1 (c) of the Constitution of the Republic of South Africa, 1996 affirms the supremacy of the Constitution and the rule of law. Section 2 states that the Constitution is the supreme law of the Republic, that law or conduct inconsistent with it is invalid and that the obligations imposed by it must be fulfilled. This provision must be read with Sections 7, 8 and 237.

<sup>36</sup>Section 39 (2) of the 1996 SA Constitution.

<sup>37</sup> See *Gormley v West City Precinct Properties (Pty) Ltd and Another; Anglo Irish Bank Corporation Limited v West City Precinct Properties (Pty) Ltd and Another* (19075/11, 15584/11) [2012] ZAWCHC 33 para 8. In this decision, the High Court stated that creditors have the major financial interest in the outcome of a proposed business rescue. Claessens and Klapper, 'Bankruptcy Around the World: Explanations of its Relative Use,' (2002), World Bank Policy Research Working Paper 2865 Control and Corporate Rescue, page 1, state as follows:

"This literature finds that greater investor protection encourages the development of capital markets and that *countries that better protect creditors have more developed credit markets*. Important aspects of the strength of creditor rights are the specific features of a country's insolvency regime and its enforcement." [Emphasis supplied]

It is trite that credit is the lifeblood of many businesses in the modern world; see the United Kingdom Report of the Review Committee on Insolvency Law and Practice, (the Cork Report) (1982) para 10.

<sup>38</sup> *Luthuli Power Corporation (Pty) Ltd v Transfix Transformers SA (Pty) Ltd* [2016] ZAFSHC 220 at para [32]; A Loubser 'Tilting at Windmills? The Quest for an Effective Corporate Rescue Procedure in South African Law,' (2013) 25 SA Merc LJ at 444.

<sup>39</sup>2012 (2) SA 423 (WCC).

provide a viable rescue plan showing that, if the attempted resuscitation of the company should fail, the creditors would not be worse off than if the company had been immediately liquidated;<sup>40</sup> this approach has an implicit pro-creditor bias. But in *Oakdene Square Properties (Pty) Ltd*<sup>41</sup> the Supreme Court of Appeal rejected this view and held that an applicant should not be required to provide a detailed rehabilitation plan in order to be granted a business rescue order; all that was necessary was to establish grounds for a reasonable prospect of achieving one of the two goals in s 128(1) (b); in short, a pro-debtor approach that lays a lesser burden on the company seeking to be permitted an attempt at business rescue. The latter interpretation sets a lower bar for an applicant than was required to secure an order for judicial management; but a lower bar in this regard makes it easier for a debtor company to use the process as a delaying tactic

Internationally, one view is that the successful corporate rescue regimes are those that favour the company's creditors.<sup>42</sup> Examples are administration in the UK under

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<sup>40</sup> The supremacy of creditors' interests was confirmed to have been compromised in *Absa Bank Ltd v Newcity Group (Pty) Ltd, Cohen v Newcity Group (Pty) Ltd* [2012] ZAGPJHC 144; para 31 where Sutherland J. said:

"In plain terms, it seems now to be incorrect to speak of an "entitlement" to a winding up order simply because the applicant is an unpaid creditor. The rights of creditors no longer have pride of place and have been levelled with those of shareholders, employees, and with the public interest too."

To similar effect, in *Koen v Wedgewood Village Golf & Country Estate (Pty) Ltd* 2012 (2) SA 378 (WCC) para 14, the High Court said that:

"It is clear that the legislature has recognised that the liquidation of companies more frequently than not occasions significant collateral damage, both economically and socially, with attendant destruction of wealth and livelihoods. It is obvious that it is in the public interest that the incidence of such adverse socio-economic consequences should be avoided where reasonably possible."

In discussing the operation of a Chapter 11 reorganisation, which bears some similarity to South Africa's business rescue legislation, MS Scarberry et al in *Business Reorganisation in Bankruptcy: Cases and Materials*, 2<sup>nd</sup>ed (2001) page 1 say :

"Chapter 11 of the federal Bankruptcy Code gives financially distressed businesses an opportunity to reorganize and avoid liquidation. Liquidation of a business's assets can be very costly to the persons directly involved and to society. Keeping the business in operation will often be much more desirable than liquidating it. The fundamental premise of chapter 11 of the Bankruptcy Code is that reorganization is desirable."

This approach is in line with the view expressed in R Jordan et al *Bankruptcy*, 5<sup>th</sup> Ed (1999) page 633: "Society is better off also when a firm that is worth more alive than dead is successfully rehabilitated."

<sup>41</sup> 2013 (4) SA 539 (SCA) at para 31.

<sup>42</sup> In *Richter v Absa Bank Limited* (20181/2014) [2015] ZASCA 100; para 13, the Supreme Court of Appeal observed that South African's business rescue process borrows some concepts from the United States of America and the United Kingdom. This was also noted by a member of the team engaged in advising on the reform of South Africa's company law; see T Mongalo 'An Overview of a Company Law Reform in South Africa: From the Guidelines to the Companies Act 2008,' 2010 *Act Juridica*, page 16. This article names the international reference team which included four experts from the USA, three from England and two from Australia and Canada. It is not surprising that some of the concepts that were adopted in the legislation were inspired by the corporate law systems of these countries.

Part II of the Insolvency Act 1986,<sup>43</sup> Debtor in Possession in Chapter 11 of the Bankruptcy Code of the United States of America<sup>44</sup> and Voluntary Administration in Part 5.3 A of Australia's Corporations Act 2001 are examples of flourishing pro-creditor corporate rescue regimes.

The contrary view is that corporate rescue regimes have a better rate of success where they are debtor-friendly, rather than creditor-friendly.<sup>45</sup> This view is rejected in the UNCITRAL Guide<sup>46</sup> in proposing the design of corporate reorganisation legislation.

- (ii) The wide statutory powers accorded to the business rescue practitioner<sup>47</sup> and to the courts,<sup>48</sup> respectively, and the impact of those powers on creditors' rights and creditors' voices.<sup>49</sup>

#### 1.4 Research Objectives and Key Questions

The central objective of this study is to analyse the protection of creditors in South Africa's business rescue process, as provided for in *Sections* 127-154 of the 2008 Act. This will involve a critical evaluation of the relevant provisions of the legislation and its judicial interpretation. Some international comparisons will be drawn to throw further light on this question.

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<sup>43</sup> Amended by the Enterprise Act 2002 and introduced as Schedule B1 in the Insolvency Act 1986.

<sup>44</sup> Although the American system appears, on paper, to be debtor-friendly, it has been argued that in practice it is a pro-creditor system.

<sup>45</sup> RW Harmer 'Comparison of Trends in National Law: The Pacific Rim,' (1997) 1 *Brooklyn Journal of International Law*, page 147.

<sup>46</sup> See United Nations Commission on International Trade Law: Legislative Guide on Insolvency Law (2005), page 15, footnote 3 which states that:

"While the rate of successful reorganizations varies considerably between those regimes classified as creditor-friendly, research appears to suggest that the assumption that creditor-friendly regimes lead to fewer or less successful reorganizations than debtor-friendly regimes is not necessarily true."

<sup>47</sup> Sections 132 (1) (a), 134 (1)(a) (ii), 134 (1)(c), 136 (2), 137, 140 (3) (1) (i), 142 (4), 143 (5), 145 (5), 149 (1) (a) and 153 (1) (ii) of the 2008 Act.

<sup>48</sup> Sections 129 (5) (b), 130, 131, 132 (2) (a) (3), 133 (1) (b) (2), 136 (2) (b) (2A) (b), 137 (1) (b) (5) (6), 139 (1) (a) (1), 140 (2) (3) (a), 141 (2) (a) (i) (ii) (b) (i) (3), 142 (3) (b), 143 (4), 145 (6), 150 (5), 153 (1) (a) (ii) (b) (i) (bb) (6) (7) of the 2008 Act.

<sup>49</sup> In developed commercial jurisdictions, the business rescue process involves what amounts to a consensus between the company and creditors, particularly secured creditors. This has led to what is known in the UK as 'pre-pack administration'. See in this regard M Haywood 'Pre-pack Administrations', (2010) 23 (2), *Inslv.Int.*, 17-22; B Xie 'Regulating Pre-package Administration-Complete Agenda', (2011) 5 *JBL* 513; V Finch *Corporate Insolvency Law*, (2009) page 452; and L Qi 'The Rise of Pre-Packaged Corporate Rescue on both sides of the Atlantic', (2007) 20 (9) *Inslv. Int.* 129, 131. As to packing reorganisation in the United States of America, see Baird, D.G. and Rasmussen, R.K., 'Control Rights, Priority Rights and the Conceptual Foundations of Corporate Reorganisations', (2001), 87, *V.L.R.*, page 941, and Baird, D.G. and Rasmussen, R.K., *The End of Bankruptcy*, (2002), 55, *S.L.R.*, page 786-788.

More specifically, this study seeks to:

- i. Determine the attitude of the court in relation to the initiation of business rescue proceedings in South Africa particularly since the enactment of the 2008 Act.
- ii. Explore the legal implication of the shift from the culture of liquidation (pro-creditor) to a rescue culture (pro-debtor) during the operation of South Africa's business rescue proceedings.
- iii. Suggest an optimal model for the protection of creditors' rights in South Africa's business rescue regime.

These specific objectives will involve addressing the following questions:

- i. What is the attitude of the court in relation to the initiation of business rescue proceedings in South Africa particularly since the enactment of the 2008 Act?
- ii. What is the legal implication of the shift from the culture of liquidation (pro-creditor) to a rescue culture (pro-debtor) during the operation of South Africa's business rescue proceedings?
- iii. What is the optimum model that can guarantee for a protection of creditors' rights in the South African business rescue procedure?

### **1.5 Research Methodology**

This has been entirely a desktop study. The research materials were drawn from both primary and secondary sources. The primary data sources include legislation, case law and international instruments. Secondary sources included journal articles, textbooks, commercially-oriented newspapers and magazines, Government reports, dissertations and theses.

Most of these materials were researched through the full text academic database system to which the University of KwaZulu-Natal (UKZN) subscribes. These include LexisNexis Butterworths (South Africa), Sabinet Legal, Hein online, Juta's Unreported Judgements, JSTOR, Netlaw South Africa legislation, Safflii, Westlaw and Google Scholar.

The research methodology included keyword searches inter alia of the following terms: business rescue in South Africa; judicial management; creditor protection; creditors under business rescue; creditors under judicial management; creditors; corporate rescue; creditor rights; creditors in South African company law and corporate rescue in South Africa.

I was able to identify a large volume of case law from the contents and footnotes of journal articles, textbooks, theses and dissertations, and the full text of the relevant cases was downloaded from a full text database system. The bibliographies of the aforementioned materials also provided extensive references to primary and secondary sources.

The law library of the University of KwaZulu-Natal (Pietermaritzburg Campus) was my major physical research base.

## **1.6 Structure of the Thesis**

### **Chapter 1**

This chapter sets out the scope of the study by articulating specific research issues. The background to the study as well as an outline of the research problem will now be discussed. A justification for the study is presented, the objectives of the study as well as the associated research questions are laid down. This chapter sets out the structure of the thesis and its division into six chapters.

### **Chapter 2**

Provides a comprehensive analysis of the concept of corporate rescue. This includes a critique of the underlying logic of the process in order to shed light on how the corporate rescue process can be used in an attempt to salvage a financially distressed company. Consideration is given to the influence of various interested parties in the process. Some alternative processes are discussed. The chapter concludes with a discussion of the historical evolution of corporate rescue in South Africa.

### **Chapter 3**

Examines the role of creditors in the initiation of business rescue proceedings in order to analyse the impact of the various commencement routes for business; vis-à-vis the rights of creditors and the role of creditors in the activation of the process. The competing objectives governing the initiation of business rescue proceedings are analysed in depth. The business rescue practitioner's powers and their impact on creditors are discussed.

### **Chapter 4**

Assesses the manner in which the statutory provisions involve the creditors in the business rescue process and discusses their responsibilities. An analysis is provided of the impact of a

business rescue plan on creditors' rights from the commencement of the process to its conclusion. The rights of creditors who dissent from the business rescue plan, as well as the rights of creditors in challenging the approved rescue plan and the legal provisions governing the principle of inappropriateness are critically analysed.

#### Chapter 5

Examines key issues in the business rescue process with particular regard to creditors' rights. The issues analysed include the statutory moratorium and its impact on creditors' rights and powers. The position of sureties and the impact of business rescue on suretyship agreements are analysed. The status of post-commencement financiers and their ranking for payment under business rescue proceedings are critically examined. The concept of a binding offer in the context of business rescue is discussed in the context of the protection of creditors' rights.

#### Chapter 6

Concludes the study with a summary of the research findings and offers answers to the central questions posed in the thesis. This chapter indicates the contribution of the study to knowledge and to the literature on this topic. Finally, the chapter proposes reforms to South Africa's business rescue legislation with a view to putting in place a more appropriate protection of creditors' rights.

## CHAPTER TWO

### DEVELOPMENT FRAMEWORK OF THE CORPORATE RESCUE MECHANISM

#### 2.1 Introduction

A significant number of countries have accorded great importance to corporate rescue in the reform of their companies' legislation, regulations and policies. The major impetus for reform is recognition that, from a macro and a micro-economic viewpoint, and from a societal point of view, the solvent survival of financially struggling companies is preferable to their liquidation.<sup>50</sup> This broad policy must however take account of the interests of a wide range of stakeholders.

This chapter provides an overview of corporate rescue and its underlying logic and objectives so as to shed light on the use of corporate rescue process in the attempted salvage of a financially distressed company and the influence of interested parties throughout the process. This chapter will also identify alternative approaches in this regard. Lastly, this chapter will discuss the evolution of corporate rescue legislation in South Africa to the present day.

#### 2.2 A History of Corporate Rescue

Historically, South Africa's companies legislation was based on and remains significantly influenced by English company law, but its current corporate rescue legislation has features that in some respects resemble a reorganisation under Chapter 11 in the USA. The historical outline provided in this chapter is in the main limited to South Africa and England..

In past eras, the failure to pay a debt when it fell due was considered to be an criminal infraction,<sup>51</sup> punishable in some jurisdictions with imprisonment.<sup>52</sup> A defaulting debtor was regarded as a thief and the failure to pay was categorised as a felony. England, for instance,

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<sup>50</sup> See *DH Brothers Industries (Pty) Ltd v Gribnitz NO and Others* (3878/2013) [2013] ZAKZPHC 56; para 1 where Gorven J said:

"Goods and services are the lifeblood of an economy. Business entities, in providing goods and services, generate this lifeblood. Regulatory provisions are geared to assist the lifeblood to flow as efficiently as possible. Companies are the main business entities which provide the goods and services in the South African economy".

<sup>51</sup> V Finch *Corporate Insolvency Law: Principles and Perspectives*, 2<sup>nd</sup> ed (2009) page 9.

<sup>52</sup> M Hunter 'The Nature and Functions of a Rescue Culture,' 1999 J.B.L., page 494. The Debtors Act 1869 in England provided for the imprisonment of defaulting debtors. The most severe legislative regime was the Napoleonic Commercial Code of 1807 which treated debtors as criminals, even if default was not fraudulent, and its focus was on the repayment of debt.

which was one of the first jurisdictions to enact insolvency legislation, used to imprison people who failed to pay their debts.<sup>53</sup> Insolvency laws were originally draconian, but started to ease around the beginning of the eighteenth century when the concept of rescue gained acceptance. In England, the industrial revolution resulted in a rapid growth of commerce, and lending and borrowing in the business world became the norm. Bankruptcy legislation enacted in 1825 to deal with insolvency matters gave priority to creditors' interests, and the legal protection afforded to creditors remains to this day a feature of current English corporate rescue legislation,<sup>54</sup> inter alia by allowing creditors a large measure of control of the rescue process.

Chapter 11 of the USA legislation, which has been very influential in the enactment or reform of various countries' corporate rescue legislation, originated in the crisis in that country's railroad sector in the 19<sup>th</sup> century.<sup>55</sup> Each creditor held a security interest in a certain segment of a railway line which, if sold alone, was worthless; hence, it was prudent for the creditors to act collectively to save the business rather than liquidate it.

The particular circumstance that inspired Chapter 11 is seldom relevant today,<sup>56</sup> but modern variants of such circumstances may well be. For example, a software application, invented and owned by an information technology corporation that is on the verge of financial failure could be worth more if sold to another company in the same line of business than if the software were to remain with its current, struggling owner. The selling company could then use the proceeds to pay creditors and then be wound up or, if there was a surplus after the sale, the company could continue with other aspects of its business.<sup>57</sup> In the modern era, the grouping of a company's creditors in order to sell its property is seldom necessary and this is one reason for the increased popularity of so-called "pre-packaging" by financially struggling companies, discussed later in this chapter.

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<sup>53</sup> Under the Bankruptcy Act 1542.

<sup>54</sup> Efforts to reform the United Kingdom corporate reorganisation legislation, such as amendments to the Insolvency Act of 1986 and the enactment of the Enterprise Act 2002 governing administration, receivership and company voluntary arrangement, encountered fierce opposition.

<sup>55</sup> This was called Federal equity consent receivership. See DG Baird and RK Rasmussen' *Boyd's Legacy and Blackstone's Ghost*, (1999) 393 Sup. Ct. Rev. pages 402–406 and D Skeel *Debt's Dominion: A History of Bankruptcy Law in America* (2001), pages 48-69.

<sup>56</sup> G McCormack 'Corporate Rescue Law in Singapore and the Appropriateness of Chapter 11 of the US Bankruptcy Code as a Model,' (2008) 20, SAclJ, page 398.

<sup>57</sup> See McCormack 'Corporate Rescue Law in Singapore and the Appropriateness of Chapter 11 of the US Bankruptcy Code as a Model,' (2008) 20 SAclJ, page 399.

In the history of the development of corporate rescue, the culture of the particular jurisdiction plays a significant role in its conception, form and implementation. In a country such as China, with its complex political, economic and social structure,<sup>58</sup> a debt could pass from generation to generation. This notion had its roots in Confucian theory.<sup>59</sup> On the basis of that model and the way of life of its people, the country did not have insolvency legislation, let alone rescue provisions.<sup>60</sup> The reluctance to enact insolvency legislation was also influenced by the form of ownership of the means of production in China prior to its economic reforms.<sup>61</sup> China is, therefore, a striking example of the role played by culture in a corporate rescue statute.

The literature indicates that, under influence of their particular legal systems, most countries in East Asia have been unenthusiastic about adopting any of the international models of insolvency legislation.<sup>62</sup> Instead, what occurs in that part of the world is mere debt rescheduling, with no impact on the mode of operation of the business entity.<sup>63</sup> Thus, even if a company recovers from financial distress, the probability of its collapsing in the future is high because the underlying structural causes have not been addressed. In particular, the management of the company, whose shortcomings are often responsible for its financial plight, remains unreformed.

The lesson to be learned is that, in devising corporate rescue legislation, a jurisdiction should take account of the country's unique culture, history and economic milieu.<sup>64</sup> Corporate rescue

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<sup>58</sup> J Fan and J Wang *Bankruptcy Law*. (2008), page 26.

<sup>59</sup> R Parry et al (eds) *China's New Enterprise Bankruptcy Law: Context, Interpretation and Application* (2010), page 4. Confucian theory deals with morality and values human beings above property; it is effectively a religion for its disciples.

<sup>60</sup> A Tang *Insolvency in Hong Kong, Hong Kong* (2005) para 1.07.

<sup>61</sup> Prior to the 21<sup>st</sup> century. China established itself as a socialist state; its market economy was a later development. During that earlier epoch the working class controlled the machinery of the government and bankruptcy involving the retrenchment of employees was unthinkable. H Zhang 'Long March towards an China and Entirely New Bankruptcy and Corporate Rescue Legal Framework in China,' (2012) 27 (4), *J.I.B.L.R.* page 167 observes that all the enterprises in China at that time were state owned and that winding up a distressed corporation would be tantamount to admitting that the state was insolvent.

<sup>62</sup> MJ Blazic 'In Search for Rescue Culture: A Review of the Australian Part 5.3A Legislation', (2010), SBS HDR Student Conference Paper 8, page 12 available at <http://ro.uow.edu.au/sbshdr/2010/papers/8> accessed on 11.05.2014.

<sup>63</sup> L Vassiliou 'The Restructuring Revolution in the Asia-Pacific Region,' (2006), *Restructuring and Insolvency Guide*, page 24.

<sup>64</sup> M Yang and X Li 'The History of Corporate Rescue in the UK,' (2012) 8 (13) *Asian Social Science*, page 23; H Rajak and J Henning, 'Business Rescue for South Africa', (1999) 116 *S. African L.J.* page 269.

legislation cannot be imposed in disregard of these influences.<sup>65</sup> It is, moreover, vital for the given jurisdiction to take account of the impact on business of the technological revolution that has swept the world. Failure to take cognisance of these factors will impact adversely on any attempt to introduce appropriate corporate rescue legislation.<sup>66</sup>

### 2.3 The Evolution of Corporate Rescue

In the past few decades, a corporate rescue culture has taken root in a number of jurisdictions across the world<sup>67</sup> often under influence of the Bankruptcy Reform Act of 1978 in the USA, incorporating the well-known Chapter 11.

South Africa is amongst the jurisdictions that began giving attention to the reform of its corporate rescue legislation around this time. Corporate rescue has become the subject of extensive academic debate.<sup>68</sup> Major issues in the scholarly literature are the question of what constitutes “rescue”, the mode of the attempted rescue operation, and how the interests of the affected parties should be protected.<sup>69</sup> Changes to corporate insolvency law have been influenced by advancements in technology, economic reforms, the prospering of the service sector in national economies, and the impact of globalisation.<sup>70</sup>

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<sup>65</sup> The attempt to do has been dubbed “parachuting”; N Martin ‘The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation’, (2005) 28 (1) *Int’l & Comp.L.Rev.* page 12.

<sup>66</sup> RW Harmer ‘Comparison of Trends in National Law: The Pacific Rim,’ (1997) 23 *BJIL* page 140.

<sup>67</sup> In South Africa, the Companies Act 71 of 2008, US Chapter 11, Australia (Part 5.3 ) German Insolvenzordnung, Belgium Concordat Judiciaire, Finnish Sanerauslaki, The UK Enterprise Act 2002, Netherlands (Act of November 24, 2004), Spain (Ley Concursal 22/2003), Italy (Decreto-legge 35/2005 and Legge 80/2005), France (Act of July 26, 2005). This trend reached the Asia-Pacific geographical region, see Blazic, M.J., In Search for Rescue Culture: A Review of the Australian Part 5.3A Legislation, (2010), SBS HDR Student Conference Paper 8 available at <http://ro.uow.edu.au/sbshdr/2010/papers/8> accessed on 27.04.2015

<sup>68</sup> Kloppers, P., ‘Judicial Management-A Corporate Rescue Mechanism in Need of Reform?’, (1999), 10 Stellenbosch LR, page 368, Rajak, H. and Henning, J., ‘Business Rescue for South Africa’, (1999), 116 S. African L.J. page 268 , Burdett, D.A., ‘The Introduction of a Truly Unified Insolvency Act: Ancillary Matters,’ PART 4 C, (2002), page 48-49, Keay, A., ‘To Unify or not to Unify Insolvency Legislation: International Experience and the Latest South African Proposal,’ (1999), De Jure 73-74

<sup>69</sup> Kloppers, P., ‘Judicial Management - A Corporate Rescue Mechanism in Need of Reform’, (2010) 10 Stellenbosch L. Rev. 423; Sandra, F., ‘In Search of a Rescue Regime: The Enterprise Act 2002,’ (2004), 67 (2) MLR page 248; Phillips, M. and Goldring, J., ‘Rescue and Reconstruction’, (2002), Insolvency Intelligence, London, HMSO, page 75 and 76; and Baird, G.D. and Rasmussen, R.K., ‘The End of Bankruptcy,’ (2002) 55, Stan L Rev, page 758.

<sup>70</sup> Graham, D.A., ‘A Dark and Neglected Subject: Landmarks in the Reform of English Insolvency Law,’ (2002), 11(2), Int. Insolv. Rev, page 119 and Baird, D. and Rasmussen, R., ‘Chapter 11 at Twilight,’ (2003), 56, SLR, page 102.

The burgeoning practice of attempted corporate rescue has impacted on the behaviour of other players. For instance, creditors usually no longer sit idly by when a company shows signs of increasing financial distress; but intervene at an early stage to try to protect their interests.<sup>71</sup> Early action gives creditors the option of injecting funds, before it is too late, to assist the company if they think it commercially wise to do so.<sup>72</sup>

The issue of funding in relation to a company showing signs of financial distress is often of paramount importance<sup>73</sup> and critical to its survival. It has been noted that the lack of funds to facilitate the revival of a financially distressed company often renders a corporate rescue attempt futile, and reduces it to mere academic theory.<sup>74</sup> Business rescue legislation invariably tries to encourage such funding.<sup>75</sup> The problem that struggling companies generally have inadequate security to offer potential lenders<sup>76</sup> is addressed by statutory provisions that facilitate and give special protection to post-commencement finance,<sup>77</sup> and this encourages interested parties to try to assist in salvaging the company, rather than simply scrambling to protect their interests in anticipation of liquidation.<sup>78</sup>

In the modern era, the monitoring of commercial debt by institutions such as credit insurance firms, debt collectors and credit management firms plays an important role in identifying financial distress before it becomes overwhelming. Banks<sup>79</sup> have specialised departments that monitor their debtors' financial and business affairs and can provide expert assistance. In short, banks and other financial institutions now embrace and contribute to a corporate rescue culture.

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<sup>71</sup> Finch, V., 'The Recasting of Insolvency Law,' (2008), 68 M.L.R., 713.

<sup>72</sup> But of course not without addressing managerial deficiency, fraud or corruption

<sup>73</sup> Martin, N., 'The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation,' (2005) 28 (1) Int'l & Comp .L. Rev., page 55 and R3's Ninth Survey (2001).

<sup>74</sup> Hunter, M., 'The Nature and Functions of a Rescue Culture,' (1999), J.B.L., page 512

<sup>75</sup> Section 128 (1) (f) (i) and (ii) of the 2008 Act defines "financially distressed".

<sup>76</sup> McKnight, A., 'The Reform of Corporate Insolvency Law in Great Britain-The Enterprise Bankruptcy Law,'(2002), 17(11), JIBL, page 328

<sup>77</sup> Post-commencement finance is accorded preference; see s 135 of the 2008 Act.

<sup>78</sup> In this regard *ex ante* approach yields better results than an *ex post* approach; Finch, V., 'Corporate Rescue in a World of Debt,'(2008), 8, JBL, page 758

<sup>79</sup> Wood, P.R., *Law and Practice of International Finance: Principles of International Insolvency*, 2nd Edition, Sweet and Maxwell, (2007); at page 7 it is noted that banks remain the primary source of loan finance in this context.

## 2.4 The Concept of Corporate Rescue

### 2.4.1 Corporate Rescue

There is now an extensive scholarly literature regarding a ‘rescue culture’<sup>80</sup> in relation to corporate entities, and there is evidence that a country’s legislature, judiciary, financial institutions and government departments all now recognise the importance of trying to salvage entities that are in financial distress, rather than making liquidation the knee-jerk response.

“It is a multi-aspect concept, having both a positive and protective role, and a corrective and a punitive role. On one level, it manifests itself by legislative and judicial policies, directed to the more benevolent treatment of insolvent persons, whether they be individuals or corporations, and at the same time to a more draconian treatment of true economic delinquents. On another level, it entails the adoption of a general rule for the construction of statutes, *which is deliberately inclined towards the giving of a positive and socially profitable meaning* (rather than a negative or socially destructive meaning), to the statutes of social-economic import. Of such statutes, insolvency legislation may justly be regarded as the paramount example.”<sup>81</sup>  
[Emphasis supplied]

It is now generally accepted that rescuing a corporate entity extends further than merely securing the survival of the company and should take account of the interests of other affected players. An influential inquiry into insolvency law and practice in England and Wales (culminating in the Cork Report) noted that:

“The business or commercial insolvent presents an entirely different picture. The failure of such an *insolvent* has wider repercussions, not only upon those intimately concerned with the conduct of the business, such as directors, shareholders and

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<sup>80</sup> V Finch *Corporate Insolvency Law: Principles and Perspectives*, 2<sup>nd</sup> ed (2009) page 245-251: R Parry ‘United Kingdom: Administrative Receivership and Administration’ in Broc, GK and Parry, R, (Editors) *Corporate Rescue: An Overview of Recent Development from Selected Countries in Europe*, Hague, Kluwer Law International, (2004) page 145; Harmer ‘Comparison of Trends in National Law: The Pacific Rim,’ (1973) 23 *BJIL* page 143-148; I Fletcher and G Squires ‘Nortel in the Court of Appeal - How Damaging is the Result to the Wider Interests of the Rescue Culture? Part 1,’ (2012) 25(5) *Insolv.Int.* page 78; Fletcher and Squires ‘Nortel in the Court of Appeal - How Damaging is the Result to the Wider Interests of the Rescue Culture Part 2,’ (2012) 25(6) *Insolv.Int.* page 93 and M Blazic ‘In Search of a Corporate Rescue Culture: A Review of the Australian Part 5.3A Legislation’ (2010) SBS HDR Student Conference Paper 8, page 6, available at <http://ro.uow.edu.au/sbshdr/2010/papers/8> accessed on 12.01.2013.

<sup>81</sup> Hunter ‘The Nature and Functions of a Rescue Culture,’ (1999) *J.B.L.* page 498.

employees, *but on other interests, such as suppliers*, etc. The effect of failure upon the realisable value of stock, plant and goodwill can be disastrous, and not infrequently there is a general feeling of desperation which needs to be resolved. A modern manifestation of this is a sit-in by *workers seeking by their physical presence to ensure that their jobs will not be lost, by having some new organisation to carry on the business.*”<sup>82</sup> [Emphasis supplied]

The Review Committee noted as follows the broader dimensions of rescuing a struggling company:

“We believe 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 consequent upon any given failure can potentially be so *disastrous to creditors, employees and the community that it must not be overlooked.*”<sup>83</sup> [Emphasis supplied]

These dimensions of corporate rescue are now generally acknowledged. The corollaries include the need to create a mechanism for corporate rescue in which creditors will be have a strong incentive to participate. As with other jurisdictions, South Africa recognises the broad economic and social benefits of restoring financially distressed companies to solvency and viability in a way that balances the rights and interests of a broad range of stakeholders.<sup>84</sup>

In South Africa, the successful rescue of a financially distressed company involves the company’s creditors, the business rescue practitioner and, potentially, the High Court.

#### **2.4.2 Operation of Corporate Rescue**

The attempted rescue of a financially distressed company can proceed formally (that is to say, in a process governed by legislation) or informally, where the process is initiated voluntarily

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<sup>82</sup> United Kingdom Report of the Review Committee on Insolvency Law and Practice, ‘Cork Report’, (1982) para 203.

<sup>83</sup> United Kingdom Report of the Review Committee on Insolvency Law and Practice, ‘Cork Report’, (1982) para 204.

<sup>84</sup> Section 7 (d) and (k) of the 2008 Act.

by the company and proceeds outside of any legislative framework. <sup>85</sup> An informal process, based on consensus, is generally regarded as preferable and, internationally, has achieved some notable successes.<sup>86</sup> In South Africa, the informal process is generally regarded as the norm<sup>87</sup> although, in the nature of things, no reliable statistics exist.

#### **2.4.2.1 Informal Corporate Rescue Procedure**

An informal business rescue can be effected entirely outside of a legislative regime by way of agreement between a company and its creditors.<sup>88</sup> The process may involve assistance from corporate rescue experts.<sup>89</sup> Such an informal process can involve a change in the company's management, the revision of credit arrangements, a scaling down of the company's operations, the injection of funds, or a combination of these.<sup>90</sup> An informal rescue tends to preserve a company's business reputation and avoids the stigma of a statutory rescue that ensues even where the rescue was successful.<sup>91</sup> An informal rescue avoids the delays and costs of legal proceedings.<sup>92</sup> An informal process is also very flexible.<sup>93</sup> Even a statutory business rescue regime should be flexible enough to accommodate informal negotiations between the affected parties.<sup>94</sup>

An attempted business rescue, whether formal or informal, carries no guarantee of success. Informal rescue is particularly susceptible to failure because the terms of the rescue plan require the agreement of all the creditors (except those who allow their claims to be bought out by other, assenting creditors) and this is often difficult to achieve. The involvement of independent expert negotiators or mediators may improve the prospects of success. Throughout the process,

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<sup>85</sup> PR Wood *Law and Practice of International Finance: Principles of International Insolvency*, 2<sup>nd</sup> ed (2007) page 31.

<sup>86</sup> The informal process has enabled the rescue of large corporations such as Queens Moat (now QMH UK Ltd which was bought by Goldman Sachs in 2005),

<sup>87</sup> DA Burdette 'Some Initial Thoughts on the Development of a Modern and Effective Business Rescue Model for South Africa (Part 1)', (2004) 16 *S.Afr.Mercantile L.J.* page 252.

<sup>88</sup> In England the situation is somewhat different in that the Financial Service Authority acts as a broker by attempting to convince reluctant parties to agree to attempt to rescue the company. This can be done via the Informal mechanism dubbed "the London Approach".

<sup>89</sup> Such as Turnaround expert, Business Rescue Practitioner, Insolvency Practitioner or even Accountant Firm.

<sup>90</sup> V Finch, *Corporate Insolvency Law: Principles and Perspectives*, 2<sup>nd</sup> ed (2009) page 25.

<sup>91</sup> Wood, *Law and Practice of International Finance: Principles of International Insolvency*, 2<sup>nd</sup> ed (2007).

<sup>92</sup> D Brown, *Corporate Rescue: Insolvency Law in Practice*, Chichester (1996), page 11.

<sup>93</sup> Avoiding the involvement of the court allows the procedure to be more flexible and less adversarial, see, UNCITRAL Insolvency Guide (2005), para. 32.

<sup>94</sup> Finch, 'Corporate Rescue in the World of Debt,' (2008) 8 *J.B.L* page 776.

there is a risk that a dissenting creditor may apply to court for the liquidation of the company.<sup>95</sup> But creditors are likely to accept an informal rescue plan if they will or may derive a greater or more certain benefit than from the company's immediate liquidation.<sup>96</sup> One of the downsides of an informal rescue is that misconduct on the part of the company's incumbent directors (which may be the root cause of the company's woes) may be glossed over. Consequently, incompetent or unscrupulous directors who may have caused the company's difficulties in the first place may remain in office; there may then be a significant risk that the company's financial problems will reoccur.

#### **2.4.2.2 Formal Corporate Rescue Procedure**

A formal corporate rescue process will be laid down in the companies or insolvency or corporate rescue statute of the particular jurisdiction. Commonly, a key aspect of the formal process is that once a rescue plan has been duly approved, it binds all parties, even those who have not assented to the plan, thereby solving the problem that would arise where the unanimous consent of creditors could not be obtained. Usually, the formal process allows companies a specific period of time to arrange their affairs and formalise the plan, under a temporary immunity from litigation by creditors seeking to prove and enforce their claims.<sup>97</sup>

The commencement of a formal rescue process may, but does not in all jurisdictions, require an application to court, which of course adds to the costs of the process and may prolong it. In some jurisdictions the involvement of the court extends to acting as the supervisor of the rescue process.<sup>98</sup> An over-reliance on the courts can be a factor in the failure of some corporate rescue processes.<sup>99</sup> On the other hand, where there is no involvement by the courts, the credibility of the process may be diminished, with an increased risk that creditors may, from the outset, withhold consent to the process.<sup>100</sup> Arguably, the optimal rescue model is one in which the

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<sup>95</sup> Burdette, 'Some Initial Thoughts on the Development of a Modern and Effective Business Rescue Model for South Africa (Part 1)', (2004) 16 *S.Afr.Mercantile L.J.* page 252.

<sup>96</sup> UNICTRAL Insolvency Guide, (2005), para 52.

<sup>97</sup> Most legislative models of business rescue that follow the UNICTRAL insolvency Guide (2005) provide for an automatic moratorium on creditors' claims for the duration of the formal business rescue process.

<sup>98</sup> In South Africa's now-repealed a judicial management process for corporate rescue, the Master of the High Court acted as supervisor of the process.

<sup>99</sup> The failure of South Africa's now-repealed judicial management procedure has been attributed, inter alia, to excessive court involvement in the process.

<sup>100</sup> Thus, minor, unsecured creditors might take the view that the rescue process does not adequately protect their interests; see P Kloppers, 'Judicial Management Reform -Steps to Initiate a Business Rescue' (2001) 13 *S. Afr. Mercantile L.J.*, page 368.

intervention of the court is required only to protect the parties' interests when an infringement is threatened.<sup>101</sup>

A formal rescue process tends to improve the protection accorded to unsecured creditors who may have been vulnerable in an informal rescue. The statutory protection may give unsecured creditors bargaining power to put forward demands to their advantage, thereby increasing the prospects of the attempted rescue going ahead on the requisite consensual basis. On the other hand, since secured creditors are invariably accorded a more substantial voting interest than unsecured creditors, the secured creditors tend to dominate the process.

Usually, a legislative rescue procedure recognises and protects unsecured creditors by giving them the right to vote on the terms of the proposed rescue plan. In this way, a formal corporate rescue process attempts to recognise the rights of all creditors, even those with relatively small claims against the company.

#### **2.4.2.3 Analysis of Formal and Informal Corporate Rescue Procedures**

Formal and informal modes of corporate rescue have a common objective – to restore the financially distressed company to viability. If this can be achieved, all parties with an interest in the company will almost certainly be better off than they would have been if the company had been immediately liquidated.<sup>102</sup> As was noted earlier, a successful outcome requires a bona fide effort by and the co-operation of all affected parties, particularly the company's creditors,<sup>103</sup> and often involves some compromise of creditors' claims.

The overall process of corporate rescue tends to be complex, not least because it involves parties who may only have conflicting interests vis-à-vis the company and who may have different views on what would qualify as a successful rescue of the particular company.<sup>104</sup> Usually, the affected parties are the company's shareholders, creditors, directors, and employees. Indeed, society at large may be an affected party, for example, where the company is a major employer in its geographical area and its failure would impact an entire region. The

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<sup>101</sup> PG Dal Ponand L Gig, 'A Principled Justification for Business Rescue laws: A Comparative Perspective (Part I),' (1996) 5 (1) *IIRV*, page 76.

<sup>102</sup> N Martin, 'The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation', (2005) 28 (1) *Int'l & Comp.L.Rev.* page 2.

<sup>103</sup> R Tomasic, 'Creditor Participation in Insolvency Proceedings-Towards the Adoption of International Standards,' (2006) 14 *ILJ* page 184.

<sup>104</sup> Finch. 'Control and Co-ordination in Corporate Rescue,' (2005) 25 *Legal Stud.* page 387.

company's major creditors are usually its bankers and trade suppliers, and they are likely to be the first to experience the impact of the company's financial distress by way of the non-payment or late payment of debts due to them.

Creditors always see the liquidation of a company that is unable to pay its debts as an option, in which they can make application to court for the company to be wound up as insolvent and then prove their claims and hope for that their claim, or at least part of it, will be paid in the course of the process. By contrast, the company's directors will probably try to persuade the creditors to reschedule or compromise their debts, so that they can continue in office. The employees of the company have a strong incentive to preserve the company's existence and safeguard their jobs and their income. The general public may lose twice from the extinction of a company, first as consumers of its goods or services and secondly as dependants of the company's employees. All these parties will thus gain or lose to varying degrees from the rescue or failure of the company.

Compromise is usually a component of business rescue.<sup>105</sup> Thus, for example, creditors may agree to accept part-payment in full satisfaction of their claims in order to preserve the company as a customer.

An optimal approach needs to be adopted in any attempt to salvage a distressed company.<sup>106</sup> This usually entails a hybrid of formal and informal methods. In other words, the company and the creditors must follow the procedure laid down in the legislation, but at the same time must be flexible enough to include any informal means<sup>107</sup> that is not inconsistent with the legislation. Such a hybrid approach requires a high level of expertise on the part of the rescue practitioner and the goodwill of creditors. Some jurisdictions have already started to institutionalise a hybrid approach, with promising results.<sup>108</sup>

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<sup>105</sup> Tomasic, R., 'Creditors Participation in Insolvency Proceedings-Towards the Adoption of International Standards,' (2006), 14, *Insolvency Law Journal*, page 179.

<sup>106</sup> Martin 'The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation', (2005) 28 (1) *Int'l & Comp.L.Rev.* page 148.

<sup>107</sup> This approach can be regulated by agreements between the interested parties that are not inconsistent with the applicable legislation.

<sup>108</sup> The UK's pre-package administration is a mixture of formal and informal rescue mechanism, see Wood., *Law and Practice of International Finance: Principles of International Insolvency*, 2<sup>nd</sup> ed (2007) page 32.

## 2.5 Reasons for Corporate Failure

Internal deficiencies and pressures from external factors are amongst the causes of company failure.<sup>109</sup> Managerial inefficiency, which is considered an internal deficiency, includes imprudent or defective accounting, a lack of accountability, fraud, inappropriate planning, the production of substandard products, an excessive number of employees, a lack of innovative ideas and a low usage of technology.<sup>110</sup> Endemic problems of this nature can threaten the viability of the company. Where such problems become evident, immediate action is required, usually including an independent audit of the company's financial affairs in order to identify the nature, origin and seriousness of the problem. Other measure may include hiring an outside consultant to assess the company's human resources and an independent assessment of the quality of its products and services.

Currently, most companies legislation requires registered companies to make their solvency status publicly available on an annual basis,<sup>111</sup> and this is therefore a source of information readily available to a company's creditors. Where managerial error is concerned, not all poor decision-making can be branded as a managerial deficiency. Entrepreneurial risk-taking is of the essence of business; some risks pay dividends, others turn out poorly. From a legal point of view, directors usually enjoy considerable protection from such risk-taking in terms of a statutory or common law business judgement rule.

External factors can be responsible for or contribute to a company's financial distress. Such factors include the instability of the global financial system, loss of markets, economic recession and the withdrawal or tightening of credit facilities.<sup>112</sup> According to the traditional macroeconomic theory of business cycles, such negative influences are inevitable over a period of time. Thus, there are cycles of general prosperity and financial growth, followed by a

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<sup>109</sup> Finch *Corporate Insolvency Law: Principles and Perspectives*, 2<sup>nd</sup> ed (2009) page 152. This conclusion is supported by a study in South Africa by M Pretorius 'Business Enterprises at University of Pretoria (Pty) Ltd, Business Rescue Status Quo Report Final Report', (30 March 2015), page 22 available at [http://www.cipc.co.za/files/4714/2866/7900/Report\\_Number\\_3\\_ammended\\_30032015.pdf](http://www.cipc.co.za/files/4714/2866/7900/Report_Number_3_ammended_30032015.pdf) accessed on 11 May 2014. This study records statistical results for the main reasons for a company's financial failure, as follows. Pressure from creditors, thirty six percent, profitability issues, twenty percent; efficiency and professionalism of management, thirteen percent and unique circumstances ten per cent.

<sup>110</sup> The R3 Twelfth Survey, page 26. It is reported that sixty three percent of European corporate failures resulted from normal entrepreneurship risks; see R Meuwissen, et al *Classification and Analysis of Major European Business Failures*(2005)..

<sup>111</sup> The objective of such legislation is to promote transparency and accountability; cf Chapter 3 Part C and D of the 2008 Act.

<sup>112</sup> Bank of England, *Financial Stability Report* Issue 24 (2008).

widespread decline.<sup>113</sup> The last major negative period in the international business cycle was the 2007/8 credit crisis.<sup>114</sup> Such cyclical downturns are beyond the control of even the most capable company directors. During this particular crisis, some governments bailed out key companies<sup>115</sup> to prevent a collapse that would have negatively impacted society and the broad economy.

Government`s policies may contribute to the corporate failure. High corporate tax can be a factor, particularly where unexpected and unbudgeted additional assessments to tax are suddenly received, as can government policies aimed at suppressing certain industries, such policies aimed at discouraging cigarette smoking.<sup>116</sup> However, government policies aimed at enhancing the health of the populace generally enjoy popular support, even where the policies adversely impact particular industries.<sup>117</sup>

When a corporate entity fails, the following are amongst the possible adverse consequences beyond the impact on the company itself: a decline in confidence in the business sector; concerns regarding the creditworthiness of other similar companies; disruption to the supply chain which may impact on small suppliers; inconvenience to consumers; the loss of jobs with consequential financial hardship to communities that depended on the particular company; the impoverishment of a local community heavily dependent on the company; the breaking-up of teams of expertise at all levels in the company from the board of directors down.<sup>118</sup> These consequences need to be borne in mind when weighing the expense of an attempt at business rescue.<sup>119</sup> Changes to the company`s mode of operation and its structure are to be expected, as are amendments to agreements with suppliers.<sup>120</sup>

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<sup>113</sup> Hubbard and O`Brien, *Macroeconomics*, 2<sup>nd</sup> ed (2008) chapter 9.

<sup>114</sup> Other notable global economic crises were those in 1973-1974 and 1979-1981 which were caused by sharply rising oil prices, leading to the failure of number of companies.

<sup>115</sup> These included the Goldman Sachs Group, General Motors Corporation and Chrysler LLC in the USA, the Royal Bank of Scotland, and Halifax Bank of Scotland in United Kingdom and Morgan Stanley in Japan.

<sup>116</sup> Finch *Corporate Insolvency Law: Principles and Perspectives*, 2<sup>nd</sup> ed (2009) page 164.

<sup>117</sup> Ministries of Health in many countries discourage the consumption of fast foods, and this impacts negatively on companies producing or marketing such products. The prohibition on the advertising of tobacco products naturally impacts adversely on companies in this industry and on the tobacco farming industry.

<sup>118</sup> Finch, *Corporate Insolvency Law: Principles and Perspectives*, 2<sup>nd</sup> ed (2009) page 145.

<sup>119</sup> A Belcher *Corporate Rescue* (1997) chapter 3.

<sup>120</sup> Rajak, H. and Henning, J., 'Business Rescue for South Africa', (1999), 116 S. African L.J. page 277

### 2.5.1 Identifying a Distressed Company

There are two common early symptoms of a company in financial distress and in need of rescue.<sup>121</sup> The first is the company's inability to pay its debts as they fall due. The second is actual insolvency, where the value of the company's aggregate liabilities exceeds the aggregate value of its assets.<sup>122</sup> The former symptom often becomes manifest well before the latter, in that creditors will be immediately aware of the non-payment or late payment of their claims. The second symptom may not be immediately apparent to outside parties; however, the first symptom, in and of itself, constitutes a recognised form of insolvency, namely, commercial insolvency.<sup>123</sup>

The board of directors is usually the first party to become aware that the company is in financial distress and, from that juncture, embarking on corporate rescue ought to be an option uppermost in their minds. An early response from the board is a key factor in a successful rescue.

Embarking on a formal process of corporate rescue is not appropriate if the company has passed the point of no return and is non-viable and unsalvageable.<sup>124</sup> In *Powdrill v Watson*<sup>125</sup> the House of Lords said that only viable companies should be permitted to embark on rescue procedures.<sup>126</sup> The threshold requirement for entry into a formal business rescue is whether the company is economically viable.<sup>127</sup> If such viability is disputed by an interested party, it will fall to the court to determine whether viability and any other statutory criteria for entry

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<sup>121</sup> It is however difficult to pinpoint the juncture at which a company becomes factually insolvent; see the Report of the Review Committee on Insolvency Law and Practice-Cmnd 8558 (1982) paragraph 205.

<sup>122</sup> These two tests are commonly referred to respectively as the cash flow test and balance sheet test; see P Okoli 'Rescue Culture in the United Kingdom: Realities and the Need for a Delicate Balancing Act' (2012) 23(2) *I.C.C.L.R.* page 62. It has been suggested that a rescue process ought to be commenced immediately financial distress becomes apparent on the basis of either the balance sheet or the cash flow aspect.

<sup>123</sup> RM Goode, *Principles of Corporate Insolvency Law*, 4<sup>th</sup> ed (2011). Chapter 4 and A Keay. and P Walton *Insolvency Law Corporate and Personal*, 2<sup>nd</sup> ed(2008) chapter 2.

<sup>124</sup> Martin, 'The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation, (2005) 28 (1) *Int'l & Comp.L.Rev.* page 10, and UNICTRAL para 52 endorses the criterion of a reasonable prospect of the company's survival. To the same effect, see *The Insolvency Service, A Review of Company Rescue and Business Construction Mechanism: Report by the Review Group*, HMSO (2000) para 198(j).

<sup>125</sup> [1995] 2 A.C. 394 (HL).

<sup>126</sup> JJ White, 'Death and Resurrection of Secured Credit,' (2004) 12(1) *ABILR* page 139; JJ White 'Does Chapter 11 Save Economically Inefficient Firms,' (1994) 72(3) *Wash U LQ*, page 1319.

<sup>127</sup> HMSO *The Insolvency Service: A Review of Company Rescue and Business Construction Mechanism: Report by the Review Group* (2000) para 24.

into the business rescue process have been satisfied, and the inquiry will be premised on the desirability of rescuing financially distressed companies where this is reasonably possible.<sup>128</sup>

It is the domain of the legislature to craft the statutory provisions governing corporate rescue and to lay down clear and practicable criteria to differentiate between potentially viable companies that should be allowed to attempt corporate rescue and those that fail the threshold criteria in this regard.

## **2.6 Control of a Company during the Rescue Process**

Some statutory regimes provide for the company to remain under the managerial control of the incumbent board of directors whilst business rescue is in process; others place the company under the control of the business rescue practitioner. This is significant distinction.<sup>129</sup> Empirical studies do not yet persuasively indicate which of the two models yields the better outcome.<sup>130</sup> The two dominant jurisdictions in corporate rescue regimes, England and the USA, differ in this regard. The English corporate rescue model emphasises the dominance of the practitioner, whilst the USA favours the incumbent management of the distressed company retaining managerial control during the rescue processes.

The formal business rescue regime of many jurisdictions couples the appointment of a business rescue practitioner with the removal from office of the company's board of directors.<sup>131</sup> The underlying assumption is that the company's management must have been primarily or at least significantly responsible for its financial woes and that the appointed business rescue practitioner ought to have free rein to do whatever is necessary to rescue the company. A further factor may be a tacit underlying concern that, if they were to remain in office, the incumbent directors would abuse the business rescue process to their own advantage. A further concern is that the company's creditors, particularly the secured creditors, have the dominant voice in the

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<sup>128</sup> Hunter, 'The Nature and Functions of a Rescue Culture,' (1999) *J.B.L.* page 512.

<sup>129</sup> Yang and Li, 'The History of Corporate Rescue in the UK,' (2012) 8(13) *Asian Social Science* page 23.

<sup>130</sup> Goode, *Principles of Corporate Insolvency Law*, 3<sup>rd</sup> ed(2005) at page 328, argue that it is illogical to leave the incumbent management in control and expect the company to recover; Kloppers, 'Judicial Management Reform -Steps to Initiate a Business Rescue' (2001) 13 *S. Afr. Mercantile L.J.* page 368, states that it would be difficult to persuade creditors to defer payment of their claims while an attempted rescue is in process if they see that the same management is still in control. See also B Carruthers and T Halliday *Rescuing Business: The Making of Corporate Bankruptcy Law in England and the United States* (1998) at page 246.

<sup>131</sup> Inter alia Australia, Tanzania, Nigeria, Kenya, and Uganda.

choice and appointment of a business rescue practitioner<sup>132</sup> who may consequently feel beholden to them and may promote a business rescue plan that focuses on protecting the interests of the creditors to the detriment of other affected parties and without a central focus on salvaging the company.<sup>133</sup>

There is, however, a clear case to be made for a business rescue process that retains and does not totally dispense with the institutional wisdom of the incumbent directors who, for all their shortcomings, at least know how the company's business is run.<sup>134</sup> A rescue practitioner who takes over the management of the business "cold" may find that even maintaining the routine day-to-day running of the company's business is problematic, let alone undertaking major reorganisation or restructuring. Arguably, the incumbent directors have much to gain from a successful rescue of the company and are likely to make a genuine effort to secure such a result; by contrast, the business rescue practitioner will probably have earned a substantial fee even if the attempted rescue fails and the company goes into liquidation.<sup>135</sup>

In short, the company's directors, no less than its employees, will usually have a strong incentive to try to save the company and thereby save their positions. This is borne out by the fact that the reorganisation process under Chapter 11 in the USA is usually initiated by the directors of financially distressed companies.<sup>136</sup> There are, of course, many more causes of corporate financial distress than directorial incompetence or mismanagement, and it would be wrong to assume that the directors are always primarily to blame.<sup>137</sup> General market forces and economic downturns are outside the control of the directors.

The optimal model of business rescue thus seems to be one that retains the incumbent board of directors, but puts the directors under the overarching control of the business rescue practitioner

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<sup>132</sup> S Frisby, 'Report on Insolvency Outcomes', A paper presented to the Insolvency Service, available at <http://www.insolvency.gov.uk> accessed on 3.04.2014.

<sup>133</sup> J Day and P Taylor, 'Financial Distress in Small Firms: The Role Played by Debt Covenants and other Monitoring Devices' (2001) 3 *Insolvency Law* page 110.

<sup>134</sup> Okoli, 'Rescue Culture in the United Kingdom: Realities and the Need for a Delicate Balancing Act' (2012) 23(2) *I.C.C.L.R.* page 64.

<sup>135</sup> A tardy initiation of the rescue process is a major contributory factor to ultimate liquidation; see Yang, M. and Li, X., 'The History of Corporate Rescue in the UK,' (2012), 8 (13) *Asian Social Science*, page 23

<sup>136</sup> Wood, P.R., *Law and Practice of International Finance: Principles of International Insolvency*, 2nd Edition, Sweet and Maxwell, (2007), page 42.

<sup>137</sup> Goode, R., *Principles of Corporate Insolvency Law*, 3<sup>rd</sup> Edition, Thomson (2005) page 328

with the power of summarily dismissal.<sup>138</sup> In South Africa the rescue practitioner is appointed either by the company<sup>139</sup> or by the court<sup>140</sup> and in either case the directors remain in office and continue to exercise their functions subject to the authority of the practitioner.<sup>141</sup> By contrast, in terms of the now-repealed judicial management legislative provisions, directors ceased to hold office once the process commenced.

## 2.7 The Moratorium

Most corporate rescue systems provide for an automatic moratorium that is to say, a stay of all legal and enforcement proceedings against a company, from the juncture when, in terms of the legislation, business rescue commences until its termination.<sup>142</sup> Consequently, for the duration of business rescue, creditors are barred from enforcing their claims against the company, save with the consent of the practitioner or with the leave of the court.<sup>143</sup> The rights most commonly affected by the moratorium are security rights, rights of sale, other contractual rights, rights of foreclosure, reciprocal rights arising from performance by creditors, and rights to set-off.<sup>144</sup> In some jurisdictions, creditors are given the right to apply to court to institute legal proceedings against the company, notwithstanding the moratorium<sup>145</sup> and notwithstanding that such legal proceedings may impact adversely on the attempted rescue of the company. In some jurisdictions, this is a decision to be made by the practitioner or by the court, who will have to weigh the considerations pro and contra allowing such proceedings.<sup>146</sup>

A moratorium on legal proceedings against a company undergoing business rescue is a fundamental component of most statutory corporate rescue regimes and is supported

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<sup>138</sup> Yang, M. and Li, X., 'The History of Corporate Rescue in the UK,' (2012), 8 (13)Asian Social Science, page 23

<sup>139</sup> Section 129 (3) (b) of the 2008 Act.

<sup>140</sup> Ibid s 131(5).

<sup>141</sup> Ibid s 137(2).

<sup>142</sup> In some jurisdictions a moratorium can be granted by the court on application by an interested party or by the company. This model is usually found in jurisdictions with a markedly creditor-friendly corporate rescue regime.

<sup>143</sup> Claessens, S. and Klapper, L.F., 'Bankruptcy Around the World: Explanations of its Relative Use,' (2002), World Bank Policy Research Working Paper 2865 Control and Corporate Rescue, page 2, available at page 6, <http://www.univie.ac.at/bwl/ieu/lehre/ss06/.../debtorinposseession.pdf>, accessed in 25.11.2013; Tomasic, R., 'Creditors Participation in Insolvency Proceedings-Towards the Adoption of International Standards,' (2006), 14, *Insolvency Law Journal*, page 183

<sup>144</sup> Wood, P.R., *Law and Practice of International Finance: Principles of International Insolvency*, 2nd Edition, Sweet and Maxwell, (2007), page 37

<sup>145</sup> As in South Africa, England, and Australia.

<sup>146</sup> The aim of the moratorium is, inter alia, to enable the company to continue deploying its assets, without depletion by attachment and sale in execution at the instance of creditors; Haselman, R., and others, 'How the Law Affects Lending,' Columbia Law and Economic, (2006) Working Paper No.285, (2006), page 12

internationally by the UNICTRAL model for insolvency legislation as an essential component of a corporate rescue process.<sup>147</sup> The statutory provisions in respect of the moratorium require careful and expert drafting, so that creditors will regard the general moratorium as being, overall, in their interests or at the least not to their significant and long-term disadvantage.<sup>148</sup>

In *Re Alycan Interstate Carp*<sup>149</sup> and *Re Mallerof Haffner*,<sup>150</sup> two important purposes for a moratorium during the corporate rescue processes were identified. The first is to give a debtor company time to reorganise its affairs during the salvaging process, without pressure from creditors. The second is to protect the company's rights. Overall, the rationale of the moratorium is that a salvaged and viable company will be more to the advantage of creditors than one that goes into liquidation.<sup>151</sup> In other words, the moratorium is intended to benefit not only the company but its creditors as well.<sup>152</sup> Of course, a moratorium is justifiable only if there is a reasonable prospect that the company will survive and be viable for, if not, the moratorium will usually have been to the detriment of the company's creditors.<sup>153</sup>

However, the moratorium is susceptible to abuse, for example, it can be combined with so-called "pre-packing" which is a process in which a financially distressed company negotiates a sale of its business which will take effect immediately or soon after it enters liquidation. The expression "pre-pack" connotes that the terms of the sale are agreed before the company enters liquidation.<sup>154</sup> The covert arrangement is that the company will commence business rescue and enjoy the benefits of the moratorium whilst the sale is being negotiated.

The terms of the statutory moratorium, as laid down in legislation, differ between jurisdictions. But the moratorium is seldom absolute. Legal proceedings against the company involving

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<sup>147</sup>UNCITRAL Model Para 52

<sup>148</sup> Dal Pon, P.G. and Gig, L., 'A Principled Justification for Business Rescue laws: A Comparative Perspective (Part I),' (1996), 5 (1), IIRV page 67

<sup>149</sup> 11 BR 224 (1981)

<sup>150</sup> 25 BR 882 (1982)

<sup>151</sup> Tene, O., 'Revisiting the Creditors' Bargain: The Entitlement to the Going-Concern Surplus in Corporate Bankruptcy Reorganisations,' (2003), 19 BDJ, page 287, Baird, D.G., The Uneasy Case for Corporate Reorganisations in Bhandari, in J.S. and Weiss, L.A (eds), Corporate Bankruptcy, Cambridge, CUP, (1996), page 345

<sup>152</sup> Sandra, F., 'In Search of a Rescue Regime: The Enterprise Act 2002,' (2004), 67 (2) MLR page 250

<sup>153</sup> McCormack, G., 'Corporate Rescue Law in Singapore and the Appropriateness of Chapter 11 of the US Bankruptcy Code as a Model,' (2008) 20 SACLJ, page 398.

<sup>154</sup> So-called 'pre-packing', is commonplace, inter alia in the USA; see Baird, D.G. and Rasmussen, R.K., 'Control Rights, Priority Rights and the Conceptual Foundations of Corporate Reorganisations', (2001), 87, V.L.R., page 941, and Baird, D.G. and Rasmussen, R.K., The End of Bankruptcy, (2002), 55, S.L.R., page 786-788

criminal liability, tortious liability and threats to the national security are usually exempted from the moratorium.<sup>155</sup>

## 2.8 The Outcome of the Corporate Rescue Process

It is possible that a successfully “rescued” company may, at the end of the rescue process, continue with the same business under the same management, and with the same employees. It is more likely, however, that the rescued company will have been restructured in one or more respects. Its managerial structure may have changed; its operations or its staff complement may have downsized; it may have been recapitalised or re-financed; its credit arrangements may have been amended. Or the company may have been taken over by another entity, or its business may have been sold to an outside party or to its own managers.<sup>156</sup> The premise in each case is that what has been achieved is a better result for the company’s creditors, employees and shareholders than would have been secured by liquidation.

Thus, a successful business rescue encompasses more possible outcomes than simply saving the business or the company as it stands.<sup>157</sup> Chapter 11 in the USA and the UK insolvency law has room for a multitude of outcomes.<sup>158</sup> Rescuing a company as it stands is sometimes referred to as a pure rescue, in that it involves salvaging the company and its business, for the most part with the same workforce, the same controllers, and the same management. Such an outcome seems implicitly to be the primary aim envisaged in Chapter 6 of South Africa’s Companies

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<sup>155</sup> Cf England administration procedure, United States of America Chapter 11 reorganisation.

<sup>156</sup> Belcher, A., *Corporate Rescue*, Sweet and Maxwell, London, (1997) page 24-34 and Brown, D., *Corporate Rescue: Insolvency Law in Practice*, John Wiley and Sons, Chichester, (1996) page 6-8. For example in *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others, Farm Bothasfontein (Kyalami) (Pty) Ltd v Kyalami Events and Exhibitions (Pty) Ltd and Others* [2012] ZAGPJHC 12 para 12, the High Court expressed the basis of South Africa’s business rescue proceedings under Section 127 of the 2008 Act as follows:

“The general philosophy permeating through the business rescue provisions is the recognition of the value of the business as a going concern rather than the juristic person itself. Hence the name “business rescue” and not “company rescue”. This is in line with modern trend [sic] in rescue regimes. It attempts to secure and balance the opposing interests of creditors, shareholders and employees. It encapsulates a shift from creditors’ interests to a broader range of interests. The thinking is that to preserve the business coupled with the experience and skill of its employers may, in the end prove to be a better option for creditors in securing full recovery from the debtor. *To rescue the business, provision is made to “buy into” the procedure without fear of losing such investment in an ailing company by securing repayment as a preferential repayment as part of the “post-commencement financing”*. Post-commencement creditors are thus offered a “super-priority” as an incentive to assist the company financially”. [Emphasis supplied]

<sup>157</sup> Sandra, F., ‘In Search of a Rescue Regime: The Enterprise Act 2002,’ (2004), 67 (2) MLR page 248

<sup>158</sup> Including pre-pack administration or pre-pack reorganisation.

Act of 2008. But any permutation of a successful corporate rescue must have served the best interests of the company's creditors, shareholders and employees.<sup>159</sup> In practice, as was noted above, a successful rescue often involves the sale of the viable part of the business or a take-over of the whole financially distressed company.<sup>160</sup>

Usually, corporate rescue is better achieved by avoiding a piecemeal sale of the company's business because a business is often more than the sum of its parts, and because a business is usually worth more if it is preserved or sold in its entirety.<sup>161</sup> So-called "corporate rescue" is in fact more accurately termed "business rescue" in that the objective is the preservation of the business, rather than simply the preservation of the company as a legal entity. Thus a business can be saved where it is taken over by a new entity via a merger or take-over, or where the business is sold as a going concern to another commercial entity.

Internationally, it is accepted that, where a rescue process cannot save the company as an entity in its own right, the aim should be to rescue the business.<sup>162</sup>

The merits of the model of business rescue adopted in any particular jurisdiction can be judged by the rate of successful rescues,<sup>163</sup> whilst allowing for the fact that the rescue process may have effected changes to many aspects of the business.<sup>164</sup> As was pointed out, above, some phasing out or scaling down of the company's activities is likely,<sup>165</sup> as is a compromise with creditors as part and parcel of the rescue process.<sup>166</sup> Similarly, some retrenchment of employees may be necessary in order to reduce the cost of the company's operations.<sup>167</sup>

The alternative objective of business rescue, in terms of South Africa's Companies Act, is to secure a better result for creditors and shareholders than would have been achieved by the

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<sup>159</sup> Davis, N., *The Rescue Culture in the United Kingdom: Insolvency Litigation and Practice*, (1997) London, HMSO page 3 and 4.

<sup>160</sup> Phillips, M. and Goldring, J., 'Rescue and Reconstruction', (2002), *Insolvency Intelligence*, London, HMSO, page 75 and 76.

<sup>161</sup> Baird, G.D. and Rasmussen, R.K., 'The End of Bankruptcy,' (2002) 55, *Stan L Rev*, page 758

<sup>162</sup> UNICTRAL para 51-54.

<sup>163</sup> Okoli, P., 'Rescue Culture in the United Kingdom: Realities and the Need for a Delicate Balancing Act' (2012), 23 (2), *I.C.C.L.R.*, page 66.

<sup>164</sup> Cassim, F. et al, *Contemporary Company Law*, 2nd Edition, Juta, (2012), page 863.

<sup>165</sup> UNICTRAL para 52.

<sup>166</sup> Corporate rescue does not necessarily entail that creditors will be paid in full, see, UNICTRAL insolvency model (2005) para 52.

<sup>167</sup> UNICTRAL insolvency model (2005) para 52.

immediate winding up of the company.<sup>168</sup> Case law supports the interpretation that this alternative objective can be pursued only where the main objective is impossible to achieve.

## 2.9 The Necessity for a Corporate Rescue Mechanism

Companies' legislation must allow for the winding up of companies, inter alia to remove non-viable companies from the economy and allow the viable to thrive.<sup>169</sup> However, the negative consequences of winding up a company on a country's economy and society need to be borne in mind, not least because of the reduction in competition and the possibility that the remaining companies will use their dominant position to increase the prices of their goods and services, and the possible overall reduction of the number of jobs in the economy.<sup>170</sup> An unsatisfactory business rescue regime can have a destabilising impact on the national economy.<sup>171</sup>

As a general principle, the liquidation of a company should be a last resort<sup>172</sup> and well-drafted business rescue legislation has an important role to play in the economic development of a country.<sup>173</sup> Corporate rescue can indirectly preserve creativity and encourage entrepreneurship.<sup>174</sup>

All of this is particularly true of developing economies.<sup>175</sup> In the process of rescuing a corporate entity, the retention of all its employees is not a given.<sup>176</sup> In *Re Alders Department Stores Ltd*<sup>177</sup> it was held that the goal of protecting of employees should not be accorded such priority as to risk sabotaging the rescue of the company. On the other hand, too little attention to the interests of employees may scupper the rescue process.<sup>178</sup> A difficult balance needs to be struck, for the loss of jobs can have serious socio-economic consequences.

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<sup>168</sup> Yang, M. and Li, X., 'The History of Corporate Rescue in the UK,' (2012), 8 (13)Asian Social Science, page 22

<sup>169</sup> White, J., 'Corporate and Personal Bankruptcy Law,' (2011), 7, ARLSS, page 139.

<sup>170</sup> Davis, A., 'Compromise or Fudge? Reflections on the Law of the UK as it Affects the Taxation of Insolvent Companies,' (2010), 2 B.T.R., page 149.

<sup>171</sup> Report of the Review Committee on Insolvency Law and Practice-Cmnd 8558 of 1982 paragraph 204.

<sup>172</sup> Yung, P., 'The Law of Corporate Rescue and Reform In Hong Kong,' (2013), 34(4), Comp.Law., page 126.

<sup>173</sup> Blazic, M.J., 'In Search of a Rescue Culture: A Review of the Australian Part 5.3A Legislation,' (2010), SBS HDR Student Conference Paper 8, page 12 available at <http://ro.uow.edu.au/sbshdr/2010/papers/8>

<sup>174</sup> McCormack, G., 'Corporate Rescue Law in Singapore and the Appropriateness of Chapter 11 of the US Bankruptcy Code as a Model,' (2008), 20, SAclJ, page 401.

<sup>175</sup> Loubser, A., 'Business rescue in South Africa: a procedure in search of a home?', (2007) 40 Comp. & Int'l L.J. S. Afr., page 153.

<sup>176</sup> Lyons, H. and Roberts, M., 'Administration Expenses - "Friday Afternoon Drafting" and the Rescue Culture,' (2005), 16, Co.L.N., page 1.

<sup>177</sup> [2005] B.C.C 289.

<sup>178</sup> Bradstreet 'The new business rescue: will creditors sink or swim?', 2011, SALJ.

## **2.10 Weaknesses in the concept of business rescue**

Common shortcomings in business rescue legislation have come to light. As regards Australia's voluntary corporate rescue model, Blazic (2010) lists inter alia issues involving secured creditors, insolvent trading by the company, ipso-facto clauses in a business plan, procedural accountability and abuses, employees' rights, issues with creditors, globalization and cross border insolvency issues as shortcomings.<sup>179</sup> In addition to deficiencies in the legislation, these weaknesses are influenced by the economic environment, culture and history of the jurisdiction. According to the International Monetary Fund, Australia is categorised as an advanced economy,<sup>180</sup> and the shortcomings within that jurisdiction will probably be found in other similarly categorised jurisdictions..

The situation is different in the developing countries. The following factors in implementing corporate rescue legislation in such jurisdictions have come to light, namely, weak financial institutions, out-dated social protection and corporate governance mechanisms, inadequate human and financial capital and entrenched corrupt practices.<sup>181</sup> All countries in Africa, including South Africa, are categorised in the IMF report as economically developing states.<sup>182</sup> These countries seem to have lower expectations of successful corporate rescue operations.

## **2.11 South African Corporate Rescue**

### **2.11.1 Introduction to South African Corporate Rescue**

South Africa's common law is a mixture of English common law, Roman-Dutch law and customary law.<sup>183</sup> South Africa's companies legislation has been heavily influenced by English common law and companies legislation.<sup>184</sup> This is evident from the structure and content of

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<sup>179</sup> Blazic, M.J., In Search for Rescue Culture: A Review of the Australian Part 5.3A Legislation, (2010), SBS HDR Student Conference Paper 8 available at <http://ro.uow.edu.au/sbshdr/2010/papers/8>

<sup>180</sup> IMF, World Economic and Financial Surveys, World Economic Outlook: Recovery Strength Remains Uneven, (2014) page 3.

<sup>181</sup> Tomasic, R., 'Creditor Participation in Insolvency Proceedings-Towards the Adoption of International Standards,' (2006), 14, ILJ, page 180. In addition McDonald, C. and Schumacher, L., 'Financial Deepening in Sub-Saharan Africa: Empirical Evidence on the Role of Creditor Rights Protection and Information Sharing,' (2007), IMF Working Paper No. 203, page 6 states that sub-Saharan Africa has the fewest financial institution services; this is attributed to defective government policies and political influence.

<sup>182</sup> IMF, World Economic and Financial Surveys, World Economic Outlook: Recovery Strength Remains Uneven, (2014) page 160-163.

<sup>183</sup> Bruin, J. and Barratt, A., History and Development of South African Law, in Walt, M. and others, *Introduction to South African Law Fresh Perspective*, 2<sup>nd</sup> Edition, Pearson Education, South Africa, (2011), page 17-40.

<sup>184</sup> Other examples of English common law rules and principles found in South Africa's Company Act 61 of 1973 are the doctrine of disclosure and constructive notice, derivative actions, the rule in *Foss v Harbottle* (1843) 67

South Africa's first post-Union companies legislation, the Companies Act 46 of 1926, which was largely based on the United Kingdom Companies (Consolidation) Act of 1908. South Africa's company law still shows influences of its hybrid but predominantly Roman-Dutch common law.<sup>185</sup>

## **2.11.2 The Statutory Development of South African Corporate Rescue**

### **2.11.2.1 Companies Act 46 of 1926**

In South Africa the concept of corporate rescue was first introduced in the Companies Act 46 of 1926.<sup>186</sup> The process was called *judicial management*. Although South Africa's Companies Act was generally slow to adapt to economic and technological change,<sup>187</sup> the country was praised for its attempt to introduce this legislation.<sup>188</sup> Australia's *official management*, a corporate rescue mechanism introduced in 1961, is said to have been inspired by South Africa's experiment with judicial management.<sup>189</sup>

In South Africa, judicial management failed to develop into a mature corporate rescue process, inter alia because of the lack of an automatic moratorium on creditors' claims against the company for the duration of business rescue. This lacuna enabled creditors to apply for the liquidation of the company during the process of judicial management which could potentially compromise the entire rescue process. In practice the courts almost invariably imposed a moratorium.

### **2.11.2.2 Companies Act 11 of 1932**

In the 1930s the world experienced a severe economic downturn, now known as the Great Depression, and institutional lenders cut back on the extension of credit. In South Africa, there

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ER189, and the Turquand rule; Pretorius, J.T. and others (Editors), *Hahlo's South African Company Law through the Cases*, 6<sup>th</sup> Edition, Juta Company, (1999), page 1-3 and Cilliers, H.S et al, *Corporate Law*, 3<sup>rd</sup> Edition, Butterworths, Durban, (2000).

<sup>185</sup> Burdette, D. et al, 'Business Rescue in South Africa,'(2002), page 7 available at <http://www.law.hku.hk/aiifl/research/Oct2002-conference-papers.html> accessed in 22.12.2013

<sup>186</sup> Kloopers, P., 'Judicial Management Reform -Steps to Initiate a Business Rescue' (2001), 13 S. Afr. Mercantile L.J., page 358

<sup>187</sup> Amendments to the Companies Act, none of them substantial, have been suggested; Burdette, D.A., Some Initial Thoughts on the Development of a Modern and Effective Business Rescue Model for South Africa (Part 1), (2004), 16, S.Afr.Mercantile L.J., 246

<sup>188</sup>Rajak, H. and Henning, J., 'Business Rescue for South Africa', (1999), 116 S. African L.J., page 262.

<sup>189</sup> As to Australia's Official Management, see Rajak, H. and Henning, J., 'Business Rescue for South Africa', (1999), 116 S. African L.J. page 262.

was a particular fear that loans to farmers might be called in.<sup>190</sup> One of the responses of the South African government was to make changes to the companies legislation<sup>191</sup> and this led in 1932 to the enactment of an amended Companies Act which included changes to the judicial management provisions, providing for a moratorium on creditor's claims for companies under judicial management.<sup>193</sup>

The amendments also provided for the setting aside of impeachable transactions in judicial management and allowed any party or the judicial manager to apply to court for annulling an affected transaction entered into by the company prior to judicial management. Such transactions included voidable or undue preferences, dispositions without value and collusive arrangements entered into at a time when the company's liabilities exceeded its assets.

### **2.11.2.3 Companies Act 23 of 1939**

South Africa then initiated a commission of inquiry with a view to reforming company legislation, and the resultant report goes by the name of the Report of the Companies Act Commission of 1936.<sup>194</sup> The Commission recommended only minor amendments, later embodied in the Companies Act 23 of 1939. One amendment implicitly envisaged judicial management as a route to winding up a company.<sup>195</sup> The amended legislation gave the judicial manager power, during the currency of judicial management, to use the company's available funds to pay creditors' claims and costs incurred in the procedure; in hindsight this undercut the whole purpose of judicial management, which was to give the company a breathing space from claims against it, and in effect the amendment allowed the judicial manager to act as an informal liquidator.<sup>196</sup>

Nonetheless, the amendments did attempt to address the problem faced by a court in determining whether there were sufficient grounds to believe that a company might be able to recover from its financial plight.<sup>197</sup> The application for a judicial management order was now

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<sup>190</sup> Olver, A.H., *Judicial Management in South Africa*, A Thesis for the Degree of Doctor of Philosophy in the Faculty of Law of the University of Cape Town, (1980), volume 1 page 6.

<sup>191</sup> The Companies (Amendment) Act 11 of 1932.

<sup>193</sup> *Ibid* s 196 (1).

<sup>194</sup> Also known as the Lansdown Commission (UG 45 of 1936).

<sup>195</sup> Olver, A.H., *Judicial Management in South Africa*, A Thesis for the Degree of Doctor of Philosophy in the Faculty of Law of the University of Cape Town, (1980), volume 1 page 9.

<sup>196</sup> See s 197 (b) of the Companies (Amendment) Act 23 of 1939.

<sup>197</sup> Section 195 of the Companies (Amendment) Act 23 of 1939.

to be sent first to the Master of the Supreme Court who was required to investigate the affairs of the company and produce a report as to whether there was a reasonable probability for the company to attain the objectives of the judicial management process – clearly a complex task, and a procedural requirement that would delay the company’s entry into judicial management and increase the likelihood that it would simply be liquidated.

#### **2.11.2.4 Companies Act 46 of 1952**

The recommendations of the *Millin Commission*<sup>198</sup> were incorporated into the Companies Act 46 of 1952<sup>199</sup> which gave the judiciary greater power in the judicial management process. The amendments required the judicial manager to seek the approval of the court for any disposition of the company’s assets. Even though this increased dependence on the judicial system, the overall result seems to have been positive in preserving companies’ assets and diminishing the risk that the judicial manager would succumb to pressure from the company’s creditors to sell assets and pay their claims, thereby defeating the purpose of judicial management.

The amending legislation provided that if, at any time during the judicial management process, it came to the attention of the judicial manager that a company would not be able to pay all its debts in full, he should apply to court for a winding up order.<sup>200</sup> The intent was that judicial managers should not defer a decision to wind up the company, resulting in further pointless diminution of its assets to the detriment of creditors.

The amendments also provided for a ranking during the distribution of the company’s assets on the termination of judicial management. Overall priority was given to costs incurred during the process, followed by the operational expenses of the business, and lastly the claims of the company’s creditors. However, sorely lacking in the process was super-priority for post-commencement financiers of the company which would have been a stimulus for creditors to inject funds for the rescue of the company. Overall, however, the intent of the legislation was to achieve the financial rescue of the company.

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<sup>198</sup> *Verslag van die Kommissie van Ondersoek insake die wysiging van die Maatskappywet* (UG 69 of 1948).

<sup>199</sup> Companies (Amendment) Act 46 of 1952.

<sup>200</sup> See s 440 (1) Companies Act 61 of 1973.

### 2.11.2.5 Companies Act 61 of 1973

In 1963 a commission of inquiry that went by the name of the *Van Wyk de Vries Commission*<sup>201</sup> under the chairmanship of Justice Jan van Wyk de Vries began its work. The commission was tasked with collating opinions, comments and views from stakeholders and the general public regarding the reform and modernisation of South Africa's Companies Act. The various Masters of the Supreme Court expressed the view that judicial management should be abolished because it had not yielded the desired results and many companies were using it to block creditors from asserting their rights.<sup>202</sup> This view apparently carried little weight with the Commission.<sup>203</sup>

Consequently, judicial management, with a few changes, was again incorporated into the Companies Act 61 of 1973<sup>204</sup> justified by the fact that the low rate of success of judicial management in South Africa was nonetheless higher than in jurisdictions such as the USA and the United Kingdom.<sup>205</sup>

The scholarly literature reflects some support for judicial management as a way of securing a better return for creditors than would be achieved by the immediate winding up of the company.<sup>206</sup> It should however be borne in mind that, in terms of the legislation, a judicial management order was granted only if it was shown that there was a reasonable probability that the company would thereby be enabled to pay its debts and fulfil its obligations;<sup>207</sup> it did not suffice that the return to creditors would be higher than would be achieved by immediate liquidation.

A structural improvement achieved by the Companies Act 61 of 1973 was placing the winding-up provisions in a different chapter of the Act from judicial management. However, this structural change alone did not sufficiently separate the two procedures, for some of the judicial management provisions continued to refer to the winding-up provisions.

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<sup>201</sup> The commission issued two reports, the first of which was the main report (*Hoofverslag* RP 45/ 1970) and the second was a supplementary report that annexed the Companies Bill (*Aanvullende Verslag en Konsepwetsontwerp* RP 31/1972).

<sup>202</sup> *Hoofverslag* RP 45/ 1970 page 524 paragraph 51.02.

<sup>203</sup> The Companies Act 61 of 1973 incorporated the recommendations of the Van Wyk de Vries Commission; Rajak, H. and Henning, J., 'Business Rescue for South Africa', (1999), 116 S. African L.J. page 262.

<sup>204</sup> Sections 427-440 of the Companies Act 61 of 1973.

<sup>205</sup> Brown, D., *Corporate Rescue: Insolvency Law in Practice*, (1996), Chichester, John Wiley and Sons, page 247.

<sup>206</sup> Rajak, H. and Henning, J., 'Business Rescue for South Africa', (1999), 116 S. African L.J., page 267.

<sup>207</sup> Section 427 (1) of the Companies Act 61 of 1973.

### 2.11.2.6 Companies Act 71 of 2008

The reforms effected by the Companies Act 71 of 2008 were driven by the widely acknowledged need for South Africa to align itself with international trends in company law.<sup>208</sup> The reform process exposed differences of opinion between the Ministry of Justice and the Department of Trade and Industries.<sup>209</sup> In March 2003 a draft Insolvency and Recovery Bill was approved by the cabinet.<sup>210</sup> This Bill had been prepared by the South African Law Review Commission under the Ministry of Justice. The draft approved by cabinet covered both natural and juristic persons although corporate winding-up and rescue is usually located in companies' legislation. This proved to be an unsuccessful attempt by the government to reform insolvency legislation for both individuals and juristic persons within a single statute.

After a year's silence, the Ministry of Justice again attempted legislation to reform corporate rescue and announced that by the end of May 2004 a draft Business Rescue Bill would be complete.<sup>211</sup> Surprisingly, about a month later the Department for Trade and Industry also made public its intent to reform companies legislation, corporate rescue<sup>212</sup> with a target date of June 2006 for new companies' legislation.

However, it was only in 2007, a year later than the envisaged completion time for the proposed legislative changes, that the department published the Companies Draft Bill 2007. A year later, parliament approved the Bill which was signed into law by the State President on 8 April 2009, and a day later it was gazetted as the Companies Act 71 of 2008<sup>213</sup> which came into force in 2011 and repealed the Companies Act 61 of 1973 subject to certain transitional arrangements.<sup>214</sup> Thus, it took nearly three years after presidential assent for the legislation to come into force. The delay has been attributed to a significant number of faults in the signed

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<sup>208</sup> South African Company Law for the 21<sup>st</sup> Century - Guidelines for Corporate Law Reform, May 2004, 1183, page 3 available at <http://www.gov.za/documents/download.php?f=169430> accessed 1.06.2014.

<sup>209</sup> The two departments worked simultaneously on the reform of the Companies Act.

<sup>210</sup> Burdette, D.A., Some Initial Thoughts on the Development of a Modern and Effective Business Rescue Model for South Africa (Part 1), (2004), 16, S.Afr.Mercantile L.J., 243.

<sup>211</sup> So stated by the Chief State Law Adviser in the Department of Justice, April, 2004; see Loubser, A., 'Business Rescue in South Africa: A Procedure in Search of Home?', (2007), 40, Comp. & Int'l L.J.S. Afri., page 160.

<sup>212</sup> The Department of Trade and Industries South African Company Law for the 21<sup>st</sup> Century - Guidelines for Corporate Law Reform, May 2004, Notice 1183, page 43-45 available at <http://www.gov.za/documents/download.php?f=169430> accessed in 1.06.2014.

<sup>213</sup> Government Gazette Number 32121.

<sup>214</sup> However, in terms of the 'transitional arrangements', the provisions of the Companies Act 61 of 1973 still apply in the winding up of insolvent companies, as provided for in Schedule 5 item 9 of the 2008 Act.

statute<sup>215</sup> and in 2010 the errors led to the amendment of 225 provisions of the Act – nearly half of the entire statute. The rectifications received presidential assent as the Companies Amendment Act 3 of 2011.<sup>216</sup> This took place even before the legislation came into force.

The unusual sequence of events from publication of the first Bill to presidential assent raised the eyebrows of at least one academic<sup>217</sup> who called to mind other companies' legislation reforms that had been preceded by a commission of inquiry.<sup>218</sup> This scholar predicted that substantial problems would become evident when the legislation came to be implemented. As was noted, above, significant corrections were in fact made before the legislation came into effect, thus defusing this prediction to some extent.

Prior to the enactment of this new legislation, a number of submissions had been made regarding the reform of South Africa's corporate rescue legislation.<sup>219</sup> Some scholars proposed amendments to the process of judicial management procedure,<sup>220</sup> but most were of the view that the issue would be more effectively addressed by a complete replacement of judicial management with entirely new corporate rescue provisions.<sup>221</sup>

One suggestion was to integrate corporate rescue into insolvency legislation, as is done in some jurisdictions.<sup>222</sup> This had already been attempted in the Companies Act 46 of 1926 which

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<sup>215</sup>The errors included grammatical errors and incorrect cross-references; see Cassim, F. et al, *Contemporary Company Law*, 2nd Edition, Juta, (2012), page 1.

<sup>216</sup> Government Gazette Number 34243.

<sup>217</sup> Loubser, A., *Some Comparative Aspect of Corporate Rescue in South African Company Law*, Doctor of Laws Unpublished Thesis UNISA, (2010), page 5.

<sup>218</sup> This time there was no Commission formed. Loubser cited, Keay, A., 'To Unify or not to Unify Insolvency Legislation: International Experience and the Latest South African Proposal,' (1999), *De Jure* 67, notes that the English first Company Bill in 1970s which raised a lot of problems due to the fact that it was brought up without thorough inquiry from Commission.

<sup>219</sup> Kloppers, P. 'Judicial Management-A Corporate Rescue Mechanism in Need of Reform?,' (1999), 10 *Stellenbosch LR*, page 368, Rajak, H. and Henning, J., 'Business Rescue for South Africa', (1999), 116 *S. African L.J.* page 268, Burdett, D.A., 'The Introduction of Truly Unified Insolvency Act: Ancillary Matters,' PART 4 C, (2002), page 48-49, Keay, A., 'To Unify or not to Unify Insolvency Legislation: International Experience and the Latest South African Proposal,' (1999), *De Jure* 73-74.

<sup>220</sup> Proposed for amendment of the same procedure in Kloppers, P., 'Judicial Management Reform -Steps to Initiate a Business Rescue' (2001), 13 *S. Afr. Mercantile L.J.*, page 379-379.

<sup>221</sup> Loubser, A., 'Business rescue in South Africa: a procedure in search of a home?', (2007) 40 *Comp. & Int'l L.J. S. Afr.*, page 161-162 and 169-170 and Rajak, H. and Henning, J., 'Business Rescue for South Africa', (1999), 116 *S. African L.J.* page 270.

<sup>222</sup> Burdette, D.A., 'The Introduction of a Truly Unified Insolvency Act: Ancillary Matters,' Part 4 C, page 356

located judicial management and winding-up in the same chapter<sup>223</sup> and such coupling was thought to be a reason for the reluctance of companies to apply for judicial management.<sup>224</sup> The rescue process provided for in *administration* in terms of English law had experienced the same problem when that procedure and winding-up were located in the same legislation.<sup>225</sup> It seems that coupling the two concepts in this way taints the perception of corporate rescue.<sup>226</sup>

## 2.12 The General Concept of South African Judicial Management

As was noted earlier, the Companies Act 61 of 1973 took a notably creditor-friendly approach to corporate rescue.<sup>227</sup> The focus was on securing the payment of creditors' claims rather than rescuing a struggling corporate entity.<sup>228</sup> The judiciary, too, implicitly took this approach. For instance, in *De Jager v Koroo Koeldranke and Roomys (Edms) Bpk*,<sup>229</sup> it was held, in the context of granting an order for judicial management, that the court should give primary consideration to the interests of creditors and shareholders. This approach had the result that financially distressed companies seldom resorted to judicial management and of those that did, more than eighty per cent were ultimately liquidated.<sup>230</sup>

Judicial management could be applied for by various stakeholders.<sup>231</sup> If the order were granted, the court would stipulate a return date and make any other order it thought fit.<sup>232</sup> Several factors

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<sup>223</sup> The Companies Act 46 of 1926 had dealt with judicial management and winding-up in the same chapter. This, said one commentator (Olver, H., 'Judicial Management-A Case for Law Reform,' (1986) THRHR, page 84,) gave the impression that they were aspects of one and the same process.

<sup>224</sup> There are cogent arguments to have insolvency and corporate rescue in separate legislation, see Loubser, A., 'Business rescue in South Africa: a procedure in search of a home?', (2007)40 Comp. & Int'l L.J. S. Afr., page 169.

<sup>225</sup> Finch, V., *Corporate Insolvency Law: Principles and Perspectives*, 2<sup>nd</sup> Edition, CUP, (2009) page 372, Brown, D., *Corporate Rescue: Insolvency Law in Practice*, John Wiley and Sons, Chichester, (1996), page 654-657.

<sup>226</sup> The psychological impact is noted by Loubser, A., 'Business Rescue in South Africa: A Procedure in Search of a Home?', (2007)40 Comp. & Int'l L.J. S. Afr., page 162, very likely for the public lose confidence on the company once it enters into judicial management, see 37. Williams, R.C., *Concise Corporate Law*, Butterworth, (1994), page 227.

<sup>227</sup> Burdette, D.A., 'Some Initial Thoughts on the Development of a Modern and Effective Business Rescue Model for South Africa (Part 1), (2004)', 16, S.Afr.Mercantile L.J., 244.

<sup>228</sup> Even creditors were not in favour of this process, as evidenced in *Tobacco Auctions Ltd v A.W Hamilton (Pty) Ltd* 1966 (2) SA 451 (R), where the creditors preferred that the company be liquidated rather than embarking on judicial management proceeding. Perhaps the business community was sufficiently educated on the potential benefits to them of judicial judgment.

<sup>229</sup> 1956 (3) SA 594

<sup>230</sup> Olver, H., 'Judicial Management-A Case for Law Reform,' (1986) THRHR, page 84.

<sup>231</sup> Section 346 (1) of the Companies Act 61 of 1973. The interested parties are the company, the creditors (including contingent and prospective creditors), members of the company, the Master in the case of a company being wound up voluntarily and the provisional judicial manager if a final order of judicial management was being sought. These stakeholders are the same persons as are eligible to apply for the winding-up of a company. Some of the judicial management directives were located in the winding-up provisions of the legislation..

<sup>232</sup> Section 428 of the Companies Act 61 of 1973.

were then considered on the return day in determining whether to grant a final order of judicial management.<sup>233</sup> The courts inevitably set the bar higher for the granting of a final as distinct from a provisional order for judicial management<sup>234</sup> and relatively few companies were accorded a final order.

The following grounds had to be established for the court to grant an order for judicial management.<sup>235</sup> Firstly, that, by reason of mismanagement or any other cause, there was a reasonable probability that, if the company were placed under judicial management, it would be enabled to fulfil its obligations, Secondly, the court had to be satisfied that granting such an order would be just and equitable.<sup>236</sup> In combination, these requirements imposed a heavy burden of proof on an applicant for the order.<sup>237</sup> In particular, proving the requisite ‘reasonable probability’ was judicially interpreted as requiring more than just a business plan and financial projections.<sup>238</sup> Forecasts based on unprovable contingencies were not regarded as persuasive.<sup>239</sup>

The approach of the judiciary in this regard is epitomised in *Silverman v Doornhoek Mines Ltd*,<sup>240</sup> which is one of the earliest and most often cited decisions on judicial management. In this case, the court interpreted the legislative provisions as meaning that a strong probability had to be demonstrated that, if a company’s management or assets were sound, it would revive and become financially sound. It was further held that a judicial management order should be

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<sup>233</sup> Section 132 (2) of the Companies Act 61 of 1973 provides that the following factors are taken into consideration:

- (a) the opinions and wishes of creditors and members of the company;
- (b) the report of the provisional judicial manager under section 430;
- (c) the creditors who did not prove claims at the first meeting of creditors and the amounts and nature of their claims;
- (d) the report of the Master; and
- (e) the report of the Registrar,

<sup>234</sup> *Tenowitz v Tenny Investments (Pty) Ltd* 31.

<sup>235</sup> Section 427 (2) and 346 of the Companies Act 61 of 1973 stipulated the parties who could apply for a judicial management order.

<sup>236</sup> Section 427 (1) Companies Act 61 of 1973.

<sup>237</sup> *Noordkaap Lewendehawe Ko-op Bpk v Schreuder* 1974 (3) SA 102 (A).

<sup>238</sup> See also *Noordkaap Lewendehawe Ko-op Bpk v Schreuder* 1974 (3) SA 102 (A) which held that what had to be shown was a reasonable probability, not a mere possibility. Further, see Loubser, A., Some Comparative Aspects of Corporate Rescue in South African Company Law, Doctor of Laws Unpublished Thesis UNISA, (2010), page 23.

<sup>239</sup> Factors such as managerial efficiency, currency stabilization, demand fluctuation and government policies, play a significant role in a business plan.

<sup>240</sup> 1935 TPD 353.

granted only in special circumstances since it was a privilege in favour of a company. This precedent set a high bar for subsequent applications for a judicial management order.<sup>241</sup>

In their interpretation of the judicial management provisions of the Companies Act, the judiciary of that era, in seeking an interpretation of the statutory provisions, had regard to the record of parliamentary speeches at the time when the law was enacted.<sup>242</sup> In the parliamentary debate preceding the enactment of the Companies Act of 1926 the Minister for Justice said that a judicial management order was to be granted to companies that were significant for the country and its economy.<sup>243</sup> This statement that seems to have influenced the judiciary in determining whether to grant orders of judicial management<sup>244</sup>

Aside from the problematic criteria for the granting of judicial management, the process had other significant shortcomings, of which the following are particularly significant. Only companies could qualify for the process.<sup>245</sup> The statutory criterion requiring a reasonable *probability* that the company would be able to pay its debts set the bar unrealistically high<sup>246</sup> and was seldom able to be satisfied; realistically, a compromise of creditors' claims would often be necessary.<sup>247</sup> The discretion vested in the court by the legislation was arguably too wide and too vaguely expressed.<sup>248</sup> The process from application to an order of provisional judicial management, and thence to a final order, tended to be very protracted.<sup>249</sup> The involvement of the court was, arguably, excessive and the judiciary had developed significant scepticism vis-a-vis the process. Consequently, potentially salvageable companies were forced

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<sup>241</sup> *Tenowitz v Tenny Investments (Pty) Ltd* 1979 (2) SA 689 (E), *Ben-Tovim v Ben-Tovim* 2000 3 SA 325 (C), *Makhuva v Lukhoto Bus Service (Pty) Ltd* 1987 3 SA 376 (V) and *Kotze v Tulryk Bpk* 1977 (3) SA 118.

<sup>242</sup> The case law in this regard of course predates the decision in *Natal Joint Municipal Pension Fund v Endumeni Municipality* 2012 (4) SA 593 (SCA) in which the Supreme Court of Appeal essentially redefined the principles of statutory interpretation, and decisively moved away from a search for 'the intention of the legislature'.

<sup>243</sup> Union of South Africa House of Assembly Debates 25 February 1926 Volume 6 column 983-984.

<sup>244</sup> This criterion, it is submitted, is too impossibly elastic to be capable of consistent application.

<sup>245</sup> Rajak, H. and Henning, J., 'Business Rescue for South Africa', (1999), 116 S. African L.J. page 267.

<sup>246</sup> Section 427 (1) of the Companies Act 61 of 1973; in this regard, see *Silverman v Doornhoek Mines Ltd.* (1935) TPD 349 and Burdette, D.A., Some Initial Thoughts on the Development of a Modern and Effective Business Rescue Model for South Africa (Part 1), (2004), 16, S.Afr.Mercantile L.J., page 249.

<sup>247</sup> Rajak, H. and Henning, J., 'Business Rescue for South Africa', (1999), 116 S. African L.J. page 268

<sup>248</sup> A required prospect that the company would be able to pay its debts in full is believed to be the factor that led to the failure of Official Management in Australia – see Harmer, R.W., 'Comparison of Trends in National Law: The Pacific Rim,' (1973)23, BJIL, page 149. See also Burdette, D.A., Some Initial Thoughts on the Development of a Modern and Effective Business Rescue Model for South Africa (Part 1), (2004), 16, S.Afr.Mercantile L.J., 244.

<sup>249</sup> Section 428 and 427 of the Companies Act 1973.

into liquidation.<sup>250</sup> A corpus of experienced and expert judicial managers had not evolved;<sup>251</sup> the legislation laid down no criteria for such appointments and usually professional liquidators were appointed who inevitably had the wrong mind-set and lacked expertise in rescuing companies rather than winding them up.<sup>252</sup>

A moratorium on creditor's claim was not an automatic consequence where a company entered judicial management, but the court had the power to impose such a moratorium.<sup>253</sup> This was a fundamental lacuna in the legislation in that corporate rescue is scarcely conceivable in the absence of such a moratorium. Even where a moratorium was judicially imposed, creditors could apply to court for leave to sue the company.<sup>254</sup> Where such leave was sought, it was irrelevant whether the claim had arisen before or after the commencement of the judicial management proceedings.<sup>255</sup> In *Millman NO v Swartland Huis Meubeleerders (Edms) Bpk: Repfin Acceptance Ltd intervening*,<sup>256</sup> the court said that, in matters involving judicial management, the objects of the legislation had to be considered.<sup>257</sup> The decision in *Le Roux*

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<sup>250</sup> Companies seeking a compromise with creditors had to proceed in terms of s 311 of the Companies Act 61 of 1973, which explicitly provided for such compromises; but even that provision had its weaknesses as an avenue for business rescue. Kloppers, P. 'Judicial Management— A Corporate Rescue Mechanism in Need of Reform?' (1999) 3 Stell LR 417, page 430 states that "... Section 311 aimed more at the rescue of the corporate shell than the rescue of a viable commercial enterprise capable of making a useful contribution to the economic life of the country" . An effective business rescue process of course goes further than merely enabling the payment of the company's creditors.

<sup>251</sup> The inappropriateness of employing liquidators to rescue a company has often been remarked upon; see for example Olver, H., 'Judicial Management-A Case for Law Reform,' (1986) THRHR, page 87.

<sup>252</sup> Rajak, H. and Henning, J., 'Business Rescue for South Africa', (1999), 116 S. African L.J. page 267 and Burdette, D.A., A Framework for Corporate Insolvency Law Reform in South Africa (2002) LLD, University of Pretoria, page 349.

<sup>253</sup> Section 428 (2) (c) of the Companies Act 61 of 1973.

<sup>254</sup> In *Ross v Northern Machinery and Irrigation (Pty) Ltd* 1940 TPD 119 at 235 the court said that, "There is, however, great force in the contention advanced on behalf of the applicant that it is inequitable that *by the refusal of leave, the applicant should be deprived of the possession and use of the property,* with at least the potential risk of depreciation, for the benefit of creditors, of whom it is not one, when *the applicant stands to gain nothing by the eventual success of the judicial management.*" [Emphasis supplied] Under such circumstances the court could grant the creditor leave to claim possession of the company's property without an inquiry into the damage that this would do the prospect of the company's rehabilitation; the focus was entirely on the creditor's rights.

<sup>255</sup> *Samuel Osborn (SA) Ltd v United Stone Crushing Co (Pty) Ltd (Under Judicial Management)* 1938 WLD 229.

<sup>256</sup> 1972 (1) SA 741 (C) at 744B. In this case, it was held that, "The objectives of a judicial management order are to postpone a liquidation of a company which is in difficulties and to provide a moratorium for that company for a period long enough (it can be either a period fixed by the court or an indefinite period) to enable that company to meet its obligations and to become successful concern."

<sup>257</sup> To the same effect, see *Western Bank v Laurie Fossati Construction (Pty) Ltd (Under Judicial Management)* 1974 (4) SA 607 (E) at 611.

*Hotel Management (Pty) v E Rand (Pty) Ltd*<sup>258</sup> was a particular set-back for the concept of judicial management.

This study has been unable to locate empirical data as to the precise number of successful forays into judicial management.<sup>259</sup> The only available record referred to in the literature is one in the 1980s that recorded a twelve per cent success rate.<sup>260</sup> There is a similar dearth of reliable statistical data as regards more sophisticated forms of business rescue in the jurisdictions where this is provided for. Where records are available, they tend to be lacking in important details,<sup>261</sup> such as the category of company rescued, whether public or private, whether post-commencement finance was made available, and if so how much, and the proportion of their claims that was eventually paid out to creditors. It also needs to be borne in mind that corporate rescue can take place informally, by a process agreed to by the interested parties and outside of the legislative processes and structures; statistical records of such informal processes are of course simply not kept.

### **2.13 The General Concept of South African Business Rescue<sup>262</sup>**

In terms of the Companies Act 2008, for a company to commence business rescue procedure, it must be ‘financially distressed’.<sup>263</sup> The Act tries to provide for a time frame to take action in this regard.<sup>264</sup> This implies that the company which qualifies for entry into business rescue need not necessarily be actually insolvent (even commercially insolvent), merely financially distressed. Further, it shows that the legislation recognises the desirability of early remedial action.

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<sup>258</sup> [2001] 1 All SA 233 (C).

<sup>259</sup> In principle, judicial management can involve a compromise with creditors, which would increase the prospects of a successful outcome; see Henning, J., ‘Judicial Management and Corporate Rescues in South African Law,’ in Rajak, H., (Editor), *Insolvency Law Theory and Practice*, (1993) page 308.

<sup>260</sup> Olver, A.H., ‘Judicial Management- A Case for Law Reform,’ (1984) 49, THRHR, page 85.

<sup>261</sup> Wood, P.R., *Law and Practice of International Finance: Principles of International Insolvency*, 2nd Edition, Sweet and Maxwell, (2007), page 48.

<sup>262</sup> All the issues raised and discussed in this sub-chapter are analysed further in the following chapters.

<sup>263</sup> Section 128 (1) (f) provides a definition of a financially distressed company in this context, as follows:

(i) a company that appears to be reasonably unlikely to be able to pay all of its debts as they become due and payable within immediately ensuing six months; or  
(ii) where it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months.

<sup>264</sup> The importance of prompt actions is discussed in Finch, V., ‘The Recasting of Insolvency Law,’ (2008), 68 M.L.R., 723-726 and Finch, V., ‘Doctoring in the Shadows of Insolvency,’ (2005), J.B.L., page 690. See Esty, B. and Megginson, W., ‘Creditor Rights, Enforcement, and Debt Ownership Structure: Evidence from the Global Syndicated Loan Market,’ (2003), 38 (1), *The Journal of Financial and Quantitative Analysis*, 37-59.

A financially distressed company can commence business rescue via either of two processes. The first is by way a resolution of the board which is then filed with the Companies and Intellectual Property Commission.<sup>265</sup> The second is where an affected person applies to court to place a company in business rescue.<sup>266</sup> Each of these two modes of entry into business rescue has its own grounds.<sup>267</sup> The grounds required for the court to order that business rescue commence are wider than where the board passes a resolution in this regard in that, where an order of court is sought, an issue arises as to whether such an order would be “just and equitable” – as was the case for an order of judicial management.

Once a company has commenced business rescue, the following are the phases in the process:<sup>268</sup>

- (i) the temporary supervision of the company, and the management of its affairs, business and property;
- (ii) a temporary moratorium on the rights of the claimants against the company or in respect of property in its possession, and on enforcement action; and
- (iii) the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and its equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if this is not possible, that results in a better return for the company’s creditors and shareholders than would result from the immediate liquidation of the company.

The management of a company that is under business rescue is vested in the turnaround expert referred to as the business rescue practitioner.<sup>269</sup> This person is appointed either by the company or by the “affected persons”, which includes the company’s creditors. The practitioner is appointed by the company if business rescue commenced via a resolution of the board of directors.<sup>270</sup> (An affected person then has the right to apply to court for to have the appointment set aside.<sup>271</sup>) Where an application has been made to court for a company

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<sup>265</sup> Section 129 (2) of the Act.

<sup>266</sup> Section 131 (1) of the Act.

<sup>267</sup> Section 129 (1) where the company voluntarily commences rescue and section 131 (4) (a) where the court makes an order.

<sup>268</sup> Section 128 (1) (b) of the 2008 Act.

<sup>269</sup> Section 128 (1) (d) read with s 140(1) of the 2008 Act.

<sup>270</sup> Section 129 (3) of the 2008 Act.

<sup>271</sup> Section 130 (1) (b) of the 2008 Act.

to commence business rescue, the court appoints an interim practitioner,<sup>272</sup> nominated by the affected person who is the applicant.<sup>273</sup> The secured creditors are often dominant in this process, in which event their nominee will be appointed, thereby giving those creditors significant assurance that their interests will be protected.<sup>274</sup>

Chapter 6 of the Companies Act 2008 (which has the heading ‘Business Rescue and Compromise with Creditors’) accords a company significant protection once business rescue commences.<sup>275</sup> In particular, a statutory moratorium automatically comes into place barring the commencement of legal proceedings against the company or any enforcement action, unless the practitioner or the court consents.<sup>276</sup>

Overall, the statutory scheme for business rescue attempts intends to balance the interests of employees of the company and the interests of other affected persons – which the judicial management legislation did not attempt to do.<sup>277</sup> The company must also comply with

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<sup>272</sup> Section 131 (5) of the 2008 Act.

<sup>273</sup> An independent creditor who has a majority voting interest has the power to reject the practitioner; section 131 (5) and Section 147 of the 2008 Act.

<sup>274</sup> Discussed in detail in Chapter 3.

<sup>275</sup> Section 133 of the 2008 Act.

<sup>276</sup> Section 133 of the 2008 Act.

<sup>277</sup> Employees’ interests are protected by section 136 of the Act 2008 which provides as follows:

“ Effect of business rescue on employees and contracts

(1) Despite any provision of an agreement to the contrary-

(a) during a company’s business rescue proceedings, employees of the company immediately before the beginning of those proceedings continue to be so employed on the same terms and conditions, except to the extent that-

(i) changes occur in the ordinary course of attrition; or

(ii) the employees and the company, in accordance with applicable labour laws, agree different terms and conditions; and

(b) any retrenchment of any such employees contemplated in the company’s business rescue plan is subject to section 189 and 189A of the Labour Relations Act, 1995 (Act No. 66 of 1995), and other applicable employment related legislation.”

Further protection is afforded in terms of sections 130, 131, 148 and 150 (2) (c) (ii) of the Act 71 of 2008. Similar protection for employees is found in the administration process in the UK, See McCormack, G., *Corporate Rescue Law-An Anglo-American Perspective*, Edward Elgar Publishing Ltd., (2008), page 294. The situation is, however, different in terms of reorganisation in the USA where employees are not protected during the process and the terms and conditions of employment, including a modification of collective bargaining agreements, can be amended without considering the interests of an employee, see Skeel, D., ‘Employees, Pension and Governance in Chapter 11,’ (2004), 82,(4), (WULQ, page 1472, Where the business is transferred, Chapter 11 offers no protection to employees; see McCormack, G., *Corporate Rescue Law-An Anglo-American Perspective*, Edward Elgar Publishing Ltd., (2008), page 294.

relevant labour legislation.<sup>278</sup> Employees' claims are accorded preferential status<sup>279</sup> and are arguably over-protected,<sup>280</sup> to the extent that creditors may be reluctant to co-operate in the rescue process.

## 2.14 Types of Business Entities Qualifying for South African Corporate Rescue

### 2.14.1 Judicial Management

A judicial management order could be made only in respect of companies registered under the Companies Act.<sup>281</sup> On occasion the courts took cognisance of the size of the company's business, as in *Tobacco Auctions Ltd v A W Hamilton (Pty) Ltd*<sup>282</sup> as an issue relevant to whether an order of judicial management should be granted. Other factors sometimes considered by the courts were the number of the company's members and the value of its assets.<sup>283</sup> Some scholars suggested that judicial management should be made available to other forms of business entities.<sup>284</sup>

It seems that the judicial management legislation was not designed to assist small companies.<sup>285</sup> The scholarly literature, however, favoured having only one legislative rescue process.<sup>286</sup> In South Africa, the business rescue provisions of the Companies Act are available to close corporations as well as companies.<sup>287</sup>

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<sup>278</sup> See *Oakdene Square Properties (Pty) Ltd and Others* para 15 where the court said:

"The philosophy is to try and prevent the negative social results following upon companies in distress having to lay off or retrench its employees. Of course, where a company has no employees, these considerations may not apply and the court will have to take this fact into consideration when exercising its discretion whether or not to grant a business rescue order". [Emphasis supplied]

<sup>279</sup> Section 144 (2) of the Act.

<sup>280</sup> In jurisdictions where international standard labour laws are adhered to, the employer has no discretionary power, and an agreement is needed between employer and employee within the ambit of the labour law framework; see Articles 3, 4 and 10 of the International Labour Organisation, Protection of Workers' Claims (Employer's Insolvency) Convention, 1992 (No. 173).

<sup>281</sup> That is to say, companies registered in terms of Chapter IV of Companies Act 61 of 1973.

<sup>282</sup> 1966 (2) SA 451 (R) at 453.

<sup>283</sup> Kloppers, P., 'Judicial Management Reform - Steps to Initiate a Business Rescue' (2001), 13 S. Afr. Mercantile L.J., page 369.

<sup>284</sup> Partnerships, close corporations, sole proprietorships and business trusts were amongst the structures suggested to be included in judicial management, see Kloppers, P., 'Judicial Management-A Corporate Rescue Mechanism in Need of Reform?', (1999), 10 Stellenbosch LR, page 367 and Smits, J., 'Corporate Administration: A proposed Model,' (1999), 32 De Jure, page 94.

<sup>285</sup> Olver, H., 'Judicial Management-A Case for Law Reform,' (1986) THRHR, page 87.

<sup>286</sup> Kloppers, P., 'Judicial Management-A Corporate Rescue Mechanism in Need of Reform?', (1999), 10 Stellenbosch LR, page 368, Rajak, H. and Henning, J., 'Business Rescue for South Africa', (1999), 116 S. African L.J. page 268, Burdette, D.A., 'The Introduction of Truly Unified Insolvency Act: Ancillary Matters,' PART 4 C, (2002), page 48-49, Keay, A., 'To Unify or not to Unify Insolvency Legislation: International Experience and the Latest South African Proposal,' (1999), De Jure 73-74.

<sup>287</sup> Section 72 of the Close Corporations Act 69 of 1984.

### **2.14.2 Business Rescue**

In contrast to judicial management which was available only to companies registered under the companies legislation, business rescue in terms of the Companies Act 2008 is available not only to registered companies,<sup>288</sup> but is also potentially available to close corporations.<sup>289</sup> This is a positive development, given that most South African businesses are small to medium-sized enterprises<sup>290</sup> and there are many close corporations in existence. The legislated process of business rescue has not however been made available to partnerships, business trusts or sole traders, but an argument can be made that the process should be so extended.

### **2.15 Conclusion**

The concept of business rescue, and its manifold potential benefits, has gained broad acceptance in South Africa, and the failed experiment with judicial management has been consigned to history. However, improvements to the business rescue provisions of the Companies Act will no doubt continue to be made, as weaknesses in the legislation are revealed, inter alia, by judicial decisions.

The process of such an attempted rescue involves significant costs, both direct and indirect. Direct costs are those incurred by the company in applying for a court order and the hiring of experts such as financial analysts, accountants and lawyers to assist in carrying out the rescue activities. Indirect costs include the possible loss of customers, trade suppliers and employees, thereby preventing business activities from being conducted in the same manner as before. The company's shareholders and creditors will usually receive less than what they are owed by the company.

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<sup>288</sup> Section 14 of the 2008 Act provides for the registration of companies, as defined in s 1.

<sup>289</sup> This is provided for in terms of Section 224 and Item 6 of Schedule 3 of Companies Act 71 of 2008 which amended Section 66 of the Close Corporations Act 69 of 1984.

<sup>290</sup> Burdette, D.A., Some Initial Thoughts on the Development of a Modern and Effective Business Rescue Model for South Africa (Part 1), (2004), 16, S.Afr.Mercantile L.J., 252.

## **CHAPTER THREE**

### **CREDITORS' POSITION IN THE COMMENCEMENT OF THE BUSINESS RESCUE PROCEEDINGS**

#### **3.1 Introduction**

As indicated in the preceding chapter, a company can commence business rescue via two possible routes, namely, through a board resolution filed with the Companies Commission or by an order of the High Court following an application by an affected person.<sup>291</sup>

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<sup>291</sup> Section 129 and 131 of the 2008 Act.

This chapter discusses the impact on the company's creditors where business rescue commences via either of these two routes, and goes on to discuss the duties of the business rescue practitioner.

## **3.2 Commencement of Business Rescue Proceedings**

### **3.2.1 Company Resolution to Commence Business Rescue Proceedings**

Commercial insolvency, sometimes called cash flow insolvency (connoting an inability to pay debts as they fall due) is a common early symptom of financial distress in a company.<sup>292</sup> At this juncture, the company's liabilities may, but do not necessarily, exceed its assets – which would constitute factual insolvency as distinct from commercial insolvency.<sup>293</sup>

If the board has reasonable grounds to believe the company is financially distressed, the Act implicitly requires the directors to confront the situation and either place the company in business rescue or explain in writing to all affected persons why, as a board, they are not doing so.<sup>294</sup> The fact that the company has been placed in liquidation is not a barrier to its commencing business rescue;<sup>295</sup> in such circumstances, the board is not permitted to resolve that the company enter business rescue<sup>296</sup> but there is no bar on an affected person's applying to court for an order that the company commence business rescue.

The board of directors of a company is usually well placed to become aware at an early stage of the company's actual or pending financial distress. A report of the Companies and Intellectual Property Commission report released in 2015<sup>297</sup> reflects that 90 percent of business

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<sup>292</sup> Goode, R.M., *The Principles of Corporate Insolvency Law*, (Sweet & Maxwell), 3<sup>rd</sup> Edition, 2005, pages 86-87

<sup>293</sup> *Ibid.*

<sup>294</sup> Section 129(7); in terms of s 128 (1) (f) "financially distressed", in reference to a particular company at any particular time, means that-

(i) it appears to be reasonably unlikely that the company will be able to pay all of its debts as they become due and payable within the immediately ensuing six months; or

(ii) it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months;

<sup>295</sup> See *Welman v Marcelle Props 193CC and Another* (33958/2011) [2012] ZAGPJHC 32, para 28; *Sulzer Pumps (South Africa) (Pty) Ltd v O&M Engineering CC* [2015] ZAGPPHC 59 para 23; *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Ltd & Another* [2013] ZAGPPHC 109 para 8 and *Gormley v West City Precinct Properties (Pty) Ltd & Another* [2012] ZAWCHC 33 para 11. To the same effect, see *Redpath Mining South Africa (Pty) Ltd v Marsden No and Others* (18486/2013) [2013] ZAGPJHC 148, para 47.

<sup>296</sup> Section 129(2)(a).

<sup>297</sup> Companies and Intellectual Property Commission, *Business Rescue Status Quo Report*, Prepared by Pretorius, M. of Business Enterprises at University of Pretoria (Pty) Ltd, 2015, page 31.

rescue proceedings commenced via board resolutions and the remaining 10 percent via applications to court by affected persons.

The ease of access into business rescue via a board resolution (subject to possible formal objection by an affected person) is one of the factors that identifies the South Africa's business rescue regime as debtor-friendly.<sup>298</sup> The board is thereby in a position to initiate the process in order to temporarily escape pressure from creditors<sup>299</sup> through the coming into force of the statutory moratorium. The directors may be motivated primarily by a desire to avoid liquidation in order to avoid the consequential loss of their source of income.<sup>300</sup> On the other hand, the ease of entry into business rescue via a board resolution opens the door for unsalvageable companies.<sup>301</sup> A filtering mechanism in this regard is desirable.<sup>302</sup>

Business rescue commences immediately the board has passed and filed the requisite resolution with the Commission or when the court has given its consent to file such a resolution.<sup>303</sup> At this juncture, the statutory moratorium takes effect<sup>304</sup> but the creditors and other affected persons have the right to apply to the High Court to set aside the board resolution.<sup>305</sup>

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<sup>298</sup> In *Ex parte: Nell N.O. and Others* (45279/14) [2014] ZAGPPHC 620, para 27 the judge commented that a resolution of the board to commence business rescue mechanism is an easier route into business rescue than an application to court. In this regard, see also dicta in *Griessel and Another v Lizemore and Others* (2015/24751) [2015] ZAGPJHC 189; para 4 where the company had passed the resolution without the knowledge of the shareholders.

<sup>299</sup> In *Griessel and Another v Lizemore and Others* (2015/24751) [2015] ZAGPJHC 189; 84 Spilg, J. specified factors to be considered when determining whether the directors had initiated business rescue proceedings in bad faith, namely: the attitude of the major creditors; whether the company has assets; whether there are possibilities of funding for it to be rescued; whether the company intends to implement a plan that meets the objectives stipulated by the statute and whether there is a reasonable prospect of the plan being implemented.

<sup>300</sup> Where directors take the initiative they avoid the legal risks involved in continuing to manage an insolvent or near insolvent company.

<sup>301</sup> See *African Banking Corporation of Botswana v Kariba Furniture Manufacturers & Others* (228/2014) [2015] ZASCA 69; 2015, where the company filed for business rescue in circumstances where there were no prospects of financial recovery. A similar issue has arisen in Sweden; see Lofalk, G., 'The Far-reaching Reforms of Swedish Insolvency Legislation,' *Eurofenix* (Autumn 2003), pages 8-11, and Bergstrom, C. and Others, 'Secured Debt and the Likelihood of Reorganisation,' 21 *International Review of Law and Economics*, (2002), page 359.

<sup>302</sup> The Court has the power, on application by an affected person, to set aside board's resolution under s 130 (1) (a) of the 2008 Act.

<sup>303</sup> Section 132 (1) (a) of the 2008 Act, further all the directors should sign a business rescue resolution agreement document failure to do so the resolution is at risk of being set aside of failure to comply with the procedure as it is provided under Section 129 of the 2008 Act; this was situation was witnessed in *DH Brothers Industries (Pty) Ltd v Gribnitz NO and Others* 2014 (1) SA 103 (KZP) para 16

<sup>304</sup> Once a creditor has failed to pay a debt, the creditors have the right to enforce repayment' see section 129 (1) of the National Credit Act 34 of 2005. This is subject to any credit agreement in a restructuring order or proceedings as provide for in s 129 (2) of the statute.

<sup>305</sup> Section 130 (4) of the 2008 Act, explained later in this chapter.

The Act places an obligation on the board of directors in this regard.<sup>306</sup> If the board has reasonable grounds to believe that the company is financially distressed, but it does not pass a resolution to commence business rescue, the board is obliged to inform each affected party in writing why such a resolution was not passed and filed. This is in compliance with the objective of the legislation that seeks to identify and then rehabilitate financially distressed companies.<sup>307</sup>

The Act attempts to pre-empt abusive conduct in this regard<sup>308</sup> by requiring the board to act in good faith.<sup>309</sup> It is submitted that the Act could profitably be more explicit in this regard.

### **3.2.2 Setting Aside Business Rescue Resolution**

An affected person is given the right to apply to court to set aside a resolution of the board of directors for the commencement of business rescue.<sup>310</sup> The grounds for doing so are specified in the Act. The court is given a discretion as to whether to receive a report from the practitioner as to whether the company appears to be financially distressed and if so whether there is a reasonable prospect of rescuing the company.<sup>311</sup>

A director who has not voted against the resolution has the right to apply to court to set aside the board resolution.<sup>312</sup> A further basis for judicial intervention is that accorded to any affected party if the company has not adhered to the procedural requirements for the filing of the resolution. These provisions of the Act will fall to be interpreted in accordance with the

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<sup>306</sup> Section 129 (7) of the 2008 Act

<sup>307</sup> In the USA Chapter 11 sections 303 and 105 provide for a business judgement.

<sup>308</sup> Section 130 (5) (c) (iii) of the Act, provides that if the court finds that there were no reasonable grounds for believing that the company would be unlikely to pay all of its debts as they became due and payable, an order of costs may be made against any director who voted in favour of the resolution to commence business rescue proceedings, unless the court is satisfied that the director acted in good faith and on the basis of information that the director was entitled to rely upon in terms of section 76(4) and (5). In appropriate circumstances, the directors can be subjected to other liabilities for carrying on business recklessly, with gross negligence or for any fraudulent purpose as envisaged in Section 77 and 22 (1) of the 2008 Act.

<sup>309</sup> See *Climax Concrete Products CC t/a Climax Concrete Products CC v Evening Flame Trading 449 (Pty) Ltd and Others* (812/2012) [2012] ZACPEHC 39, para 19.

<sup>310</sup> Section 130 (1) (a) of the 2008 Act provides for setting aside the resolution, on the grounds that:

- (i) there is no reasonable basis for believing that the company is financially distressed;
- (ii) there is no reasonable prospect for rescuing the company or;
- (iii) the company has failed to satisfy the procedural requirements set out in section 129.

<sup>311</sup> Section 130 (5) (b) of the 2008 Act.

<sup>312</sup> Section 130 (2) of the 2008 Act grants a right to a director who in good faith voted for the resolution to apply to set it aside after he or she has discovered that the information were false or misleading.

decision of the Supreme Court of Appeal in *Natal Joint Municipal Pension Fund v Endumeni Municipality*<sup>313</sup> which emphasised the importance of context in statutory interpretation.

One of the statutory criteria to be applied by the court where application is made for the setting aside of the board resolution in this regard is that it would be “just and equitable” to do so.<sup>314</sup> This aspect of the legislative provisions came under critical scrutiny in *Absa Bank Limited v Caine NO and Another, In Re; Absa Bank Limited and Another*<sup>315</sup> where the view was expressed that this ground should also have been made available to creditors and affected persons seeking the setting aside of the resolution. Similar criticism was voiced by the court in *DH Brothers Industries (Pty) Ltd v Gribnitz NO and Others*.<sup>316</sup>

The “just and equitable” criterion in this context came under scrutiny by the Supreme Court of Appeal in *Panamo Properties (Pty) Ltd and Another v Nell N.O. and Others*<sup>317</sup> where the court observed that –

“It has been suggested that the effect of the inclusion of sub-para (ii) in this section is to introduce a fourth ground for setting aside a resolution to commence business rescue in addition to those set out in s 130 (1) (a). I do not think that is correct. This appears to me to be yet another case in a long line... in which the legislation uses the disjunctive word `or`, where the provisions are to be read conjunctively and the word `and` would have been more appropriate. Where to give the word `or` a disjunctive meaning would lead to inconsistency between the two subsections it is appropriate to read it conjunctively as if it were `and`. This has the effect of reconciling s 130 (1) (a) and s 130 (5) (a) and *limiting the grounds upon which an application to set aside a resolution can be brought, whilst conferring on the court in all instances a discretion, to be exercised on the grounds of justice and equity in the light of all the evidence as to whether the resolution should be set aside*” [Emphasis supplied].

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<sup>313</sup> 2012 (4) SA 593 (SCA) para 18.

<sup>314</sup> Section 130 (5) (a) (ii) of the 2008 Act.

<sup>315</sup> (2813/2013, 3915/2013) [2014] ZAFSHC 46 para 26.

<sup>316</sup> (3878/2013) [2013] ZAKZPHC 56 para 18.

<sup>317</sup> (35/2014) [2015] ZASCA 76 para 31

After the passing and filing of the board resolution to commence business rescue, the company is protected, for the duration of the business rescue process, by a moratorium against any legal or enforcement proceedings,<sup>318</sup> although the legislation does not impose a complete bar in this regard and, moreover, an affected person has the right to apply to court to set aside the resolution.<sup>319</sup> In this regard, the legislation attempts to balance the rights of the company against the rights of creditors and other affected persons, as was noted in *Suidwes Landbou (Pty) Ltd v Wynlandi Boerdery CC and Others*<sup>320</sup> where the judge commented that the right to apply for the setting aside of the board resolution was intended to prevent the business rescue process from being abused by the management of the company and that after a business rescue plan has been adopted, the creditors' right in this regard terminates.<sup>321</sup> It is significant that, in terms of the legislation, it is not open to the company's creditors to argue that the board resolution should be set aside on the ground that it is 'just and equitable' to do so.

According to Section 130 (5), when considering an application in terms of subsection (1) (a) to set aside the company's resolution, the court may:-

(a) set aside the resolution:-

- (i) on any grounds set out in subsection (1); *or*
- (ii) if, having regard to all of the evidence, the court considers that it is otherwise just and equitable to do so. [Emphasis supplied]

The presence of the word "or" between sub-sections (i) and (ii) is significant in making 'just and equitable' considerations a self-standing criterion.

### 3.2.3 Court Application for Business Rescue Proceedings

An "affected person" has the right to apply to court for the commencement of business rescue proceedings.<sup>322</sup> The court has the power to grant such an order on the basis of any of the following criteria:<sup>323</sup>

- (i) the company is financially distressed;

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<sup>318</sup> Section 133 of the 2008 Act

<sup>319</sup> See Ayotte, K and Morrison, E., 'Creditor Control and Conflict in Chapter 11, Journal of Legal Analysis', (2009)1 (2), page 539.

<sup>320</sup> (1510/2013) [2013] ZANWHC 73 para 20

<sup>321</sup> (1510/2013) [2013] ZANWHC 73 para 23

<sup>322</sup> Section 131 (1) of the 2008 Act.

<sup>323</sup> Section 131 (4) (1) (a) (i)-(iii) of the 2008 Act.

- (ii) the company has failed to pay over any amount in terms of an obligation under or in terms of a public regulation, or contract, with respect to employment-related matters; or
- (iii) it is otherwise just and equitable to do so for financial reasons and there is a reasonable prospect for rescuing the company.

These grounds reflect that the situation is having a direct impact on the company’s creditors. This study will examine the first and third ground.

By comparison, in the now-repealed system of judicial management the bar was placed higher – the applicant was required to demonstrate a “reasonable probability” that the company would be enabled to pay all of its debts.<sup>324</sup> In *Noordkaap Lewendhawe Ko-operasie Bpk v Schreuder*<sup>325</sup> the word “probability” in this context was interpreted by distinguishing it from a “possibility” and the court concluded that the former expression connotes a likelihood of the occurrence of the event.

This interpretation was adopted in *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd*.<sup>326</sup> where it was held that an applicant for an order for the commencement of business rescue must lay before the court a well-researched basis for concluding that the company is capable of being rescued, and not mere speculation.<sup>327</sup>

This approach has been endorsed in subsequent decisions such as *AG Petzetakis International Holdings Ltd v Petzetakis Africa (Pty) Ltd and Others (Marley Pipe Systems (Pty) Ltd and Another Intervening)*<sup>328</sup> where the court took cognisance of the two alternative objectives of business rescue, the second being that a greater return would be secured for the company’s creditors and shareholders than would be achieved by immediate liquidation.

There is now general acceptance by the courts of the proposition articulated in *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others*<sup>329</sup> that –

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<sup>324</sup> Section 427 of the Companies Act 61 of 1973; section 195 (1) of the Companies Act 46 of 1926.

<sup>325</sup> (1974) 3 SA 102 (A)

<sup>326</sup> [2011] ZAWCHC 442 para 21

<sup>327</sup> [2011] ZAWCHC 442 paras 24 and 25

<sup>328</sup> 2012 (5) SA 515 (GSJ)

<sup>329</sup> 2013 (4) SA 539 (SCA) para 29

“a reasonable prospect is less than a reasonable probability but more than a mere speculative suggestion. *It must be a prospect based on reasonable grounds*”. [Emphasis supplied]

The lesser requirement of showing a mere ‘reasonable prospect’ in this regard significantly reduces the evidential burden for creditors, bearing in mind the likelihood that they have little knowledge of the company’s financial affairs.<sup>330</sup>

This interpretation has been followed in later decisions.<sup>331</sup> In *Propspec Investments v Pacific Coast Investments 97 Ltd and Another*,<sup>332</sup> it was held that an applicant need not provide a detailed rescue plan, as this is the later task of the business rescue practitioner after a thorough investigation of the company’s managerial and financial affairs.<sup>333</sup> It has been held that an applicant need do no more than explain a strategy that, if developed into a plan, could achieve the objectives of business rescue.<sup>334</sup>

Nevertheless, this interpretation – which is the one currently followed by the courts – makes it easier for affected persons, particularly directors and shareholders, to apply for an order placing the company in business rescue as a mere delaying tactic,<sup>335</sup> aimed at halting or setting

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<sup>330</sup> See Joubert, E.P and Loubser, A., ‘Executive Directors in Business Rescue: Employees or Something Else?’, (2016) De Jure, page 99 available at <http://dx.doi.org/10.17159/2225-7160/2016/v49n1a6> accessed 27.09.2016.

<sup>331</sup> *Newcity Group (Pty) Ltd v Pello NO, China Construction Bank Corporation Johannesburg Branch v Crystal Lagoon Investments 53 (Pty) Ltd* [2013] ZAGPJHC 54; Ex parte: Target Shelf 284 CC; Commissioner, South African Revenue Service and Another v Cawood N.O. and Others (21955/14; 34775/14) [2015] ZAGPPHC 740. See the criticism in Delpont, P., *Henochsberg on the Companies Act 71 of 2008* (2012) page 464 .

<sup>332</sup> 2013 (1) SA 542 (FB) paras (11) and (15)

<sup>333</sup> Section 141 of the 2008 Act lays down the duties of the business rescue practitioner. In *Nedbank Ltd v Bestvest 153 (Pty) Ltd; Essa and Another v Bestvest and Another* (21857/2011, 2106/2012) [2012] ZAWCHC 139, para 41 the court said: “That is not to say, however, that a party can approach the Court for the appointment of a business rescue practitioner with flimsy grounds in the hope that the practitioner will provide the panacea to its problems. The application must set out sufficient facts, if necessary augmented by documentary evidence, from which a Court would be able to assess the prospects of success before exercising its discretion”

<sup>334</sup> *Newcity Group (Pty) Ltd v Pellow NO and Others, China Construction Bank Corporation Johannesburg Branch v Crystal Lagoon Investments 53 (Pty) Ltd and Others (GSJ)* [2014] ZASCA 162 para 13; see also *Finance Factors CC v Jayesem (Pty) Ltd and Others* [2013] ZAKZDHC 45 para 22 and *Oakdene Square Properties (Pty) Ltd* (2013) para 31.

<sup>335</sup> This was among the reasons for providing strict requirement for one to apply for business brought forward by the judge in *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd* 2012 (2) SA 423 (WCC) para 24

aside liquidation proceedings.<sup>336</sup> This stratagem is particularly tempting where the directors are also the only shareholders.<sup>337</sup> In general, shareholders may be tempted to engage in such tactics because they often stand to receive little or nothing if the company is liquidated.<sup>338</sup> On the other hand, the aforementioned lesser burden of proof assists those who have an untainted desire to see the company rescued from pending insolvent liquidation.

In adjudicating an application for the commencement of business rescue, the court takes cognizance of the applicant's access or lack of access to relevant information regarding the company and the prospects of a successful rescue.<sup>339</sup>

Section 131 (4) (a) of the 2008 Act is expressed as allowing the court to consider any of three grounds for placing the company in business rescue. This provision envisages that an applicant does not have to show that the company is financially distressed or that it has failed to pay over any amount in terms of an obligation under or in terms of public regulation and that an applicant is entitled to rely only on the third ground, namely that such an order is otherwise just and equitable and that there is a reasonable prospect of "rescuing the company" by achieving either of two objectives specified in s 128(1)(b)(iii).

However, where business rescue commences by the passing of a board resolution, s 129(1)(a) read with s 130(1)(a)(i) makes clear that the company must be "financially distressed". Section 128(1) (b) (iii) is explicit that the alternative goals of business rescue are, firstly, that the company will continue in existence on a solvent basis or, if that is impossible, that the process

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<sup>336</sup> Section 131 (6) of the 2008 Act. These affected persons are necessitated to use the court application for that purpose as the legislation already limit the board resolution to pass business rescue proceedings when the company is in liquidation under Section 129 (2) (a) of the 2008 Act.

<sup>337</sup> *Griessel and Another v Lizemore and Others* (2015/24751) [2015] ZAGPJHC 189; [2015] 4 All SA 433 (GJ), para 140 where the court learnt that one of the shareholders passed a resolution to activate the business rescue proceedings without the knowledge of his co-shareholders.

<sup>338</sup> Companies and Intellectual Property Commission, Business Rescue Status Quo Report, Prepared by M. Pretorius of Business Enterprises at University of Pretoria (Pty) Ltd, 2015, page 31, discovered that the applicants for court route business rescue proceedings are 50 percent shareholders and 50 percent unsatisfied creditors. It was further stated that for the shareholders of a company, the only incentive they have is to delay the whole process of winding a company, see McCormack, G., *Corporate Rescue Law-An Anglo-American Perspective*, Edward Elgar Publishing Ltd., (2008), page 293 and Jacobs, L., 'Post-Commencement Financing and Creditors: A South African Perspective,' (2012), 33 (3), *Comp.Law.*, page 95, and White, J. J., 'Death and Resurrection of Secured Credit,' (2004), 12, *ABILR*, page 149

<sup>339</sup> The company's financial records may be erroneous or faulty; see *Yatzee Investments CC (Under Business Rescue) v Capx Finance (Pty) Ltd and Others* (3300/2015) [2015] ZAWCHC 117, para 13

will result in a better return for the company's creditors and shareholders than would be achieved by immediate liquidation.

The drafting of these poorly integrated provisions calls for improvement.<sup>340</sup> This study is of the view that the grounds set out under Section 131 (4) (a) of the 2008 Act would be more coherent if they were redrafted to read as follows:

- (i) The company is financially distressed;
- (ii) The company has failed to pay over any amount in terms of an obligation under or in terms of a public regulation, or contract, with respect to employment-related matters; and
- (iii) It is otherwise just and equitable to do so for financial reasons and there is a reasonable prospect for rescuing the company.

### **3.2.4 Application of Business Rescue Proceedings when a Company is in Liquidation**

The application to court for an order that a company commence business rescue proceedings can be made "at any time", save where the board has already so resolved.<sup>341</sup> The phrase "at any time" extends to the situation where the company in question is already in liquidation.<sup>342</sup> If such an order is sought when the company is in liquidation, the court will suspend the liquidation process until the adjudication of the application.<sup>343</sup> The applicant for an order should ensure that all the requirements necessary for the court to grant a suspension of the liquidation proceeding are adhered to, as provided for in Section 131 (2).<sup>344</sup>

In *Sulzer Pumps (South Africa) (Pty) Ltd v O&M Engineering CC* the applicant for a winding-up order argued that there is a clear distinction between Section 129 (2) (a) and 131 (6) of the

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<sup>340</sup> See *Panamo Properties (Pty) Ltd and Another v Nell N.O. and Others* (35/2014) [2015] ZASCA 76 para 31 when dealing with the setting aside of a business rescue resolution.

<sup>341</sup> Section 131 (1) of the 2008 Act. In *Sulzer Pumps (South Africa) (Pty) Ltd v O&M Engineering CC* [2015] ZAGPPHC 59 para 29 the court said that, "...The Act does not set out a time frame within in which an application for business rescue must be launched, but it must be done at a time when the entity can still be rescued, not to thwart an application for liquidation" ..

<sup>342</sup> This is so regardless of the stage of the liquidation process; *Richter v Absa Bank Limited* (20181/2014) [2015] ZASCA 100, para 12. T

<sup>343</sup> Section 131 (6) (a) of the 2008 Act. In *Industrial Development Corporation of SA Limited and Another v Schroeder N.O and Others* (1958/2015) [2015] ZAECMHC 65, para 43 it was held that the liquidation proceedings will be suspended, not discharged.

<sup>344</sup> See *Standard Bank of South Africa Limited v Gas 2 Liquids (Pty) Limited* (45543/2012) [2016] ZAGPJHC 38, where neither the provisional liquidator nor all of the affected person had been given notice and the court refused to grant an order, following in this regard the decisions in *Taboo Trading 232 (Pty) Ltd v Pro Wreck Scrap Metal CC and others* 2013 (6) SA 141 KZP and *ABSA Bank Ltd v Summer Lodge (Pty) Ltd* 2013 (5) SA 444 GNP.

2008 Act<sup>345</sup> and that, where liquidation proceedings are already initiated, the only way for the liquidation to be suspended is via an application as envisaged in Section 131 (6), and not by a board resolution. The act of the company's board, in resolving to commence business rescue when liquidation had already commenced, was held to have the purpose of frustrating the liquidation proceedings.<sup>346</sup>

The conversion from winding up proceedings to business rescue is a significant mode of entry into business rescue in allowing entry by a company in liquidation that, nonetheless, demonstrably has a reasonable prospect of being rescued.

### 3.3 Competing Objectives of Business Rescue Proceedings

A business rescue practitioner will have to choose which of the two alternative objectives of business rescue to pursue. Restoration of the company to viability has been held to be the primary objective,<sup>347</sup> as was recognised by Eloff, AJ in *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd*<sup>348</sup> where he compared the South African corporate rescue process to that in Australia..

In *Gormley v West City Precinct Properties (Pty) Ltd and Another, Anglo Irish Bank Corporation Ltd v West City Precinct Properties (Pty) Ltd and Another*<sup>349</sup> it was held that the notion of a “better return to creditors” envisaged in Section 128 (b) (iii) should be interpreted in context and with reference to a business rescue plan under Section 150. To similar effect, see *Absa Bank Limited v Caine N.O. and Another, In Re; Absa Bank Limited v Caine N.O. and Another*<sup>350</sup> where the court said that:

“The potential business rescue plan provided for in ss 128 (1) (b) (iii) has two objects in mind, the primary object being to facilitate the continued existence of the company in a state of solvency and secondly and in the alternative, in the event that the primary objective cannot be achieved or appears not to be viable, to facilitate a better return for

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<sup>345</sup> [2015] ZAGPPHC 59 para 25

<sup>346</sup> [2015] ZAGPPHC 59 para 30 and para 28.

<sup>347</sup> This view was also observed in Joubert, E.P., “Reasonable Possibility” versus “Reasonable Prospect”: Did Business Rescue Succeed in Creating a better than Judicial Management?, 76, *Contemp. Roman-Dutch L.*, (2013)page 52

<sup>348</sup> [2011] ZAWCHC 442 para 2.

<sup>349</sup> [2012] ZAWCHC 33 para 13.

<sup>350</sup> (3813/2013, 3915/2013) [2014] ZAFSHC 46, para 40.

the creditors or shareholders of the company than would result from immediate liquidation.”

The court went on to say that:

“If a purposive approach to interpretation of the Act is undertaken as one should do, there can be little doubt that companies, being vehicles to obtain economic and social well-being, should rather be rescued if at all possible, than “killed” in a winding-up process...”<sup>351</sup>

That the primary objective of business rescue is restoring the company to viability was affirmed in *Redpath Mining South Africa (Pty) Ltd v Marsden No and Others*<sup>352</sup> where the judge drew a distinction in this regard between business rescue and judicial management. In *AG Petzetakis International Holdings Ltd v Petzetakis Africa (Pty) Ltd and Others (Marley Pipe Systems (Pty) Ltd and Another Intervening)*,<sup>353</sup> Coetzee AJ drew a further distinction in saying –

“Section 131 (4) does not incorporate the alternative object of the (at the s 131 stage future) rescue plan which is referred to in s 128, namely a plan which could result in better return of creditors or shareholders than would result from immediate liquidation. It seems that the intention of the legislation at this point is as follows:

[17.1] The requirements for granting of a s 131 rescue order include the *company under consideration must have a reasonable prospect of recovery.*

[17.2] *Once a company is under business rescue, its rescue plan may be aimed at the alternative object, namely a better return than the return of immediate liquidation.”*

[Emphasis supplied]

“Rescuing the company” is defined in s 128 (1) (h) as achieving one of two alternative objectives. Some decisions have accorded the two objectives equal weight.<sup>354</sup> In *Newcity Group (Pty) Ltd v Pellow NO and Others, China Construction Bank Corporation*

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<sup>351</sup> Ibid para 47.

<sup>352</sup> (18486/2013) [2013] ZAGPJHC 148, paras 43 and 44

<sup>353</sup> 2012 (5) SA 515 (GSJ), para 17

<sup>354</sup> Anderson, C., ‘Viewing the Proposed South African Business Rescue Provisions from an Australian Perspective,’ 4, Potchefstroom Electronic Law Journal, (2008), page 110.

*Johannesburg Branch v Crystal Lagoon Investments 53 (Pty) Ltd and Others (GSJ)*,<sup>355</sup> the court held that an order for the commencement of business rescue will be granted at least if a rescue plan could fulfil either of the two objectives.

Either objective, it seems, can be pursued as long as there is a serious and executable plan. To the same effect, see *Propspec Investments (Pty) Ltd v Pacific Coast Investments 97 Ltd*<sup>356</sup> and *Griessel*.<sup>357</sup>

In *Koen v Wedgewood Village Golf and Country Estate (Pty) Ltd*.<sup>358</sup> Binns-Ward J accorded equal weight to the two objectives. It is noteworthy, however, that the alternative objective is not aimed at “rescuing the company” in any ordinary sense of the word.<sup>359</sup>

*Oakdene Square Properties (Pty) Ltd and Others Case (2013)*,<sup>360</sup> which is now a leading decision, held that either of the two objectives envisaged in Section 128 (1) (b) would qualify as a “business rescue” in terms of Section 131 (4).<sup>361</sup> This accords with administration proceedings in the UK, where the objectives of the proceedings are not considered to follow the priority in which they are stated in the legislation.<sup>362</sup>

In *Commissioner, South African Revenue Service v Beginsel NO and Others*<sup>363</sup> the court granted an order for business rescue to continue on the basis that the process could result in better returns for creditors than immediate liquidation.

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<sup>355</sup>[2013] ZAGPJHC 54 para 23

<sup>356</sup> 2013 (1) SA 542 para 7

<sup>357</sup> [2015] ZAGPJHC 189 [2015] para 79.

<sup>358</sup> 2012 2 SA 378 (WCC) para 17

<sup>359</sup> See also *Griessel and Another Case* [2015],.

<sup>360</sup> 2013 (4) SA 539 (SCA) at para 26 and para 31

<sup>361</sup> To similar effect, see *Ex parte: Target Shelf 284 CC; Commissioner, South African Revenue Service and Another v Cawood N.O. and Others* (21955/14; 34775/14) [2015] ZAGPPHC 740, para 50.

<sup>362</sup> Section 8 of the UK Insolvency Act 1986 provides that-

(3) The purposes for whose achievement an administration order may be made are-

(a) the survival of the company, and the whole or any part of its undertaking, as a going concern ;

(b) the approval of a voluntary arrangement under Part 1 ;

(c) the sanctioning under section 425 of the Companies Act of a compromise or arrangement between the company and any such persons as are mentioned in that section ; and

(d) a more advantageous realisation of the company's assets than would be effected on a winding up ;

*and the order shall specify the purpose or purposes for which it is made.*.[Emphasis supplied]

<sup>363</sup> 2013 (1) SA 307 (WCC).

Section 128 (1) (b) (iii) of the 2008 Act clearly states the objectives of business rescue proceedings in hierarchical form as, first, “the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis” and –

“if it is not possible for the company to so continue in existence results in a better return for the company’s creditors or shareholders than would result from the immediate liquidation of the company;” [Emphasis supplied].

Arguably the decision in *Oakdene Square Properties (Pty) Ltd*,<sup>364</sup> where the court gave equal weight to both objectives is inconsistent, at least on the literal level, with the language of this provision.

Loubser<sup>365</sup> has suggested that business rescue proceedings can properly focus on the sale of the business, or part of it, for the purpose of paying the creditors more than would have been payable on immediate liquidation. In *Redpath Mining South Africa (Pty) Ltd v Marsden NO and Others* the court endorsed the sale of a company as a going concern to achieve a similar objective.<sup>366</sup> A distinction needs to be drawn in this regard between disposing of the company’s business and merely disposing of its assets. In *Oakdene Square Properties (Pty) Ltd Case* (2013),<sup>367</sup> the court held that business rescue should not be employed as an alternative to liquidation.<sup>368</sup>

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<sup>364</sup> 2013 (4) SA 539 (SCA) at para 26 and para 31

<sup>365</sup> Loubser, A., ‘Tilting at Windmills? The Quest for an Effective Corporate Rescue Procedure in South African Law’ page 144.

<sup>366</sup> [2013] ZAGPJHC 148 para 44. In *Oakdene Square Properties Case* (2012) para 12, the court held that the general philosophy of business rescue is the recognition of the value of the *business* as a going concern rather than the juristic person itself. Hence the name “business rescue” and not “company rescue”. See also *Merchant West Working Capital Solutions (Pty) LTD v Advanced Technologies and Engineering Company (Pty) Ltd and Another* [2013] ZAGPJHC 109, para 5

<sup>367</sup> 2013 (4) SA 539 (SCA) at para 33, the court referred to making the business rescue process an avenue for liquidating companies; this arguably, is contrary to what is envisaged in the legislation.

<sup>368</sup> *Absa Bank Limited v Caine N.O. and Another, In Re; Absa Bank Limited v Caine N.O. and Another* (3813/2013, 3915/2013) [2014] ZAFSHC 46 para 52. The World Bank Principles for Effective Insolvency and Creditor/Debtor Regime, (2016), page 8 states that where an enterprise is viable, meaning that it can be rehabilitated, its assets are often more valuable if retained in a rehabilitated business than if sold in liquidation.

The alternative objective of business rescue can encourage creditors, particularly unsecured creditors, to support the process.<sup>369</sup> Secured creditors are inherently less likely to give their support to a business plan aimed at securing the alternative objective, since their interests are probably fully catered for by the security they hold.<sup>370</sup>

In the UK, the administration process focuses on the repayment of creditors. In France, the rehabilitation legislation focuses on protecting employees' jobs by keeping the company in existence. In the USA, Chapter 11 salvaging the business as a going concern is the primary objective of corporate reorganisation.

### **3.4 Business Rescue Practitioner Role and its Impact on the Rights of Creditors**

The business rescue process is inherently difficult to administer where the legislation leaves the company's incumbent management in office whilst according priority to the interests of the company's creditors.<sup>371</sup>

As was noted earlier, South Africa's now-repealed judicial management process protected the company's creditors, while the new business rescue regime leaves the company's directors in office, with overall control vested in the business rescue practitioner. The objective of the legislature in this regard was to balance the interests of the company and its creditors<sup>372</sup> with a statutory system of checks and balances.<sup>373</sup>

In South Africa, the person mandated by the Act to oversee the process of business rescue is termed the "supervisor" or the "business rescue practitioner" or simply "the practitioner".<sup>374</sup>

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<sup>369</sup> See Balcerowicz, E. and others, 'The Development of Insolvency Procedures in Transition Economies: A Comparative Analysis,' (2003), CASE Network Studies and Analyses No.254, page 20

<sup>370</sup>Pretorius, M., Addressing Principal-Agent Conflict in Business Rescue, (2014), Conference Paper, page 330, available at [http://www.repository.up.ac.za/bitstream/handle/2263/51599/Pretorius\\_Addresssing\\_2014.pdf?sequence=1&isAllowed=y](http://www.repository.up.ac.za/bitstream/handle/2263/51599/Pretorius_Addresssing_2014.pdf?sequence=1&isAllowed=y) accessed on 27.04.2016

<sup>371</sup> Yang, M. and Li, X., 'The History of Corporate Rescue in the UK,' (2012), 8 (13)Asian Social Science, page 23.

<sup>372</sup> See S Franken 'Creditor- and Debtor-Oriented Corporate Bankruptcy Regimes Revisited', (2004) 5(4) *European Business Organization Law Review*, page 652; to the same effect, see J Qian and PE Straha 'How Laws and Institutions Shape Financial Contracts: The Case of Banks Loans', (2007) 62 (6) *The Journal of Finance* page 2804.

<sup>373</sup> See Carapeto, M., Does Debtor-in-Possession Financing Add Value?, Working Paper, Cass Business School, (2003), page 8; see also, see McCormarck, G., *Corporate Rescue Law- An Anglo-American Perspective*, Edward Elgal Publishing Ltd., (2008), page 294. For a contrary view, see Yang, M. and Li, X., 'The History of Corporate Rescue in the UK,' (2012), 8 (13) Asian Social Science, page 23.

<sup>374</sup> This official goes by different colloquial titles in different jurisdictions, including turnaround professional, company doctor, risk consultant, business recovery specialist, interim turnaround executive, cash-flow manager,

The rescue process envisages several avenues for the appointment of a business rescue practitioner. Firstly, the practitioner is appointed by the board where the process was commenced by a board resolution.<sup>375</sup> A second method is nomination by the affected persons who applied to court for the commencement of business rescue.<sup>376</sup> A court appointment of a business rescue practitioner is subject to ratification by the holders of the majority of the independent creditors' voting interests. The creditors' right to nominate a rescue practitioner gives them an indirect voice in the rescue process.<sup>377</sup> The practitioner is expected to act in a professional manner and with integrity.<sup>378</sup>

The Act gives a potential voice to disgruntled creditors where the practitioner was appointed by a board resolution by giving them the right to apply, on specified statutory grounds, to have the appointment of the business rescue practitioner set aside.<sup>379</sup> Creditors may resort to such an application if they believe it necessary to protect their interests, such as where they suspect that

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debt management company, private equity provider, credit adviser and insurer, independent business reviewer and solution provider; see MacDonald, D., 'Turnaround Finance,' (2002) *Recovery* (Winter) 17; Bingham, R., 'Poacher Turned Gamekeeper,' (2003), *Recovery* (Winter) 27; and Godfrey, P., 'The Turnaround Practitioner – Advisor or Director?' (2002) 18 *IL&P* 3

<sup>375</sup> Section 129 (3) (b) of the 2008 Act

<sup>376</sup> Section 131 (5) of the 2008 Act; the practitioner is appointed by the court but is nominated by the affected persons.

<sup>377</sup> Tomasic, R., 'Creditors Participation in Insolvency Proceedings-Towards the Adoption of International Standards,' (2006), 14, *Insolvency Law Journal*, page 178

<sup>378</sup> See *Absa Bank Limited v Caine NO and Another, In Re; Absa Bank Limited v Caine N.O. and Another* (3915/2013) [2014] ZAFSHC 46, para 10 where the court referred to an earlier decision where the business rescue practitioner was removed from the office after failing to: (i) convene a first meeting of creditors in terms of s 147 of the Act within the requisite ten business days after being appointed; (ii) prepare and publish a business rescue plan in terms of s 150 of the Act which had to be done within twenty five business days after being appointed; (iii) convene a meeting in terms of s 151; (iv) file a report in terms of s 132(3)(a) or apply for an extension of the three month period within which the business rescue had to be finalised. Similar failures of duty on the part of the business rescue practitioner feature in *African Banking Corporation of Botswana v Kariba Furniture Manufacturers & Others* (228/2014) [2015] ZASCA 69 para 35; *Resource Washing (Pty) Ltd v Zululand Coal Reclaimers Proprietary Limited and Others* (10862/14) [2015] ZAKZPHC 21 paras 55 and 58; *Absa Bank Limited v Caine N.O. and Another, In Re; Absa Bank Limited v Caine N.O. and Another* (3813/2013, 3915/2013) [2014] ZAFSHC 46, para 56; and *Griessel and Another v Lizemore and Others* (2015/24751) [2015] ZAGPJHC 189; para 8. See also Pretorius, M. Business Enterprises at University of Pretoria (Pty) Ltd, Business Rescue Status Quo Report Final Report, (30 March 2015), page 75 available at [http://www.cipc.co.za/files/4714/2866/7900/Report\\_Number\\_3\\_ammended\\_30032015.pdf](http://www.cipc.co.za/files/4714/2866/7900/Report_Number_3_ammended_30032015.pdf) accessed on 23 November 2015. See also Finch, V., *Corporate Insolvency Law: Principles and Perspectives*, 2nd Edition, CUP (2009) page 245.

<sup>379</sup> Section 130 (1) (b) read with Section 139 (2) (a) (b) (c) (d) (e) of the 2008 Act., see Stevenson, M., 'The Enterprise Bill 2002 - A Move Towards Rescue Culture?', 2002, 15(7), *Insolv.Int.*, page 54. See also Frisby, S., Report on Insolvency Outcomes, A paper presented to the Insolvency Service, available at <http://www.insolvency.gov.uk> accessed on 23.11.2015

the practitioner is not maintaining a proper balance between the company's interests and their own,<sup>380</sup> or where they suspect that the practitioner is engaging in some form of abuse.<sup>381</sup>

A rigorous exercise of his statutory powers of investigation<sup>382</sup> is crucial to the exercise of the mandate of the business rescue practitioner and the prospects of a successful rescue of the company.

It is well established that when a company becomes financially distressed, the duties of its directors, previously confined to the interests of the company, extend to a certain degree to its creditors; see *Kinsela v Russell Kinsela*<sup>383</sup> and *Liquidator of West Mercia Safetywear v Dodd*.<sup>384</sup>

### 3.4.1 Compensation of the Business Rescue Practitioners

The remuneration of the rescue practitioner impacts on the company's creditors. The Minister of Trade and Industry is empowered to prescribe the scale of fees in this regard.<sup>385</sup> The scale takes account of the size of the company.<sup>386</sup> The agreement between the company in business rescue and the practitioner in this regard has to be approved by the creditors' meeting. The practitioner's claim is accorded preferential status in the business rescue process.<sup>387</sup>

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<sup>380</sup> Ayotte, K and Morrison, E., 'Creditor Control and Conflict in Chapter 11', *Journal of Legal Analysis*, (2009)1 (2), page 512.

<sup>381</sup> See for example *Ex parte: Nell N.O. and Others* (45279/14) [2014] ZAGPPHC 620; para 35 footnote 16 where the court commented that, for example, the directors could use the moratorium to dispose of or dissipate company assets and conceal or destroy evidence.

<sup>382</sup> In terms of s 141 of the 2008 Act.

<sup>383</sup> (1984) 4 A.C.L.C. 215 at page 221; the court said that 'But where a company is insolvent the interests of the creditors intrude. They become prospectively entitled, through the mechanisms of liquidation, to displace the power of the shareholders and directors to deal with the company's assets.'

<sup>384</sup> (1988) 4 B.C.C. 30.

<sup>385</sup> Section 143 of the 2008 Act read with Regulation 128 of the Companies Regulation 2011 Gazetted on 26 April 2011: Tariff of Fees for Business Rescue Practitioners:

(1) The basic remuneration of a business rescue practitioner, as contemplated in section 143 (1), to be determined at the time of the appointment of the practitioner by the company, or the court, as the case may be, may not exceed;

(a) R 1250 per hour, to a maximum of R 15 625 per day, (inclusive of VAT) in the case of a small company;

(b) R 1500 per hour, to a maximum of R 18 750 per day, (inclusive of VAT) in the case of a medium company; or

(c) R 2000 per hour, to a maximum of R 25 000 per day, (inclusive of VAT) in the case of a large company, or a state owned company.

<sup>386</sup> See *Absa Bank Limited v Golden Dividend 339 (Pty) Ltd and Others* (70637/13) [2014] ZAGPPHC 1048 para 66 where it had come to light that the business rescue practitioner was being remunerated on the scale appropriate to a large company while the company in question was a small one.; see also Pretorius, M. Business Enterprises at University of Pretoria (Pty) Ltd, Business Rescue Status Quo Report Final Report, (30 March 2015), page 37.

<sup>387</sup> Section 145 (5) of the 2008 Act.

### 3.5 Conclusion

The legislation attempts to provide for entrance into business rescue either by the relatively quick and simple route of a board resolution or by the more complex route of a High Court application. The latter process will require an applicant creditor to have substantial knowledge of the company's financial and other affairs, and such knowledge may be difficult for a creditor to acquire. In relation to both of these routes, the legislation needs to have safeguards against abuses, such as application for entry into business rescue as a mere stratagem for the company to delay payments of its debts by getting the benefit of the statutory moratorium.<sup>388</sup>

The relative merits of the two alternative objectives of business rescue proceedings have given rise to some controversy, revealed inter alia in the judicial interpretation that does not accord the payment of creditors' claims against the company as a priority.. However, other decisions have given equal weight to the two alternative objectives of business rescue.

This study takes the view that the primary objective of the legislation, as currently drafted, makes the rescue of financially distressed companies the broad primary objective and the payment of creditors' claims as an ancillary objective.

This study has revealed that creditors, who are so minded, have a significant chance of succeeding in setting aside the appointment of a business rescue practitioner who was chosen by the directors, and securing the appointment of a practitioner of their choosing.

The business rescue process leaves in office the incumbent board of directors of the company, and required to work with and under the supervision of the business rescue practitioner. The possibility of conflicts of interest in this arrangement is significant. A business rescue practitioner who was nominated by the company's creditors is likely to enjoy the latter's confidence, but there is a risk that the business rescue process may then, de facto, be substantially controlled by creditors who will strive primarily to secure the payment of their claims, even if this will leave the company struggling to survive financially in the future.

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<sup>388</sup> This is against the intent of the business rescue process, as was noted in *Griessel and Another v Lizemore and Others* (2015/24751) [2015] ZAGPJHC 189; [2015] 4 All SA 433 (GJ), para 84.

## CHAPTER FOUR

### LEGAL IMPLICATIONS ON THE RIGHTS OF CREDITORS DURING THE EXECUTION OF THE BUSINESS RESCUE PROCEEDINGS

#### 4.1 Introduction

The company's creditors are key players in the business rescue process. Chapter 6 of the Act requires the creditors to be given notice of "each court proceeding, . . . decision . . . or other relevant event concerning the business rescue proceedings".<sup>389</sup> Other affected persons' interests also have to be taken into account.<sup>390</sup>

This chapter examines the statutory provisions in terms of which creditors are involved in the business rescue process and relevant judicial decisions.

#### 4.2 Position of Creditors in the Hearing of the Business Rescue Proceedings

Mere entry into the corporate rescue process of course carries no guarantee of a successful outcome. It is important that the confidence of the creditors be retained throughout.<sup>391</sup>

After business rescue commences, affected persons have the right to participate in the hearing of any application by an affected person to set aside the board's resolution in this regard.<sup>392</sup> In *Cape Point Vineyards (Pty) Ltd v Pinnacle Point Group Ltd and Another (Advantage Project Managers (Pty) Ltd intervening*,<sup>393</sup> Rodgers AJ said:

"I do not think that the legislature contemplated that an affected party would have to apply for leave to intervene in the proceedings. If the person is an 'affected person' such person has a right to participate in the hearing. If the person wishes to file affidavits, the court will obviously need to regulate the procedure to be followed to ensure fairness to all concerned."

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<sup>389</sup> Section 145(1)(a) 2008 Act.

<sup>390</sup> See Qian, J. and Strahan, P.E., 'How Laws and Institutions Shape Financial Contracts: The Case of Banks Loans,' 62 (6), *The Journal of Finance*, (2007), page 2804 and Mülbart, P. O., 'A Synthetic View of Different Concepts of Creditor Protection - Or a High-Level Framework for Corporate Creditor Protection', (2006). ECGI - Law Working Paper No. 60/2006, page 22.

<sup>391</sup> See Franken, S., 'Creditor and Debtor-Oriented Corporate Bankruptcy Regimes Revisited,' (2004), 4, *European Business Organization Law Review*, page 672. A statutory business rescue regime that impedes creditors' intervention in the corporate rescue process is a debtor-oriented system. .

<sup>392</sup> Section 130 (4) and 131 (3) of the 2008 Act.

<sup>393</sup> 2011 (5) SA (WCC) para 21.

To similar effect, in *Engen Petroleum Ltd v Multi Waste (Pty) Ltd and Others*,<sup>394</sup> Boruchowitz J said:

“Engen, as an affected person, has a right to participate in the hearing of an application in terms of s 131(1) of the Act. It would not require leave of the court to intervene. Such leave may, however, be necessary as a procedural requirement.”

In *AG Petzetakis International Holdings Ltd v Petzetakis Africa (Pty) Ltd and Others (Marley Pipe Systems (Pty) Ltd and Another Intervening)*<sup>395</sup> Coetzee AJ said:

“In my view it follows that they have an automatic right to participate in the proceedings (without the need for an order authorising them to do so) in terms of section 130(4) of the Companies Act...”

This right of participation continues after the adoption of the business rescue plan, as was observed in *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd and Others*. A business rescue plan may provide that a creditor loses the right to enforce a debt if the plan is implemented according to its terms and conditions.<sup>396</sup> As was noted earlier, the creditors have the right, during the rescue proceedings, to participate in any hearing arising out of the proceedings,<sup>397</sup> and can thus voice grievances and protect their interests.

The judiciary’s divergent views regarding the need to join creditors as parties to judicial hearings in the course of business rescue have now been settled by the Supreme Court of Appeal. In *Absa Bank Limited v Golden Dividend 339 (Pty) Ltd and Others*<sup>398</sup>, the court took the view that mere notice to creditors sufficed, and that they need not be joined as parties, saying that this would be illogical and contrary to commercial practice. On appeal, (reported as *Absa Bank Limited v E J Naude NO and Others*<sup>399</sup>) the Supreme Court of Appeal held that where a creditor of the company makes application to court in respect of business rescue proceedings, the other creditors must be cited as joint applicants. It was held that mere

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<sup>394</sup> 2012 (5) SA 596 (GSJ) para 30

<sup>395</sup> 2012 (5) SA 515 (GSJ) para 4

<sup>396</sup> Section 154 of the 2008 Act.

<sup>397</sup> Section 144 (3) (a) and (b), Section 145 (1) (a)-(c) and Section 146 (a)-(c) of the 2008 Act.

<sup>398</sup> (70637/13) [2014] ZAGPPHC 1048, para 29 and 30.

<sup>399</sup> [2016] ZASCA 78.

knowledge on the part of the other creditors of an application to set aside an adopted business rescue plan does not suffice; they have a direct and substantial interest in the matter and their non-joinder would be a fatal flaw in the application.<sup>400</sup> This decision was followed in *Stalcor (Pty) Ltd v Kritzinger NO and Others* where it was held that creditors have a direct and substantial interest in every matter that arises during the operation of the proceedings.<sup>401</sup>

### 4.3 Creditors' Committee in Protection of Creditors' Interests

The Companies Act provides that a creditors' committee may be formed as part of the business rescue proceedings.<sup>402</sup> Such a committee has a useful role in protecting the rights of the creditors.<sup>403</sup> The importance of establishing a creditors' committee is expressed in the World Bank Principles as follows.<sup>404</sup>

“The role, rights and governance of creditors in the proceedings should be clearly defined. Creditor interests should be safeguarded by appropriate means that enable creditors to effectively monitor and participated in insolvency proceedings to ensure fairness and integrity, including by *creation of a creditor's committee as a preferred mechanism*, especially in cases involving numerous creditors.” [Emphasis supplied].

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<sup>400</sup> The court referred to *Gordon v Department of Health, Kwazulu-Natal* [2008] ZASCA 99; 2008 (6) SA 522 (SCA) where it was held that if an order or judgment cannot be sustained without prejudicing the interests of third parties, then those third parties have a legal interest in the matter and must be joined as parties.

<sup>401</sup> (1841/2012) [2016] ZAFSHC 6 at para 43. Rampai, J said: “The mere service of the application, although it constituted proper notice to them, was not enough. It could not be regarded as a proper substitute for citation. Citation is not a mere notice of intention to go to war. It is a declaration of war itself. Once a party is cited as a respondent then the rules of engagement apply. Such rules do not have their ordinarily binding force where, as in this matter, an uncited individual or enterprise with a direct and substantial interest in the relief sought is merely given notice of the application.”

<sup>402</sup> Section 145 (3) and 147 (1) (b) of the 2008 Act. The UNCITRAL Legislative Guide 2004 states at para 129 that: “The insolvency law should facilitate the active participation of creditors in insolvency proceedings such as through a creditor committee, a special representative or other mechanism for representation. The insolvency law should specify whether a committee or other representation is required in all insolvency proceedings. Where the interests and categories of creditors involved in insolvency proceedings are diverse and participation will not be facilitated by the appointment of a single committee or representative, the insolvency law may provide for the appointment of different creditor committees or representatives.”

<sup>403</sup> Mindlin, P., ‘Comparative Analysis of Chapter 6 of the South African Companies Act, 71 of 2008’, (Business Rescue Proceedings), Presentation to the Company Law Symposium organised by the South Africa Department of Trade and Industry & The Specialist Committee on Company Law, Johannesburg, South Africa, 1.03.2013, page 21, available at <http://www.thedti.gov.za/business-regulation/presentations/symposium1of6.pdf> accessed on 23.11.2015 In comparing South African business rescue proceedings with that of USA Chapter 11, Mindlin states that a creditors' committee is among the factors that has played a major role in the success of reorganisation under Chapter 11.

<sup>404</sup> Principle C7.1 of the World Bank Principles for Effective Insolvency and Creditor/Debtor Regime, (2016)

The World Bank Principles goes on to say:<sup>405</sup>

“Where a committee is established, its duties and functions, and the rules for the committee’s membership, quorum and voting, and the conduct of meetings should be specified by the law. It should be consulted on non-routine matters in the case and have the ability to be heard in key decisions in the proceeding. The committee should have the right to request relevant and necessary information from the debtor. It should serve as a conduit for the processing and distributing that information to other creditors and for organising creditors on critical issues. In reorganisation proceedings, creditors should be entitled to participate in the selection of the insolvency representative.”

In line with this approach, Section 149 (1) of the 2008 Act states that a committee of creditors:

“(a) may consult with the practitioner about any matter relating to the business rescue proceedings, but may not direct or instruct the practitioner;  
(b) may, on behalf of the general body of creditors or employees, respectively, receive and consider reports relating to the business rescue proceedings; and  
(c) must act independently of the practitioner to ensure fair and unbiased representation of creditors’ or employees’<sup>406</sup> interests.”

The creditors’ committee has a role to play in ensuring that a business rescue plan is adhered to<sup>407</sup> and that the company’s incumbent management does not abuse its powers.<sup>408</sup>

The Act is silent as to who is to bear the operating costs of a creditors’ committee,<sup>409</sup> and this lacuna needs to be filled. Arguably, the costs should be part of the administrative expenses of the

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<sup>405</sup> Principle C7.2 of the World Bank Principles for Effective Insolvency and Creditor/Debtor Regime, (2016)

<sup>406</sup> Similar duties apply to the employees committee.

<sup>407</sup> What is required, but is missing from the Act, is a mechanism to solve conflicting matters that might arise between the business rescue practitioner and the creditors’ committee, as is suggested in the UNCITRAL Legislative Guide on Insolvency Law, page 204.

<sup>408</sup> UNCITRAL (2004) page 242. Tomasic, R., ‘Creditors’ Participation in Insolvency Proceedings-Towards the Adoption of International Standards,’ (2006), 14, *Insolvency Law Journal*, page 179 notes that that the incumbent management of the company is likely to influence decisions during the rescue, but the creditors will exercise oversight.

<sup>409</sup> The UNCITRAL Legislative Guide (2004) recommendation 130 states that: “...The insolvency law should specify how the costs of the creditors committee would be paid.”

business rescue proceedings<sup>410</sup> with appropriate safeguards to prevent improper collusion with the rescue practitioner in regard to such costs.<sup>411</sup>

The Act allows employees to form a committee to safeguard their rights<sup>412</sup> and there may thus be costs incurred by two committees. The Act does not compel the formation of such committees.<sup>413</sup> The employees of a company are creditors to the extent of their unpaid remuneration, reimbursement or other entitlements.<sup>414</sup> Nor does the Act prescribe the number of members of such committees; a one-person committee is conceivable.

#### **4.4 The Business Rescue Plan and its Impact on Creditors' Rights**

The business rescue practitioner has a duty to prepare a business rescue plan<sup>415</sup> within 25 days after appointment.<sup>416</sup> A registered trade representing employees, and any employee not so represented, has the right to propose an alternative business plan if the one prepared by the practitioner is rejected.<sup>417</sup> The creditors can informally make proposals to the practitioner for a business rescue plan.<sup>418</sup>

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<sup>410</sup> See Mindlin, P, *op cit*, page 21.

<sup>411</sup> Section 149 (1) (a) and (c) of the 2008 Act requires that the committee neither direct nor instruct the rescue practitioner when consulting on the implementation of the rescue plan. In Zhang, H. and others, 'The Balance of Power in Insolvency Proceedings: The Case of China', (2011), 8 International Corporate Rescue, pages 10-13 it is said that banks and other financial institutions possess great influence in the functioning of creditors' committees. This influence normally starts during the preparation of the rescue proposal where their status as secured creditors ensures that their interests are not put at risk. Zhang, H., 'Balance of Power and Control of Creditors in the Insolvency Procedures: a Comparison between the UK and China,' (2011), 26 (10), J.I.B.L.R., page 493 states that in practice these financial institutions decide the fate of the rehabilitation proceedings.

<sup>412</sup> Section 148 of the 2008 Act.

<sup>413</sup> Section 147 (1) (1) of the Act 2008 states that during the creditors' meeting they "may determine whether or not a committee of creditors should be appointed" [Emphasis supplied]. It is noted in UNCITRAL (2004), page 250 that creditors' committees are costly and not time-effective unless the procedure includes creditors with diverse interests in the rescue process and are also geographically dispersed.

<sup>414</sup> Section 144 (2) of the Act 2008; see *A G Petzetakis International Holding Ltd v Petzetakis Africa (Pty) Ltd and Others* 2012 (5) SA 515 (GSJ) para 12.

<sup>415</sup> Section 140 (1) (d) of the 2008 Act has similarities to the UK administration mechanism where the rescue proposal is prepared by the administrator; by contrast, in the USA, France and Spain the management of company has a mandate to do so, but in some cases the creditors prepare the rehabilitation plan.

<sup>416</sup> Section 150 (5) of the 2008 Act. The Act does not specify the consequences where the business rescue practitioner fails to publish the business rescue plan on time.

<sup>417</sup> Section 144 (3) (g) (i) and 145 (2) (b) (l) of the 2008 Act. In *Ex parte: Target Shelf 284 CC; Commissioner, South African Revenue Service and Another v Cawood N.O. and Others* (21955/14; 34775/14) [2015] ZAGPPHC 740, para 36 and *Gormley v West City Precinct Properties (Pty) Ltd and Another; Anglo Irish Bank Corporation Limited v West City Precinct Properties (Pty) Ltd and Another* (19075/11, 15584/11) [2012] ZAWCHC 33 para 8 the persuasive power of creditors in developing a business rescue plan under Chapter 6 was acknowledged.

<sup>418</sup> Section 145 (1) (d) of the 2008 Act.

The Act does not oblige the practitioner to liaise with other stakeholders in the preparation of the rescue plan, though it would almost always be wise to do so, and the practitioner has the right to apply to court to set aside the result of a vote rejecting the business plan.<sup>419</sup>

In *Resource Washing (Pty) Ltd v Zululand Coal Reclaimers Proprietary Limited*<sup>420</sup> Pillay J said:

“The scheme of business rescue is manifestly to enable stakeholders to participate meaningfully in the business rescue process. The [business rescue plan] must make full disclosure of all relevant information to enable stakeholders to make informed decisions. Such disclosure must also seek to clarify and convince stakeholders of the factual basis for seeking business rescue, that it is a genuine attempt at rescuing the business and not a subversive exercise to enable the company to avoid its creditors. A BRP cannot hope to secure buy-in or endorsement of stakeholders without full and meaningful disclosure of relevant information.”

In order to enhance the prospects of consensus in regard to the business plan, the Act, as was noted earlier, explicitly permits creditors to informally propose a rescue plan to the rescue practitioner.<sup>421</sup>

A question arises as to whether creditors can utilise corporate restructuring, as encountered in the US Chapter 11 and UK administration proceedings, such as a compromise or a “pre-pack sale” of the whole or part of the company’s business or assets.<sup>422</sup> The business rescue provisions of South Africa’s Companies Act are silent in this regard, but has no explicit prohibition on including a compromise with creditors in a business rescue plan, for the Act does not specify any arrangement that is barred from inclusion in a business rescue plan.

The Act does however provide positively for what must be contained in a business rescue plan.<sup>423</sup>

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<sup>419</sup> Section 153 (1) (a) (ii) of the Act 2008.

<sup>420</sup> [2015] ZAKZPHC 21 at para 24.

<sup>421</sup> Section 145 (1) (d) of the 2008 Act.

<sup>422</sup> The sale of assets in pre-packing administration has been endorsed by the English courts; see *Re T&D Industries Plc* [2000] 1 WLR 646; *Re Transbus International Limited* [2004] 1 WLR 2654 where the administrator was allowed to sell the company’s assets immediately after his appointment.

<sup>423</sup> Section 150 (2) of the 2008 Act provides that a proposed plan must be divided into three parts as follows:

In *Eveleigh v Dowmont Snacks (Pty) Ltd and Others*<sup>424</sup> the court said that mere speculative suggestions would not suffice in a business rescue plan.

In *Commissioner of South African Revenue Services v Beginsel NO and Others*<sup>425</sup>, the court said that the content of the rescue plan depends on the nature of and the reason for financial distress of the company in question. Fourie J went on to say:

“It follows, in my view, that, upon a proper construction of section 150 (2), *substantial compliance with the requirements of the section will suffice*. This would, in my view, mean that, where sufficient information, along the lines envisaged by section 150 (2), has been provided to enable interested parties to take an informed decision in considering whether a proposed business rescue plan should be adopted or rejected, there would have been substantial compliance” [Emphasis supplied].

A similar view was taken in *Propspec Investments (Pty) Ltd v Pacific Coast Investments 97 Ltd and Another*<sup>426</sup> where Van De Merwe J said that:

“...It also seems to me that *to require, as a minimum, concrete and objectively ascertainable details* of the likely cost of rendering the company able to commence or resume its business, and the likely availability of the necessary cash resource in order to enable the source, nature and extent of the resources that are likely to be available to the company, as well as the basis and terms on which such resources will

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Part A- Background: this includes the list of company’s assets and their status, also provide a list of post-commencement creditors if any, together with the creditors status if the company was to go to liquidation. Also remuneration agreement of business rescue practitioner should be seen in this part of the rescue plan

Part B- Proposals: this should provide for the duration which the plan will be implemented, the extent of claims payment to the creditors. It should also give the significance of the business rescue proceeding as to compare with the immediate liquidation together with the impact of plan to each class of creditors.

Part C-Assumptions and Conditions: this includes any available condition for the rescue plan to operation and implemented to the fully and any impact that it will have on the employees. Importantly the envisaged company’s financial stability for the coming three years.

This mandatory content of a South African business rescue plan resembles the provisions of Section 1123 (a) of the Bankruptcy Act 1978 in the USA where Chapter 11 states that the reorganisation plan must provide for the classes of creditors, the treatment of creditors that will be barred from claiming, and must provide for the equal treatment of each creditor in a given class, except where the creditor has agreed to less favourable treatment.

<sup>424</sup> [2014] ZAKZPHC 1 at para 29.

<sup>425</sup>[2012] ZAWCHC 194 para 38.

<sup>426</sup>2013 (1) SA 542 para 15.

be available, tantamount to requiring proof of a profitability and unjustifiability limits the availability of business rescue proceedings” [Emphasis supplied].

The judicial interpretation of Section 150 (2) of the 2008 Act, which prescribes the content of a rescue plan, thus emphasises the right of creditors to detailed information before voting on a proposed plan.<sup>427</sup>

Significantly, Part E of the 2008 Act which deals with “compromises with creditors”<sup>428</sup> does not extend to companies undergoing business rescue proceedings.<sup>429</sup> However, there is no bar on a business rescue plan incorporating a compromise with creditors<sup>430</sup> and this is foreshadowed in Section 150 (2) (b) (ii) of the 2008 Act which provides that the plan must specify the extent to which a company is to be released from the payment of its debts.

In *Tyre Corporation Cape Town (Pty) Ltd and Others v GT Logistics (Pty) Ltd and Others*<sup>431</sup> the applicant argued that a compromise with creditors could be achieved only under the compromise provisions of Section 155 of the 2008 Act. The court rejected this argument and pointed out that the non-availability of a compromise with creditors in business rescue could prevent the realisation of the objectives of the process.<sup>432</sup>

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<sup>427</sup> See further *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd* 2012 (2) SA 423 (WCC) para 24 where Eloff J expanded on what should be contained in a business rescue plan. He said that if the objective was to salvage the company, the plan should include:-the likely costs of rendering the company able to commence with its intended business, or to resume the conduct of its core business; the likely availability of the necessary cash resource in order to enable the ailing company to meet its day-to-day expenditure, once its trading operations commenced or resumed. If the company was to be reliant on loan capital or other facilities, some concrete indication should be given of the extent and the basis or terms upon which it will be available, including the availability of any other necessary resources, such as raw materials and human capital; and the reasons why it was being suggested that the proposed business plan would have a reasonable prospect of success.. In the event the business rescue proceeding aimed at increasing the value of creditors’ claims compared to what they would accrue if there was an immediate winding-up, then the following details should be given, namely, the source, nature and extent of the resources likely to be available to the company; and the basis and terms upon which such resources would be available..

<sup>428</sup> This is a mechanism that provides for the restructuring of the financial affairs of a company without the involvement of a business rescue practitioner, it allows a company to propose a compromise or arrangement to its creditors in a form that is almost identical to a business rescue plan.

<sup>429</sup> Section 155 (1) of the 2008 Act.

<sup>430</sup> Section 150 (2) of the 2008 Act.

<sup>431</sup> [2016] ZAWCHC 124, para 35.

<sup>432</sup>[2016] ZAWCHC 124, para 35, the court further stated that Sections 150 (2) and 154 (2) of the 2008 Act have incorporated elements of compromise for the purpose of smoothly functioning of business rescue proceedings.

## 4.5 Approving the Business Rescue Plan and the Role of Creditors

Creditors' meetings have a role to play in ensuring that the rights of creditors are respected in a business rescue process. The Act provides that the agenda of the meeting must be set out in the notice of the meeting.<sup>433</sup> Creditors are required to participate in the process in good faith.<sup>434</sup>

At creditors' meetings, decisions are taken by voting,<sup>435</sup> including a vote on a proposed business rescue plan.<sup>436</sup> Voting is on the basis of voting interests,<sup>437</sup> determined with reference to the amount owed to the creditor by the company.<sup>438</sup> The rescue plan will be deemed to be approved if it is supported by creditors who hold more than 75 percent of the voting interests<sup>439</sup> and 50 percent of the independent creditors' voting interests.<sup>440</sup> The criteria for approving the plan, varies between jurisdictions.<sup>441</sup>

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<sup>433</sup> Section 147 of the 2008 Act provides as follows: First meeting of creditors

(1) Within 10 business days after being appointed, the practitioner must convene, and preside over, a first meeting of creditors, at which-

(a) the practitioner-

(i) must inform the creditors whether the practitioner believes that there is a reasonable prospect of rescuing the company; and

(ii) may receive proof of claims by creditors; and

(b) the creditors may determine whether or not a committee of creditors should be appointed and, if so, may appoint the members of the committee.

(2) The practitioner must give notice of the first meeting of creditors to every creditor of the company whose name and address is known to, or can reasonably be obtained by, the practitioner, setting out the-

(a) date, time and place of the meeting; and

(b) agenda for the meeting.

(3) At any meeting of creditors, other than the meeting contemplated in section 151, a decision supported by the holders of a simple majority of the independent creditors' voting interests voted on a matter, is the decision of the meeting on that matter.

<sup>434</sup> In *Employees of Solar Spectrum Trading 83 (Pty) Ltd v AFGRI Operations Ltd and Another, In Re; AFGRI Operations Limited v Solar Spectrum Trading 83 (Pty) Ltd.*(666226/2011) [2012] ZAGPPHC 359 para 36 a creditor had decided not to approve the business plan before it had been developed. The court said in this regard that "I would imagine that at the very least there would be an obligation on [the creditor] to participate in good faith and to consider on its own merits or demerits any business plan proposed." To similar effect, see *Nedbank Ltd v Bestvest 153 (Pty) Ltd; Essa v Bestvest 153 (Pty) Ltd* 2012 (5) SA 497 (WCC) at para 55.

<sup>435</sup> Section 147 (3) of the 2008.

<sup>436</sup> Sections 145 (2) (a) and 146 (d) read with Section 152 of the 2008 Act.

<sup>437</sup> Section 128 (1) (j) of the 2008 Act defines "voting interest" to mean an interest as recognised, appraised and valued in terms of section 145(4) to (6).

<sup>438</sup> Section 145 (4) (a) provides that a secured or unsecured creditor has a voting interest equal to the value of the amount owed to that creditor by the company; and that (b) a concurrent creditor who would be subordinated in a liquidation has a voting interest, as independently and expertly appraised and valued at the request of the practitioner, equal to the amount, if any, that the creditor could reasonably expect to receive in such a liquidation of the company.

<sup>439</sup> Section 152 (2) (a) of the 2008 Act.

<sup>440</sup> Section 152 (2) (b) of the 2008 Act.

<sup>441</sup> For example in Bulgaria the passing of the plan requires a simple majority and half of the value of the claims, Croatia requires a simple majority of each group and half of the claims. The Czech Republic has two restructuring systems, the first requiring compulsory settlement by a simple majority and three quarters of the volume of claims and the other the same as the first one but with a prohibition on obstruction, Germany requires a simple

In South Africa's business rescue proceedings, creditors are grouped together in the voting process.<sup>442</sup> The business rescue practitioner is required to hold separate meetings of the holders of company securities interests whose rights are to be altered.<sup>443</sup>

In principle, it is not always advisable for a business rescue process to give the final say on a rescue plan to the company's creditors<sup>444</sup> for this effectively gives them a power of veto.<sup>445</sup> A better balance needs to be struck between the affected parties.

#### **4.5.1 Rights of Creditors who Dissent from the Business Rescue Plan**

Once the business rescue plan is approved it binds all creditors regardless of whether they voted for or against it.<sup>446</sup> The legislation should provide protection to the creditors who voted against it.<sup>447</sup> The South African Companies Act provides a measure of such protection in that the business rescue plan may provide that, on implementation, a dissenting creditor has a right to

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majority of each group and half of the volume of claims with a prohibition to obstruct; Hungary requires a simple majority and three quarter of volume of claims; Poland with its three systems, the compulsory settlement requires majority vote of three quarter of claims, the continuation it needs simple majority if creditors committee, Romania it requires two of six debtor categories approve by majority vote of three quarter of value of claims, and Slovakia majority vote of two third of value of claims. These illustrations were provided in a tabulated form in Balcerowicz, E. and others, 'The Development of Insolvency Procedures in Transition Economies: A Comparative Analysis,' (2003), CASE Network Studies and Analyses No.254, page 22

<sup>442</sup> Section 152 (2) of the 2008 Act unlike in compromise with creditor mechanism of Section 155 (6) of the same Act where creditors are categorised in classes when voting.

<sup>443</sup> Section 152 (3) (c) (i) of the 2008 Act.

<sup>444</sup> Save for Section 153 (1) (a) (ii) and (b) (i) (bb) dealing with setting aside the results of the vote on the grounds that it was inappropriate by either the business rescue practitioner or any affected persons.

<sup>445</sup> See Asian Development Bank, *Insolvency Law Reforms in the Asian and Pacific Region: Report of the office of the General Counsel on TA 5795-Reg: Insolvency Law Reforms, Law and Policy Reform at the Asian Development Bank*, 1, 2000, page 10-86; creditors' voting interest is a means employed in corporate rescue mechanisms to determine whether to reject or accept the company's rescue plan..

<sup>446</sup> Section 152 (4) of the Act 2008. This provision can be termed a cram-down provision compelling the creditors to affirm matters. See Cassim, FHI and others, *Contemporary Company Law*, Claremont, Juta, (2012) 2nd Edition, page 907; see also Section 1129 (7) A of the Bankruptcy Reform Act 1978 Chapter 11 – in this mechanism it is the court that has the final say on the consideration of the reorganisation plan. There are two requirements for a cram-down provision; either that the act done "does not discriminate unfairly" or that it is "fair and equitable".

<sup>447</sup> See International Monetary Foundation, 'Orderly and Effective Insolvency Procedures: Key Issues', (1999) available at <http://imf.org/external/pubs/ft/orderly/> accessed on 27.04.2015.

enforce the claim against the company.<sup>448</sup> The words “may”<sup>449</sup> and “to the extent provided for in the business rescue plan” in *Section 154* of the 2008 Act make clear that this will be so only where the business rescue plan so provides, and not otherwise.

#### **4.5.2 Rights of Creditors in Challenging the Approved Business Rescue Plan**

Arguably, the Companies Act should have stipulated the grounds that a disgruntled creditor can rely on when challenging the approved rescue plan, as in the case of a rejected plan.<sup>450</sup> It is submitted that the Act could profitably have laid down the following grounds, namely:

- (a) The meetings were not conducted in a proper manner;
- (b) Corruption and fraud;
- (c) The business rescue plan containing prejudicial terms;
- (d) Irregularities during the voting process;
- (e) Creditors within a class having been subjected to unequal treatment.

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<sup>448</sup> Section 154 Discharge of debts and claims:

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

(2) If a business rescue plan has been approved and implemented in accordance with this Chapter, a creditor is not entitled to enforce any debt owed by the company immediately before the beginning of the business rescue process, *except to the extent provided for in the business rescue plan* [Emphasis supplied].

<sup>449</sup> The word “may” expresses a possibility whereas the word “shall” expresses command, instruction or obligation; *Concise Oxford English Dictionary* 12 edition, (2011). The word “shall” could imply a.

<sup>450</sup> In *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd and Others* 2013 (6) SA 471 (GNP) at 494, paragraph [59], the court said: “...it is clear from a reading of *chapter 6 of the Act that it does not provide a remedy to an affected person to challenge the approval and adoption of a proposed business rescue plan*, regardless of whether such approval and adoption are preliminary or final. The adoption of a business rescue plan in terms of s 152 of the Act is pivotal to the business rescue process. Once adopted, the practitioner is required to manage and conduct the affairs of the company in accordance with the plan. The practitioner is responsible for the implementation of the business rescue plan: this task is not left to some other authority. Nor, for that matter, is there any need for court approval of the business rescue plan. Accordingly, once adopted or approved in terms of s 152 of the Act, a business rescue plan forms the foundation of the business rescue proceedings to which all the affected persons are bound. It is binding on the company, on each creditor and on every holder of securities of the company, whether or not that person was present at the meeting, voted in favour of adoption of the plan or in the case of creditors, had proven their claims against the company. What occurs is a process of 'cram-down' in terms of which creditors are forced to accept a business rescue plan, even against their wishes — thus enabling the business rescue to proceed, despite objections by disgruntled creditors. *It is with this object in mind that the legislature saw fit not to provide a disgruntled party with a judicial remedy to seek to set aside the adoption of a business rescue plan. It is, therefore, not open to any 'affected person', after the plan has been adopted, to seek to set it aside.* Nor is it permissible for an 'affected person' to seek to set aside the proceedings of the second meeting of creditors in terms of which a business plan is adopted” [Emphasis supplied].

### 4.5.3 Concept of ‘Inappropriateness’ and its Impact on the Creditors

A voting majority<sup>451</sup> of disgruntled creditors can be overridden where the court allows the passing of a rescue plan that received less support than the required minimum voting interest.<sup>452</sup>

A business rescue practitioner is entitled to apply to court for the setting aside of the voting results of the business rescue plan on the grounds that the result was inappropriate.<sup>453</sup> Any affected person has the right to apply to court for a similar order on the same grounds.<sup>454</sup> The court must decide the issue on specific statutory grounds.<sup>455</sup> These provisions were applied in *Copper Sunset Trading 220 (Pty) Ltd v Spar Group Limited and Another*<sup>456</sup> where the court said that, although creditors had voted against the rescue plan, once the plan was adopted the distressed company was assured of securing finance that would enable the company to restructure and become financially sound and the restructuring of the company would save 52 employees from becoming unemployed. The court thus took special account of the last-mentioned factor.<sup>457</sup> The court set aside the result of the vote; as being irrational and inappropriate in the light of the objectives of business rescue proceedings.<sup>458</sup> Similar provisions are found in other jurisdictions.<sup>459</sup>

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<sup>451</sup> The word ‘majority’ refers to a voting interest.

<sup>452</sup> The statute has not defined the term. In *Shoprite Checkers (Pty) Limited v Berryplum Retailers CC and Others* (47327/2014) [2015] ZAGPPHC 255, para 37 the court said that adopting a dictionary meaning would not be appropriate. To the same effect, see *FirstRand Bank Ltd v KJ Foods CC (In business rescue)* (734/2015) [2017] ZASCA 50, para 33.

<sup>453</sup> Section 153 (1) (a) (ii) of the 2008 Act.

<sup>454</sup> Section 153 (1) (b) (i) (bb) of the 2008 Act.

<sup>455</sup> Section 153 (7) of the 2008 Act states that.

On an application contemplated in subsection (1) (a) (ii), or (1) (b) (i) (bb), a court may order that the vote on a business rescue plan to set aside if the court is satisfied that it is reasonable and just to do so, having regard to-

- (a) the interests represented by the person or persons who voted against the proposed business rescue plan;
- (b) the provision, if any, made in the proposed business rescue plan with respect to the interests of that person or those persons; and
- (c) a fair and reasonable estimate of the return to that person, or those persons, if the company were to be liquidated.

<sup>456</sup> [2014] ZAGPPHC 688 paras 35 and 36.

<sup>457</sup> See also *FirstRand Bank Ltd v KJ Foods CC (In business rescue)* (734/2015) [2017] ZASCA 50 para 38.

<sup>458</sup> [2014] ZAGPPHC 688 para 38.

<sup>459</sup> Similar judicial discretion is found in UK where the court has the final say on the consideration of a rehabilitation plan. In the event that the creditors disapprove the plan, the court has the power to make any order that it thinks fit; see *Section 24 (5)* of the Insolvency Act 1986..

In *Shoprite Checkers (Pty) Ltd and Another*<sup>460</sup> the court laid down two stages when determining to set aside the vote results on grounds of inappropriateness. The court first considered whether the votes were inappropriate; if so, then it determined whether it would be just and reasonable to set aside the voting result. In *Ex parte: Target Shelf 284 CC; Commissioner, South African Revenue Service and Another v Cawood N.O. and Others*.<sup>461</sup> the court disagreed with the two stage approach, and Kubushi, J said:

“Much as I am in alignment with the said two stage approach adopted in the *Shoprite Checkers*-judgment above, I am not in agreement with its conclusion that only if a court finds that the vote is inappropriate can it consider whether it would be reasonable and just to set the vote aside. To my mind, a court is enjoined to consider *whether it is reasonable and just to set the vote aside even where it made a finding that the vote is appropriate*” [Emphasis supplied].

It is clear that a business rescue plan that holds out a ‘reasonable prospect’ of success should be implemented, despite the votes cast against it, and that a plan that has no such prospect cannot be allowed to proceed.<sup>462</sup>

Secured and unsecured creditors, respectively, often have different prospects for the ultimate payment of their claims and consequently may have differing views as to whether a rescue should be attempted;<sup>463</sup> secured creditors may have little or nothing to gain from business rescue, even where it is successful, and may therefore be less in favour.<sup>464</sup> This aspect has been

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<sup>460</sup> (47327/2014) [2015] ZAGPPHC 255, para 40.

<sup>461</sup>[2015] ZAGPPHC 740, para 33.

<sup>462</sup> In *Tyre Corporation Cape Town (Pty) Ltd and Others v GT Logistics (Pty) Ltd and Others* [2016] ZAWCHC 124, para 76 the court said, “Although affected parties are entitled to be heard in relation to a business rescue application, and although their attitude is relevant to the exercise of the court’s discretion, *the existence of a reasonable prospect of rescuing the company is a factual question*, albeit involving a value judgment. *If the court concludes that reasonable grounds for believing that the business can be rescued have not been established, the court cannot grant the application, even though many affected parties may support business rescue*” [Emphasis supplied].

<sup>463</sup> See *FirstRand Bank Ltd v KJ Foods CC (In business rescue)* (734/2015) [2017] ZASCA 50 para 34..

<sup>464</sup> In *Griessel and Another Case* (2015), para 81 the court said, “...There may be sound commercial reasons why suppliers within the manufacturing and service industries would wish to support the continued existence of a company (and possibly under existing ownership) in order to avoid the knock-on effect to their own commercial viability if a major manufacturer to whom they supply and have given credit, or from whom they receive essential components or product for on-sale, closes down”

the subject of comment by the courts<sup>465</sup> and in the scholarly literature.<sup>466</sup> Creditors are unlikely to vote in favour of a business plan that holds no additional benefit for them,<sup>467</sup> but the courts take cognisance of the broad policy objectives of business rescue<sup>468</sup> and are prepared to exercise their power to overturn a voting result that was “inappropriate”.<sup>469</sup>

Where the court makes an order setting aside a board resolution for the commencement of business rescue, the Act explicitly provides for two ancillary orders that the court can make,<sup>470</sup> but the Act is silent as to what ancillary order can be made where the court sets aside the creditors’ vote as inappropriate.<sup>471</sup> This lacuna seems to leave the court with two options. Firstly, the rescue practitioner could be ordered to call another creditors’ meeting for a second vote; secondly, the court could declare the rescue plan adopted. In *Copper Sunset Trading 220 (Pty) Ltd v Spar Group Limited and Another*,<sup>472</sup> the High Court set aside the result of the vote as inappropriate and declared the business plan to be duly adopted, subject to certain conditions, and this decision has since been followed.<sup>473</sup>

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<sup>465</sup> In *FirstRand Bank Ltd v KJ Foods CC (In business rescue)* (734/2015) [2017] ZASCA 50 para 37 the Supreme Court of Appeal took into consideration, inter alia, that the secured creditors favoured immediate winding up.

<sup>466</sup> See Delport, P. et al, *Henochsberg on the Companies Act 71 of 2008 Companies Act 71 of 2008 and Commentary (eds)* (Service issue 10, May 2015) page 530 which comments that since “...creditors are to be allowed to exercise their votes freely it has to be assumed that they would only vote in support of the business rescue plan if its implementation would be to their benefit.”

<sup>467</sup> See *FirstRand Bank Ltd v KJ Foods CC (In business rescue)* (734/2015) [2017] ZASCA 50 para 36.

Liquidation is a speedier process than business rescue proceedings (*KJ Food supra para 85*). Hence if the prospective returns are similar, a creditor is likely to favour liquidation over business rescue..

<sup>468</sup> In *Koen v. Wedgewood Village Golf Estate* 2012 (2) SA 378 (WCC) para 14 the court said: “...It is clear that the legislature has recognised that liquidation of companies more frequently than not occasions significant collateral damage, both economically and socially, with attendant destruction of wealth and livelihoods. *It is obvious that it is in the public interest that the incidents of such adverse socioeconomic consequences should be avoided where reasonably possible...*” [Emphasis supplied].

<sup>469</sup> See Joubert, E.P and Loubser, A., ‘Executive Directors n Business Rescue: Employees or Something Else?’, (2016) *De Jure*, page 103 where the authors refer in this regard to the decisions in *Copper Sunset Trading 220 (Pty) Ltd v SPAR Group Ltd and Normandien Farms (Pty) Ltd* 2014 6 SA 214 (LP) and *KJ Foods CC v First National Bank* [2015] ZAGPPHC 221.

<sup>470</sup> Section 130 (5) (c) of the 2008 Act.

<sup>471</sup> See in *DH Brothers Industries (Pty) Ltd supra para 58*.

<sup>472</sup> [2014] ZAGPPHC 688 para 1 sub-para 2.

<sup>473</sup> See *KJ Foods CC v First National Bank* (75627/2013) [2015] ZAGPPHC 221, para 1 (ii) declared the business rescue plan adopted after holding that the vote results were inappropriate. On appeal, the Supreme Court of Appeal said at para 89 :“...once the result of the vote is set aside the business rescue plan is adopted, by the operation of law. That being the position, the declaratory order of the court a quo that the revised business rescue plan be adopted by the affected parties is superfluous, as it is a natural consequence of the setting aside of the result of the vote.”

#### **4.6 The Notice of Implementation of the Business Rescue Plan**

A rescue plan, once adopted, must then undergo ‘substantial implementation’,<sup>474</sup> but the Act does not define this concept. Companies Regulations 2011 under paragraph 125 (5) stipulates Form CoR 125.3 as the notice to be used by the rescue practitioner to provide the stakeholders and general public with notification that the business rescue plan has achieved substantial implementation. This notice does not make any provision for the practitioner to explain the extent to which the rescue plan has achieved its objectives. Arguably, the Act should have made this a formal requirement.<sup>475</sup> As matters stand, the Companies Commission will be unaware of the manner in which the plan has achieved its objectives. By contrast, the Act provides in detail for what must be included in a notice for filing for the commencement of business rescue proceedings.<sup>476</sup>

The dictionary meaning of the word “substantial” is *of great importance, size, or value*.<sup>477</sup> The Act does not require “full” implementation of the rescue plan for the proceedings to come to an end. When notice of substantial implementation is filed, the business rescue proceedings terminate,<sup>478</sup> the moratorium falls away and creditors again have the right to institute legal proceedings against the company and take enforcement action in respect of their claims.

#### **4.7 Timeframe of Business Rescue Proceedings and its Impact on Creditors**

The companies’ legislation provides tight time constraints for the execution of the phrases in the business rescue proceeding process. In *Copper Sunset Trading 220 (Pty) Ltd v Spar Group Limited and Another*<sup>479</sup> the court said –

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<sup>474</sup> Section 132 (2) (c) and 152 (8) of the 2008 Act.

<sup>475</sup> See *Redpath Mining South Africa (Pty) Ltd v Marsden No and Others*[2013] ZAGPJHC 148 para 84 where Kgomo J said “A business rescue plan should be implemented ‘as soon as yesterday’, i.e. immediately, if the ailing business is to be healed and rehabilitated for the benefit of all creditors and affected and interested instances. If leave is granted to launch the legal proceedings the applicant seeks to institute, it may be years before such proceedings are finalised. At that stage, the company in financial distress would be long dead and buried. This, cannot be what was intended when the system of judicial management was replaced with the new baby or animal-business rescue” [Emphasis supplied].

<sup>476</sup> Section 129 (3) of the 2008 Act requires a company that has adopted and filed a business rescue resolution to publish a notice of the resolution within five days. Section 129 (7) provides that “if the board of a company has reasonable grounds to believe that the company is financially distressed, but the board has not adopted a resolution contemplated in this section, the board must deliver a written notice to each affected person, setting out the criteria referred to in Section 128 (f) that are applicable to the company, and its reasons for not adopting a resolution contemplated in this section”

<sup>477</sup> *Concise Oxford English Dictionary* 12th edition, (2011).

<sup>478</sup> Section 132(2)(b).

<sup>479</sup>(365/2014) ZAGPPHC 688, para 17.

“...this application was brought to court on urgent basis. In making out a case for urgency Counsel for the Applicant submitted, correctly in my view, that the real urgency lies in the fact that the *Applicant does not have the luxury of time on its side: every day that passes in anticipation for the plan to be approved, it becomes more difficult for the applicant to turn itself around*” [Emphasis supplied].

In this regard, Makgoba J referred to the decision in *Koen v Wedgewood Village Golf Estate*<sup>480</sup> where Binns-Ward J said that –

“...it is axiomatic that *business rescue proceedings, by their very nature, must be conducted with maximum possible expedition*. In most cases a failure to expeditiously implement rescue measure when a company is in financial distress will lessen or entirely negate the prospects of effective rescue. *Legislative recognition of this axiom is reflected in the time lines given in terms of the Act* for the implementation of the business rescue procedures if an order placing a company under supervision for that purpose is granted. There is also the consideration that the mere institution of business rescue proceedings however dubious might be their prospects of success in a given case materially affects the right of third parties to ensure their rights against the subject company...” [Emphasis supplied].

The timelines laid down in the Act must be adhered by the rescue practitioner,<sup>481</sup> or an extension of time must be sought.<sup>482</sup> If the practitioner has failed in this duty, the court can order his or her removal from office as was observed in in *Re Absa Bank Ltd v Caine NO and Another*.<sup>483</sup>

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<sup>480</sup> 2012 (2) SA 378 (WCC) para 10.

<sup>481</sup> An empirical study conducted in South Africa regarding stakeholders' views on the operation of the business rescue proceedings (see Pretorius, M. Business Enterprises at University of Pretoria (Pty) Ltd, Business Rescue Status Quo Report Final Report, (30 March 2015), page 35) comments that rescue practitioners have found ways to “stretch” the timelines. One such practice is to state at the first creditors' meeting that it will not be possible to have the completed plan within the 25-day time frame and to have the creditors vote for an extension.

<sup>482</sup> As it is enjoined by Sections 129 (3), 132 (3), 150 (5) of the 2008 Act.

<sup>483</sup> [2014] ZAFSHC 46 para 10; the court referred to a decision involving the same parties which dealt with the removal of the business rescue practitioner following a total failure to abide to the timeframe provided by the statute. The court noted that the practitioner had failed to do the following: (i) convene a first meeting of creditors in terms of s 147 of the Act which had to be done within ten business days;(ii) prepare and publish a business rescue plan in terms of s 150 of the Act which had to be done within twenty five business days after being appointed; (iii)convene a meeting in terms of s 151 of the Act to determine the future of the two entities;(iv) file a report in terms of s 132 (3) (a) of the Act, or to apply for an extension of the three month period within which the business rescue had to be finalised..

#### **4.8 Conclusion**

To ensure that the rights of creditors are protected during an attempted business rescue, they are given the statutory right to participate in every court hearing that involves the company in question. Further, creditors are entitled to form committees in order to safeguard their rights. Issue can arise in respect of such committees. The legislation does not specify the minimum number of members in such committees. Moreover, the various creditors may have divergent interests and differing economic strength, and such factors could affect the functioning of these committees. There is a possibility of the various committees having different agendas.

The court has the final say in decisions made by the creditors' meetings in respect of the proposed business rescue plan. The power of the court to set aside a voting result as inappropriate empowers the court to override a decision made by the creditors. This judicial power limits the influence exerted by the creditors in preparing and approving the rescue plan.

The power of the court in this regard was regarded as necessary in order to enhance the prospect of a successful business rescue. Where creditors hold security for their debts, they may be reluctant to support a business rescue plan that would dilute the value of that security, and the overriding power of the court in this regard reveals the determination of the drafters of the Act to achieve the successful rescue of a company against resistance by the creditors.

As regards the duration of the business rescue proceedings, the Act is tailored to allow the process to be conducted as expeditiously as possible, with due regard for the interests of the company's creditors whose rights of enforcement have been stayed by the statutory moratorium, and with appropriate regard for the burden borne by the business rescue practitioner which may impel that person to seek extensions of time from the court or the creditors.

## CHAPTER FIVE

### NOTABLE ISSUES UNDER BUSINESS RESCUE PROCEEDINGS AND THEIR IMPACT ON CREDITORS' RIGHTS

#### 5.1 Introduction

Certain statutory aspects of business rescue deserve special attention by virtue of their impact on the rights of creditors and because they have been the subject of divergent judicial interpretation.

This chapter considers aspects of the business rescue proceedings that have come under scrutiny in regard to creditors' rights. These include the statutory moratorium, post-commencement finance and the order of the payment of claims. The situation of sureties is considered, and the concept of a "binding offer" in this context.

#### 5.2 Evaluation of Moratorium on Creditors' Enforcement Rights in Business Rescue Proceedings

The preamble to South Africa's Companies Act 71 of 2008 acknowledges one of its objectives as being to provide for the efficient rescue of financially distressed companies.<sup>484</sup> An important aspect of the statutory business rescue regime is the temporary moratorium that automatically comes into place for the duration of the process,<sup>485</sup> and which is intended to give the company a breathing space in which creditors cannot institute or enforce legal proceedings for the payment of claims.<sup>486</sup> The moratorium is intended to allow viable companies to get back on

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<sup>484</sup> Section 7 (k) of the 2008 Act.

<sup>485</sup> Section 133 (1) of the 2008 Act provides that:-(1) During business rescue proceedings, no legal proceeding, including enforcement action, against the company, or in relation to any property belonging to the company, or lawfully in its possession, may be commenced or proceeded with any forum, except-

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

The moratorium in business rescue proceedings is temporary; see *JVJ Logistics (Pty) Ltd v Standard Bank of South Africa Ltd and Others* (7076/2015) [2016] ZAKZDHC 24; para 34.

<sup>486</sup> See INSOL International, Statement of Principles for a Global Approach to Multi-Creditor Workouts (2000) which discusses the extent of co-operation that is expected of a creditor toward a distressed company during

their feet financially.<sup>487</sup> Business rescue would seldom be possible without such a moratorium<sup>488</sup> The moratorium also assists in ensuring the equal treatment of the company's creditors, secured and unsecured.<sup>489</sup>

In some jurisdictions, a moratorium is not automatic as it is in South Africa, but has to be imposed by court order.<sup>490</sup> In Chapter 11 proceedings in the USA, the debtor company, once it has filed for the rehabilitation, is granted a ninety-day automatic stay of all proceedings. Some time limits also apply in South Africa's business rescue.<sup>491</sup> In the UK the moratorium in the administration proceedings must be supported by the creditors and it has to be approved by the court.<sup>492</sup> An automatic right to a of stay of execution is vulnerable to abuse.<sup>493</sup>

The legislative provisions need to be drafted in a way that retains the confidence of the company's creditors<sup>494</sup> In South Africa, creditors are entitled to seek the consent of the rescue practitioner or the leave of the court to institute or enforce legal proceedings against the

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the moratorium. In *Chetty v Hart* (20323/2014) [2015] ZASCA 112; para 39 the Supreme Court of Appeal stated the said that, "Section 133(1) was enacted to protect a company under business rescue against claims from creditors. Its object is to prevent the practitioner being inundated with legal proceedings without sufficient time within which to consider whether or not the company should resist them and to prevent the company that is financially distressed from being dragged through litigation while it tries to recover from its financial woes. Its effect is to stay legal proceedings except in those circumstances mentioned in s 133(1)(a) to (e). The creditor may initiate or continue the proceedings in terms of s 133(1)(a) with the written consent of the practitioner."

<sup>487</sup> Claessens, S. and Klapper, L.F., 'Bankruptcy around the World: Explanations of its Relative Use,' (2002), World Bank Policy Research Working Paper 2865, page 6 and 8, available at [www.univie.ac.at/bwl/ieu/lehre/ss06/.../debtor\\_in\\_possession.pdf](http://www.univie.ac.at/bwl/ieu/lehre/ss06/.../debtor_in_possession.pdf), accessed on 25. July. 2014

<sup>488</sup> The Companies Act 46 of 1926 introduced a process of judicial management without providing for an automatic stay of legal proceeding against the company, but a later amendment provided for such a moratorium; see the Companies Act 11 of 1932, discussed above in Chapter 2.11.2.

<sup>489</sup> See Pretorius, M. and Rosslyn-Smith, W., 'Expectations of a Business Rescue Plan: International Directives for Chapter 6 Implementation,' (18)2, Southern Africa Business Review, (2014), page 114.

<sup>490</sup> India is an interesting example of a jurisdiction which had no moratorium for some creditors in its corporate reorganisation mechanism, following the enactment of the Reconstruction of Financial Assets and Enforcement of Security Interest Act 2002 and before Companies Act 2013 came to force. Before 2002 India under its Sick Industrial Companies (Special Provisions) Act 1985, companies could abuse the moratorium at the expense of creditors by prolonging the restructuring procedure for years, see Zwieten, K., 'Corporate Rescue in India: The Influence of the Courts', Journal of Corporate Law Studies, (2015), page 3. See also La Porte and others, "Law and Finance", JPE, (106)6, (1998), page 1135 and 38.

<sup>491</sup> Section 132 (3) of the Act 2008. If the proceedings have not terminated within three months, the business rescue practitioner has the right to apply to court for an extension.

<sup>492</sup> Sections 10 and 11 of the UK Insolvency Act 1986. These provisions provide for a moratorium during the application stage and after the order for administration mechanism has been granted by the court.

<sup>493</sup> Haselman, R., and others, 'How the Law Affects Lending,' Columbia Law and Economic, (2006) Working Paper No.285, page 1 also observed that the presence of automatic moratorium undermines creditors' right to enforce their security.

<sup>494</sup> As it is under Sections 130, 132, 134, 136, 141, 144, 145, 146, 147, 148, 149, 151, 152, 154 to mention but few of the 2008 Act.

company, although the bar against such proceedings in this regard is not absolute<sup>495</sup> and the criteria on which consent or leave will be granted or refused are not made explicit in the Act. In *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies (Pty) Ltd and Another*<sup>496</sup> and *Redpath Mining South Africa (Pty) Ltd v Marsden NO and Others*<sup>497</sup> it was held that leave to litigate would be granted only in special circumstances.

Chapter 6 of the Act does not lay down the criteria to be applied in this regard,<sup>498</sup> although the Act is very specific on other matters affecting the moratorium. The courts are thus not constrained by the Act in this regard and will take account of the policy objectives of business rescue.<sup>499</sup> Lifting the moratorium in respect of a creditor's claim can jeopardise the entire attempt at business rescue and prejudice other creditors.<sup>500</sup>

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<sup>495</sup> Section 133 (1) (a) for the consent and 1 (b) of the 2008 Act for the application. According to *Chetty v Hart* (20323/2014) [2015] ZASCA 112; para 45 the availability of these remedies and the way the moratorium provision is tailored guarantees the creditors that there is no absolute bar on legal action against the company.

<sup>496</sup> [2013] ZAGPJHC 109; at para 67 Kgomo, J. stated that- "... A court being asked for leave to proceed against a company under business rescue, thus during a moratorium, must receive a well-motivated application for that so that it could apply its mind to the facts and the law if necessary and then be in a position to make a ruling in accordance with any terms it may consider suitable in the peculiar circumstance."

<sup>497</sup>[2013] ZAGPJHC 148 para 71 and following his judgment in *Merchant West Working Capital Solutions (Pty) Ltd Case* (2013), Kgomo, J. held that the failure of the applicant to show exceptional circumstances meant the the application had to be rejected..

<sup>498</sup> In *Concorde Plastics (Pty) Ltd v NUMSA and Others* 1997 (11) BCLR 1624 (LAC) at 1644F-1645A it was held that very powerful considerations are required.

<sup>499</sup> In *Natal Joint Municipal Pension Fund Case 2012 (4) SA 593 (SCA)* para 18 it was held that a court must take account of context, as well as language. Delpont, P., et al *Henochsberg on the Companies Act 71 of 2008*, Service Issue 9 Vol 1 at 478(6) comments that the intention of the moratorium is to cast the net as wide as possible in order to include any conceivable type of action against the company.

<sup>500</sup>*Re Absa Bank Ltd v Caine N.O and Another* [2014] ZAFSHC 46 para 48 where the rescue proceeding had already being in existence for the past two and half years. Under this prevailing circumstance the court ruled that it will not be fair to prevent creditors from exercising their contractual rights during the stay of business rescue proceeding should not exceed to an extent that it detracts the rights of creditors. This is a kind of circumstance that the court thought it just and equitable to grant leave for the party to enforce its right irrespective of the existing stay of enforcement

Further, in an English decision *Re Atlantic Computer Systems plc* [1992] Ch 505 at 542-544 where an applicant applied to be granted a permission to exercise its property right of repossessing the computers which were held by a company in administration under both hire purchase and long lease agreements. The Court of Appeal made some points that a court could consider when it is called upon to grant a leave to lift a moratorium:

1. In an event a party is applying for a leave so that it exercises its property right, such as repossession, the court will look whether that act will frustrate the mechanism, if not it will grant the leave.
2. The court should take a balance the interests of the party claiming to repossess against the interests of the other creditors.
3. In the balancing exercise undertaken by the court due weight should be given to the owners of the property. This is done for the purpose of preventing the owner of the property to indirectly finance the proceeding for the benefit of unsecured creditors.
4. Also the court would grant a leave for legal proceeding if the refusal will significant harm to the applicant.
5. In a circumstance that it has rejected a leave, the court should order the practitioner to act in a manner that ensures fairness.

The approach of Kgomo, J. in *Redpath Mining South Africa (Pty) Ltd Case* (2013) and *Merchant West Working Capital Solutions (Pty) Ltd* (2013) was held to be unconvincing in *Moodley v On Digital Media (Pty) Ltd and Others*<sup>501</sup> where the court construed the moratorium as not restricting an affected person from approaching the court on matters regarding the business rescue practitioner or the company in relation to the business rescue plan. The court observed that issues that arise during the operation of the business rescue are not subject to the moratorium. Similarly, in *Resource Washing (Pty) Ltd v Zululand Coal Reclaimers Proprietary Limited and Others* the court disagreed with the views advanced in *Redpath Mining South Africa (Pty) Ltd* and pointed out that nowhere does the Act state that exceptional circumstances must be present for the court to grant leave in this regard.<sup>502</sup>

Another contentious issue is the scope of the moratorium. Save for certain exceptions, the moratorium applies to claims that arose before the business rescue proceedings commenced. However, in *Murray NO and Another v Firstrand Bank Ltd t/a Westbank*<sup>503</sup> the Supreme Court of Appeal held that –

“The liquidators’ construction that, in terms of Section 133 (1), the cancellation of an agreement constitutes ‘enforcement action’ which requires the consent of the practitioner or the court, would also fundamentally change our law of contract. As explained earlier, our law of contract provides for a unilateral cancellation in the case of a breach of contract. The way I see it, *the legislature intended to allow the company in distress the necessary breathing space by placing a moratorium on legal*

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<sup>501</sup> (20456/2014) [2014] ZAGPJHC 137; paras 10 the court stated that: “The language of s 133, when read in context with the other relevant provisions in Chapter 6 and having regard to its purpose, *does not include within its ambit proceedings relating to the development, adoption or implementation of a business rescue plan.* It is the business rescue practitioner who must develop a business rescue plan and implement it if adopted and the company, under the direction of the practitioner, must take all necessary steps to attempt to satisfy any conditions on which the business rescue is contingent and implement the plan as adopted. *Legal proceedings, such as the present case, which seek that an adopted business rescue plan be executed and implemented strictly according to its terms and in accordance with the applicable provisions of the Companies Act, are legal proceedings against the business rescue practitioner and the company in business rescue in connection with the business rescue plan. They are not legal proceedings against the company or property belonging to the company or lawfully in its possession within the meaning of s 133(1)*” [Emphasis supplied]. In para 11 the court concluded that “Section 133, therefore, finds no application in legal proceedings against a company in business rescue and its business rescue practitioner in connection with the business rescue plan, including its interpretation and execution towards implementation...”

<sup>502</sup> (10862/14) [2015] ZAKZPHC 21, para 10-13.

<sup>503</sup> (20104/2014) [2015] ZASCA 39, para 40.

*proceedings and enforcement action in any forum, but not to interfere with the contractual rights and obligations of the parties to an agreement.* Such an intention would, in any event, be contrary to the tenet of our law that *the legislature does not intend to alter the existing law more than is necessary, particularly if it takes away existing rights*” [Emphasis supplied].

Fourie AJA held that a party to a contract can, in the exercise of common law rights, unilaterally cancel the contract without permission from the business rescue practitioner or the leave of the court, as the right of cancellation is not affected by the moratorium and does not amount to legal proceedings as envisaged in the Act.<sup>504</sup> Thus, a party to a contract can exercise this right notwithstanding the objectives of business rescue proceedings. It is unexpected that the Act was not drafted in a manner that makes the cancellation of a contract subject to the moratorium.

The stay on legal proceedings against the company during the business rescue proceeding encompasses quasi-judicial proceedings. A noteworthy aspect of South Africa’s business rescue regime is the importance accorded to the company’s employees..<sup>505</sup>

In in *Fabrizio Burda v Integcomm (Pty) Ltd*<sup>506</sup> it was held that proceedings in the Commission for Conciliation, Mediation and Arbitration constitute legal proceedings as envisaged in the business rescue legislation, and are thus subject to the moratorium. In *National Union of Metal Workers of South Africa obo Members v Motheo Steel Engineering*<sup>507</sup> which concerned an urgent application in relation to the applicability of *Section 133 (1) (a)* of the 2008 Act, the Labour Court held that labour law does not bar employees from exercising their right to institute legal proceedings, except where the Constitution provides otherwise.<sup>508</sup>

These two conflicting decisions regarding the enforcement rights of workers during business rescue proceedings were to some extent resolved in *Sondamase and another v Ellerine Holdings*

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<sup>504</sup> The court interpreted the phrase “no legal proceedings, including enforcement action” to mean enforcement action as a result of legal proceedings. Thus, cancellation of a contract is a unilateral act by a party that does not involve any legal proceedings.

<sup>505</sup> Joubert, E.P and Loubser, A., ‘Executive Directors n Business Rescue: Employees or Something Else?’, (2016) De Jure. Atpage 95, the authors acknowledge the importance accorded to employees throughout the business rescue proceedings. Lesser emphasis in this regard is accorded in countries such as UK, Germany USA and Canada.

<sup>506</sup> (Unreported case No. JS539/2012, 29.11.2013).

<sup>507</sup> (J271/2014) [2014] ZALCJHB 31, para 1.

<sup>508</sup> The court referred to Section 210 of the Labour Relation Act, 66 of 1995.

*Limited (in business rescue) and another*<sup>509</sup> where the Labour Court recognised that the stay of legal proceedings against a company in rescue proceedings includes arbitration proceedings in labour tribunals.

The Supreme Court of Appeal finally resolved the issue in *Chetty v Hart*.<sup>510</sup> In this case, the court had regard to the purpose of the moratorium in business rescue and related it to alternative dispute resolutions in labour matters, and ruled that a wide scope must be accorded to the moratorium. As to the meaning of “forum” in Section 133 of the 2008 Act, the court affirmed the interpretation adopted in *Murray NO and Another*<sup>511</sup> which held that a *forum* is a court or tribunal.

The decisions taken in these two cases took a practical approach to the purpose of moratorium in business rescue proceedings.<sup>512</sup>

The moratorium protects the debtor company from the commencement of business rescue through to its termination.<sup>513</sup> It has been suggested that in such moratoriums, the period of

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<sup>509</sup> (Unreported case No. C669/2014, 22.01.2016)

<sup>510</sup> (20323/2014) [2015] ZASCA 112; at para 35 it was held that “...the purpose of the provision, which is to give breathing space to the practitioner to get the company’s financial affairs in order, *also requires it to be construed widely because arbitrations, like court proceedings also involve diversion of resources-both time and money-that may hinder the effectiveness of the business rescue proceedings*. To construe it narrowly, as the court a quo did, and as the respondent contends we should, would be at odds with its language, defeat its purpose and lead to insensible and impractical consequences” [Emphasis supplied].

<sup>511</sup> (20323/2014) [2015] ZASCA 112. At para 19 the court ruled that if the drafters had intended to restrict legal proceedings to court proceedings, they would simply have used the word ‘court’ instead of ‘forum’ in Section 133 of the 2008 Act.

<sup>512</sup> In *JVJ Logistics (Pty) Ltd v Standard Bank of South Africa Ltd and Others* (7076/2015) [2016] ZAKZDHC 24; at para 36 it was held that it would be impossible to conduct business rescue proceedings in the absence of a moratorium.

<sup>513</sup> In *Kariba Furniture Manufacturers* (2013) at para 5.

moratorium must be neither too long nor too short<sup>514</sup> and that a balance needs to be struck in this regard between the interests of the company and the rights of its creditors.<sup>515</sup>

### 5.3 The Treatment of Suretyship in Business Rescue Proceedings

Save for the leave of the court or the consent of the practitioner, a company that has commenced business rescue proceeding cannot, as a result of the statutory moratorium, be sued in respect of a suretyship that it has given for the debt of another person.<sup>516</sup> This is not made explicit in the Act, but it has been so ruled by the courts as a matter of interpretation<sup>517</sup> and on the basis

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<sup>514</sup> In *Gormley v West City Precinct Properties (Pty) Ltd and Another, Anglo Irish Bank Corporation Ltd v West City Precinct Properties (Pty) Ltd and Another* (19075/11) [2012] ZAWCHC 33, para 11, Traverso DJP said, "...The Act envisages a short term approach to the financial position of the company. This is so for self-evident reasons. There must be a measure of certainty in the commercial world. *Creditors cannot be left in the state of flux for an indefinite period*...It must either be unlikely that the debts can be repaid within the ensuing 6 months. In the case the company is presently insolvent and cannot pay its debts unless a moratorium of 3-5 years is granted. The fact of this matter does not bring West City's financial situation within the definition of financially distressed" [Emphasis supplied]. See also Eloff AJ in *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd* [2011] ZAWCHC 442 para 24. Further, see Finch, V., 'Re-invigorating Corporate Rescue', [2003], J.B.L. page 538. In Kang, N. and Nitin, N., 'The Evolution of Corporate Bankruptcy Law in India,' ICRA Bulletin Money and Finance, Oct 2003- March 2004, page 49, the authors cite the example of India where the corporate rehabilitation procedure can take up to fifteen years to be finalised.

<sup>515</sup> Pretorius, M., Business Rescue Status Quo Report Final Report, Business Enterprises at University of Pretoria (Pty) Ltd (30 March 2015), page 34 cites the following factors when determining whether the duration of a moratorium is reasonable:

- (a) Industry effect (mining very long and retail industry short).
- (b) Sources of PCF sought (international vs local funders require different times to complete due diligences etc.).
- (c) Shareholder country of origin vs that of creditors relative to South Africa (influence \*n travel, negotiation, exchange controls).
- (d) Number of times creditors request revisions of the proposed plan.
- (e) Legal proceedings initiated by affected parties during the process of the rescue. These can be of various natures.
- (f) Nature of the cause of decline/distress
- (g) External and environmental factors (ex. Businesses in the platinum belt are suffering due to the strike).

<sup>516</sup> Section 133 (2) of the 2008 Act provides that during business rescue proceedings, a guarantee or surety by a company in favour of any other person may not be enforced by any person against the company except with leave of the court and in accordance with any terms of the court considers just and equitable in the circumstances.

<sup>517</sup> Section 5 (2) of the 2008 Act provides that in interpreting and applying this Act the courts can use foreign company law. In *Nedbank Ltd v Bestvest 153 (Pty) Ltd; Essa and another v Bestvest 153 (Pty) and Others* 2012 (5) SA 497 (WCC) paras 26 the High Court made a reference to the application of foreign law in interpreting the legislation. Hence the court applied common law suretyship principles when arriving to its decision after it discovered that there was a lacuna with regarding to surety status in business rescue proceeding.

of common law principles of suretyship,<sup>518</sup> as recognised in South African law.<sup>519</sup> A common law principle in this regard is that, unless the deed of suretyship states otherwise, if the principal debt is discharged by a compromise with or a release by the principal debtor, the surety is released from his obligations. This principle has had to be adapted to accommodate the statutory business rescue regime and the terms of an adopted business rescue plan.<sup>520</sup>

In *Tuning Fork (Pty) Ltd T/A Balanced Audio v Greeff and Another*,<sup>521</sup> the rescue plan provided for the discharge of the principal debtor's liabilities in full and final settlement, but it was silent on the status of the surety. It was held that, since the rescue plan was silent on the issue, the principles of suretyship decree that the surety is thereby discharged.<sup>522</sup> A somewhat different factual context was in issue in *Absa Bank Limited v Du Toit and Others*.<sup>523</sup> In this case the suretyship agreement had preserved the right of the creditor to enforce its claim against the surety in the event the principal debtor entered into a restructuring process. However, the business rescue plan provided that the claim in question would be paid in full and final

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<sup>518</sup> One of the relevant English decision as far as suretyship is concerned is by the full bench in *Wides v Butcher & Sons* (1905) 26 NLR 578, which dealt with a settlement between an insolvent debtor and its creditors. In this matter the deed of assignment provided that the signing creditors released, acquitted and discharged the debtor from all claims and demands whatsoever. However, the recourse remedy clause was later unilateral inserted in the deed. The court held that the recourse clause did not form part of the deed, hence the surety was full discharged of the debt obligations. It was agreed by all the judges that if the clause was part of the deed the decision would have been different. In reference to the test set forth by the House Of Lords in *Muir v Crawford* 1875 LR 2 HL at 456, the court further at para (584) stated that:

"There is no doubt that a simple discharge of a debtor by a creditor discharges also the surety, upon the simple ground that if it were otherwise, it would be a fraud upon the debtor, to profess to discharge him of the debt due to the creditor, and at the same time to leave him open to recourse against him by the surety. But a discharge of the debtor does not liberate the surety if the remedy against the surety is expressly reserved, because in that case the discharge is not an absolute release,... The reservation has the effect, because it rebuts the presumption which ordinarily exists that if you liberate the principal debtor, you mean to liberate also the surety, and it has the effect of preserving the right of recourse by the surety against the principal debtor..." [Emphasis supplied]

The preservation of right to recourse against the principal debtor in the suretyship between the parties automatically invokes the right of the creditors to proceed against the surety in the event the principal debtor has is discharged as a result of the compromise under the business rescue plan. This established principle of suretyship give reliance on what the parties have agreed in their deed.

<sup>519</sup> *Trust Bank van Afrika Bpk v Ungerer* 1981 (2) SA (T) at 225, *Leipsig v Bankorp Ltd* 1994 (2) SA 128 (A) at 132H-133A, *Kilroe-Daley v Barclays National Bank Ltd* 1984 (4) 609 (A) 6221-6231, *Millman and Another NNO v Masterbond Participation Bond Trust Managers Pty Managers Pty Ltd (under Curatorship) and others* 1997 (1) SA 133 (C) at 122C, *BOE Bank Ltd v Bassage* 2006 (5) SA 33 (SCA) and *Kilroe-Daley v Barclays National Bank Ltd* 1984 (4) 609 (A) at 6221-6231.

<sup>520</sup> *Tuning Fork (Pty) Ltd T/A Balanced Audio v Greeff and Another* [2014] 3 All SA 50 (WCC) para 14.

<sup>521</sup> [2014] 3 All SA 50 (WCC) para 14.

<sup>522</sup> *Ibid* at para 85, it was held that the adoption of a business rescue plan does not without more affect a creditor's rights against the surety; it depends on an application of the general principles of the law of suretyship to the actual provisions of the plan.

<sup>523</sup> [2013] ZAWCHC 194.

settlement. The creditor applied for judgment against the surety for the remaining balance as amended by the rescue plan. The surety argued that the suretyship was accessory in nature, with the result that once the principal debtor was discharged, the surety was released. The court held in favour of the surety, effectively ruling that the terms of the business rescue plan prevailed over the suretyship.

In *Investec Bank Ltd v Bruyns*,<sup>524</sup> Rogers AJ held that if the principal debtor enters into any legal proceedings that might have an impact on the creditor's claim, the creditor could enforce its claim against the surety. The court held that the moratorium is a defence *in personam* against the company in business rescue proceedings, which connotes that it protects the distressed company but not a surety for the company.<sup>525</sup> The debt itself is not discharged, as it is with a defence *in rem*, it merely releases the principal debtor.<sup>526</sup>

This decision was followed in *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd and Others*.<sup>527</sup> The crux of this case was the interpretation of Section 153 (1) (b) (ii) of the 2008 Act which deals with binding offers. The court was also required to determine the status of the surety in the rescue proceedings. The court held that the creditor's claim against the surety was expressly protected under the suretyship agreement in the event that the principal debtor embarked on restructuring, or in the event of its insolvency or liquidation. However, given that the rescue plan provided for the full and final settlement of the creditor's claim, the surety demanded to be released from its obligations. It was held that Chapter 6 of the Act has no provision barring a creditor from enforcing a claim against the surety, notwithstanding the terms of the business rescue plan. The court said that if the

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<sup>524</sup> 2012 (5) SA 430 (WCC) para 25.

<sup>525</sup> 2012 (5) SA 430 (WCC) para 18.

<sup>526</sup> In *Nedbank Ltd v Bestvest 153 (Pty) Ltd; Essa and another v Bestvest 153 (Pty) and Others*<sup>526</sup> the High Court judge ruled against the release of surety with reference to the terms of suretyship agreement. See further Forsyth, C.F. and Pretorius, J.T., *Caney's The Law of Suretyship in SA*, Juta, (2010) 6th Edition, page 188.

<sup>527</sup> 2013 (6) SA 471 paras 68-73. At para 69 Kathree-Setiloane, J said that: "There is, furthermore, no basis to suggest that such a provision could be read into the business rescue regime. As already explained, the express purpose of business rescue is to provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the right and interests of all relevant stakeholders`. The emphasis of the business rescue regime is therefore on the company in financial distress, and the relevant stakeholder. There need be no connection between a surety and either the company in financial distress or the stakeholders and, whether or not a creditor is entitled to pursue a surety will, in the ordinary course, have no bearing on the prospects of rescuing a company."

legislation had intended to such an extremely negative impact on creditors, this would have been expressly stated.<sup>528</sup>

In both *Tuning Fork (Pty) Ltd T/A Balanced Audio* and *Absa Bank Limited* the creditors and the principal debtors agreed on a compromise provided for in the business rescue plan in terms of which there was to be a payment in full and final settlement. The courts held that the business rescue plan overrode the suretyship and rejected the creditors' claim to be entitled to proceed against the surety. By contrast, the decisions in *Investec Bank Ltd* and *Kariba Furniture Manufacturers (Pty) Ltd and Others*, permitted the creditors to enforce their claims against the surety where the suretyship contained preservation clauses in favour of the creditor. The courts felt it was just to grant the creditor an enforcement right against the surety.

These differing interpretations were addressed by the Supreme Court of Appeal in *New Port Finance Company (Pty) Ltd and Another v Nedbank Ltd*<sup>529</sup> where Wallis, JA, obiter, regarded the terms of the suretyship as overriding the terms of the business rescue plan.<sup>530</sup>

It is likely that henceforth, suretyships will contain a standard term to govern the situation where the principal debtor enters into business rescue, and a rescue plan is adopted.<sup>531</sup> The deed

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<sup>528</sup> In *Business Partners Limited v Tsakiroglou and Another* (17827/2014) [2015] ZAWCHC 61, para 29 this interpretation was endorsed as regards the liability of a surety after the release of the principal debtor in terms of a business rescue plan.

<sup>529</sup> (30/2014) [2014] ZASCA 210 para 12.

<sup>530</sup> In *Business Partners Limited v Tsakiroglou and Another* (17827/2014) [2015] ZAWCHC 61, para 31 the court held that where a surety has renounced the benefit of excussion, the creditor has a right to proceed against the surety for the full amount and need not pursue the principal debtor for the payment; thereafter the surety has a right of recourse against the principal debtor. At para 34 the High Court said, "It is now settled that South African law of suretyship, does not recognise a so-called prejudice principle to the effect that if a creditor should do anything in his dealings with the principal debtor which has the effect of prejudicing the surety, the latter is released from his obligations." This in line with an obiter dictum of the Supreme Court of Appeal in *Absa Bank Limited v Davidson* 2000 (1) SA 1117 (SCA), para 19, where Olivier, JA stated that, "As a general proposition, prejudice caused to a surety can only release a surety (whether totally or partially) if the prejudice is the result of a breach of some or other legal duty or obligation. The prime sources of a creditor's rights, duties and obligations are the principal agreement and the deed of suretyship. If, as is the case here, the alleged prejudice was caused by conduct falling within the terms of the principal agreement or the deed of suretyship, the prejudice suffered was one which the surety undertook to suffer." In practice the surety is not totally prejudiced as he still has a right of recourse against the principal debtor.

<sup>531</sup> *Tuning Fork (Pty) Ltd T/A Balanced Audio v Greeff and Another* (18136/13) [2014] ZAWCHC 78; para 43, *Absa Bank Limited v Du Toit and Others* (7311/13) [2013] ZAWCHC 194 paras 14 and 15, *Investec Bank Ltd v Bruyns* 2012 (5) SA 430 (WCC) para 25, and *Nedbank Ltd v Wedgewood Village Golf Estate (Pty) Ltd and Others, Nedbank v Mostert and Another, Nedbank Ltd v Trustees of the IC Stratford Family Trust and Another* (20896/2010, 22331/2010, 24607/2010) [2011] ZAWCHC 384. In all these decisions, reference is made to a standard form of suretyship agreement used by banks and other financial institutions that preserves the creditor's right to pursue the surety in the event that the principal debtor is sequestered, liquidated, or placed in business rescue

of suretyship should state the juncture at which the creditor can enforce his claim against the surety, and in particular whether this can occur before the rescue plan has been approved. Secondly, the suretyship should also be explicit as to the amount that the creditor is entitled to recover from the surety before and after the approval of the business rescue plan. Thirdly, the suretyship should address the position of surety vis-a-vis the principal debtor where the latter embarks on business rescue

These issues impact on other stakeholders and the company itself. The terms of the suretyship should be such as not to jeopardise the business rescue proceedings.

These issues could usefully be addressed by legislative amendments to Chapter 6 of the Companies Act 2008.<sup>532</sup>

#### **5.4 Status of Post-Commencement Financiers in the Business Rescue Proceedings**

For a distressed company to be able to obtain finance after it has entered into business rescue proceedings, is a complex task.<sup>533</sup> Ideally, a company should negotiate for post-commencement finance before the restructuring begins.<sup>534</sup> The company or the rescue practitioner, can then

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proceedings, administration, or is party to a compromise or arrangement, under statute or otherwise in the context of insolvency or restructuring.

<sup>532</sup> In Australia the companies' legislation is explicit that the release of a company as principal debtor in rehabilitation proceedings does not affect the creditors' rights against the surety. (Section 444H (b).) Creditors who are not parties to an arrangement are not bound by it. Section 444J of the Australian Corporations Act 2001 provides that a deed of company arrangement for the release of a principal debtor does not affect the creditor's rights in terms of a guarantee or indemnity.

<sup>533</sup>Section 60 of the National Credit Act 34 of 2005 provides that "(1) Every adult natural person, and every juristic person or association of persons, has a right to apply to a credit provider for credit (2) Subject to sections 61 and 66, a credit provider has a right to refuse to enter into a credit agreement with any prospective consumer on reasonable commercial grounds that are consistent with its customary risk management and underwriting practices. (3) Subject to sections 61 and 92(3), nothing in this Act establishes a right of any person to require a credit provider to enter into a credit agreement with that person" [Emphasis supplied]. Further, see Pretorius, M. and Du Preez, W. 'Constraints on Decision Making regarding Post-commencement Finance in Business Rescue,' (2013), SAJESBM, 182 (6) page 170. On the same issue, see Burdette, D.A., The Development of a Modern and Effective Business Rescue Model in South Africa: Pre-consultation Working Document, The Centre for Advanced Corporate and Insolvency University of Pretoria, 2004 available at <http://www.turnaround-sa.com/pdf/The%20development%20of%20a%20modern%20and%20effective%20rescue%20model%20for%20South%20Africa.pdf> accessed on 27.04.2016 and Jacobs, L., 'Post-Commencement Financing and Creditors: A South African Perspective,' (2012), 33 (3), Comp. Law., 94-96.

<sup>534</sup> In *Griessel and Another* (2015), para 81 the court said "...in order to give content to the purpose of business rescue it is necessary to establish, before considering the paying out of creditors or shareholders in the form of a dividend through a business rescue plan, whether the company has access to investor funding that may tide it over or whether creditors are prepared to support the rehabilitation of the company instead of closing it down." The urgency of obtaining post-commencement finance is noted in Pretorius, M. and Rosslyn-Smith, W.J., 'Expectations of a business rescue plan: international directives for Chapter 6 implementation' *Southern African Business Review*, (2014), page 132. The early acquisition of debtor-in-possession financing reduces the risk of

negotiate with current or prospective creditors regarding financial assistance during restructuring.<sup>535</sup> Carapeto concluded that, under Chapter 11, distressed companies that secured debtor-in-possession financing have a high probability of being reorganised<sup>536</sup> and found that it is almost impossible to restructure a financially distressed company without post-reorganisation financing.<sup>537</sup>

The significant role played by post-commencement finance has been recognised by the South Africa judiciary. An applicant for entry into business rescue has a good chance of persuading the court to grant the order if there is proof that there will be a post-commencement fund to finance the company's operations.<sup>538</sup> *Newcity Group (Pty) Limited v Pellow N.O. and Others*,<sup>539</sup> was an appeal from a rejection of an application by a company in provisional liquidation to be placed in business rescue in terms of *Section* 131 (4) (a) of the 2008 Act. The appellant claimed that the company was able to secure funds and would ultimately be rescued if it was permitted to enter business rescue.<sup>540</sup> The Supreme Court of Appeal commented that the funds relied on by the appellant were just statements of intent not formal agreements<sup>541</sup> and

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liquidation and the time spent in the bankruptcy proceedings; Elayan, F. and Meyer, T., 'The Impact of Receiving Debtor in-Possession Financing on the Probability of Successful Emergence and Time Spent under Chapter 11 Bankruptcy,' 28 (7) & (8), *Journal of Business Finance and Accounting*, (2001), page 906.

<sup>535</sup> Pretorius, M. and Du Preez, W. 'Constraints on Decision Making regarding Post-commencement Finance in Business Rescue,' (2013), *SAJESBM*, 182 (6) page 180.

<sup>535</sup> Principle 3.2 of Part B of the World Bank also states that corporate rescue statute of a country should encourage lending to, investment in, or recapitalization of viable financially distressed enterprises.

<sup>536</sup> See Carapeto, M., *Does Debtor-in-Possession Financing Add Value?*, Working Paper, Cass Business School, (2003), page 2, available at <http://www.facultyresearch.london.edu/docs/294.doc> accessed in 12.12.2015. This empirical study took a sample of large companies that had filed for reorganisation during a certain period of time, and compared the success of those that had post-petition financing and those that had not.

<sup>537</sup> In business rescue, certain of the company's operations commonly require financing, such as labour costs, obtaining goods and services from trade suppliers, rent, insurance, maintenance of contracts and other operating expenses, together with the cost of maintaining the value of assets. See Pretorius, M. and Rosslyn-Smith, W.J., 'Expectations of a business rescue plan: international directives for Chapter 6 implementation' 2014 *Southern African Business Review*, page 132.

<sup>538</sup> *Optifeeds (Pty) Ltd v Business Depot 2 CC t/a GS Poultry and Others* (6885/2014) [2014] ZAGPPHC 276, paras 38 and 39, where among other things the High Court was determining the prospect of a company being rescued after it has received an application for the resolution of a company to embark on business rescue proceedings to be set-aside. The court referred to the principles for assessing the feasibility of a company being rescued that were laid down in *Prospec Investments (Pty) Ltd v Pacific Coast Investments 97 Ltd and Another* 2013 (1) SA 542 (FB): where among of them being "...the likely availability of the necessary cash resource in order to enable the company to meet its day-to-day expenditure, or concrete factual details of the source, nature and extent of the resources that are likely to be available to the company, as well as the basis and terms on which such resources will be available,..." The facts in the possession of a court show that a company is to receive funds from state that will enable it to be rescued. Consequently the court ruled that there is a reasonable prospect of a company being rescued; hence it rejected the plea of setting aside the resolution.

<sup>539</sup> (577/2013) [2014] ZASCA 162.

<sup>540</sup> (577/2013) [2014] ZASCA 162, para 8.

<sup>541</sup> (577/2013) [2014] ZASCA 162, para 19.

that, even if those funds were made available, they would not be sufficient to service the loans of its creditors to a greater extent than would be the case under liquidation or in a restructuring of the company.<sup>542</sup> The court affirmed the decision of the court a quo.<sup>543</sup>

The courts regard the availability of post-commencement finance as an important factor in determining whether there is a reasonable prospect of a company's achieving the objectives of business rescue.

The Companies Act does not give the courts the power to order an institution or individual to provide post-commencement finance to a company in business rescue;<sup>544</sup> this was stated obiter in *Kritzinger and Another v Standard Bank of South Africa*.<sup>545</sup>

A financially distressed company undergoing business rescue is permitted to issue collateral that is not already encumbered.<sup>546</sup> Post-commencement financiers can thus be granted security only in respect of the unencumbered assets of the company;<sup>547</sup> this restriction is an important protection for the company's other creditors and ensures that the secured creditors' rights and interests remain intact.<sup>548</sup> By comparison, in reorganisation proceedings under Chapter 11, a company is allowed to offer security to a post-commencement financier in respect of an encumbered property.<sup>549</sup> There is an argument that, if this is workable in the USA, the same

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<sup>542</sup> (577/2013) [2014] ZASCA 162, para 23.

<sup>543</sup> *Newcity Group (Pty) Ltd v Pellow NO and Others, China Construction Bank Corporation Johannesburg Branch v Crystal Lagoon Investments 53 (Pty) and Others* [2013] ZAGPJHC 54, para 23 where the High Court held that the fact of a company being in provisional liquidation for more than a year and nothing has materialised, and there is no imminent prospect of third party funding being obtained but only speculation is enough to comprehend that the company will not be able to achieve the objects of rescue mechanism. This was also available in *Eveleigh V Dowmont Snacks (Pty) Ltd and Others* [2014] ZAKZPHC 1 para 29, where the absence of evidence that the Trustee is willing to finance the company made the honourable Judge refuse to grant the order of business rescue proceedings, when determining the reasonable prospect it being rescued.

<sup>544</sup> This view was provided in the obiter dictum of the Supreme Court of Appeal in *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others* [2013] ZASCA 68 by stating that it is not underlying purpose of the statute to force commercial banks to finance companies which are in financial distress.

<sup>545</sup> [2013] ZAFSHC 215 para 57.

<sup>546</sup> Section 135 (2) (a) of the 2008 Act.

<sup>547</sup> This is also the practice in under Article 75 of the Chinese Bankruptcy Law 2006.

<sup>548</sup> Zhang, H., 'Balance of Power and Control of Creditors in the Insolvency Procedures: a Comparison between the UK and China,' (2011), 26 (10), J.I.B.L.R., page 497. It stated that the absence of super-priority will motivate banks to provide funds to the solvent companies knowing that their interests will not be jeopardised.

<sup>549</sup> Section 364 (c) (d) of the Chapter 11 Bankruptcy Code 1978 it provides for borrowing with a first lien on collateral subject to prior encumbrances. The first one is through junior lien this is comprised by agreement between the pre-petition security holder and the post-commencement financier. And the second is the priming lien where a distressed company is priming the existing secured creditor without its consent. However the

relaxed rule should be included in South Africa's business rescue legislation<sup>550</sup> and perhaps the statutory draftsman should go back to the drawing board in regard to the rules for post-commencement finance.<sup>551</sup>

To be more explicit in this regard: it is submitted that s 135(2)(a) of the Act should be amended to permit the company to offer security to lenders in respect of encumbered assets that are under-secured, as the present prohibition is a barrier to the acquisition of new funds during the business rescue process.

The operative portion of the amended section should then read as follows –

“...may be secured to the lender by utilising any asset of the company to the extent that it is not otherwise *fully* encumbered” [Emphasis supplied].

The proposed addition of the word ‘fully’ will allow access to under-secured company assets.<sup>552</sup> There is a downside to this suggestion, in that if the rescue attempt fails and the company is liquidated, the unsecured creditors will receive a lesser dividend.<sup>553</sup>

Post-commencement financiers, realising the dire straits of the company seeking funds, are likely to drive a hard bargain regarding interest and other terms,<sup>554</sup> to the potential detriment

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legislation has set grounds for the company to take a priming action. A company has to prove that there all other type of financing are unavailable and the interest of the primed creditor in the collateral at issue will be adequately protected.

<sup>550</sup>Dahiya, S. and others, “Debtor-in-Possession Financing and Bankruptcy Resolution: Empirical Evidence 69 J. Fin. Econ page 279, the authors found out that when comparing to debtors having no post-commencement finance, those with funds the reorganisation went very fast and their likelihood of survival was high than liquidation. On the other hand, Carapeto, M., ‘Does Debtor-in-Possession Financing Add Value?’, Working paper, Cass Business School (2003), page 2 reported that the rehabilitation process should be very cautious in preventing the existence of priming lien as they result to increase liquidation of companies as the creditors will not be comfortable in providing loans in exchange of a collateral that might in the future subjected to another loan by the other creditor.

<sup>551</sup> It is, very rare for a distressed company at this time to still have any collateral to offer for the purpose of acquiring a loan from these lenders. These financiers will need security for ensuring that their money will be paid after the procedure regardless it was successful or not, in Haselman, R., and others, ‘How the Law Affects Lending,’ Columbia Law and Economic, (2006) Working Paper No.285, page 34.

<sup>552</sup> Principle 3.2 of Part B of the World Bank (2015) recommends for countries to have enabling legal framework that encourage lending to, investment in, or recapitalization of viable financially distressed enterprises in every possible manner.

<sup>553</sup> UNCITRAL Legislative Guide on Insolvency Law, page 115.

<sup>554</sup> Zhang, H., ‘Balance of Power and Control of Creditors in the Insolvency Procedures: a Comparison between the UK and China,’ (2011), 26 (10), J.I.B.L.R., page 493 it was observed that post-commencement financiers stand a very good chance of dictating the terms of the loan agreement, since, at that moment, the survival of the

of the company's other creditors.<sup>555</sup> The company's creditors will of course be made aware of the terms of post-commencement finance, and may be given the opportunity to vote on the matter.<sup>556</sup>

Post-commencement financiers have an interest in negotiating terms that will make for efficiency in the restructuring arrangement as a whole. In Chapter 11, a performance-based compensation package<sup>557</sup> is an arrangement promised to the management of the company as motivation to expedite the reorganisation proceedings. But securing finance by offering security over the company's assets is often more straightforward and more quickly arranged.<sup>558</sup> The terms of a package invariably provide for a reduction in rewards to the company's management if they fail to meet stipulated targets. Such checks and balances, overseen by post-commencement financiers, decrease the financiers' risks in the restructuring proceedings.<sup>559</sup>

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company depends largely on them. This control can even reach a stage of demanding a position in the company's management as a control mechanism during rescue as it was observed in US debtor in possession, See White, J. J., 'Death and Resurrection of Secured Credit,' (2004), 12, ABILR, page 175.

<sup>555</sup> It was reported that in Chapter 11 the loans supplied in debtor in possession had higher interest rates than the normal credit provided when the company is solvent in Elayan, F. and Meyer, T., 'The Impact of Receiving Debtor in-Possession Financing on the Probability of Successful Emergence and Time Spent under Chapter 11 Bankruptcy,' 28 (7) & (8), Journal of Business Finance and Accounting, (2001), page 907 and see White, J. J., 'Death and Resurrection of Secured Credit,' (2004), 12, ABILR, page 139. In a recent study it was found out that debtor in possession lending interest rates is much higher as it stands at 7.63 percent and 10.73 percent Abraham, N. and Habbu, A., 'DIP Lending and the Death of Emergence: Reorganisation Outcome Post-crisis, page 13 available at <https://turnaround.org/cmaextras/The-Death-of-Emergence.pdf> accessed on 4.04.2015.

<sup>556</sup> Chapter 6 of the 2008 Act does not expressly require the rescue practitioner to involve the creditors when entering into agreements with a post-commencement financier. However, the right of creditors to be given notice of all relevant matters concerning business rescue proceedings, as required by Section 145 (1) of the 2008 Act, impliedly extends to decisions on post-commencement finance. Section 150 (2) provides that the business rescue plan must contain *all the information reasonably required* to enable affected persons to decide whether or not to accept or reject the plan. (Emphasis supplied) It seems clear that post-commencement finance agreements must be included in the rescue plan for the creditors' consideration.

<sup>557</sup> Without a success fee, the practitioner may have an interest in drawing out the procedure, particularly where he is entitled to a monthly or hourly fee.; see LoPucki, L.M., 'The Trouble with Chapter 11, Wis.L.Rev. (1993), pages 739-745. See also Davis, A. 'Want Some Extra Cash? File for Chapter 11,' Wall Street Journal, (2001).

<sup>558</sup> In the notorious Enron case a debtor-in-possession finance contract provided for a bonus to the management in consideration for effecting a quick sale of company assets; Ahrens, F., 'Enron Files for New Bonuses Severance, Washington Post, 30-3-2002.

<sup>559</sup> LoPucki, L., The Nature of the Bankrupt Firm: A Response to Baird and Rasmussen's The End of Bankruptcy, Stan. L. Rev., (56)3, (2003), page 648. This USA based study revealed that during the 1980s when the debtor company was in control of the reorganisation process only twenty percent of distressed companies embarked on a going-concern sale; by comparison, in 2002 the figure was seventy five percent. This trend is confirmed in Baird, D. and Rasmussen, R., Chapter 11 at Twilight, Stan.L.Rev. (2003), 863-699 where it is noted that permitting creditors to take control of rehabilitation proceedings can result to an acceleration of going-concern sales or the piecemeal liquidation of companies.

Such creative practices are less likely to be successful in South Africa's business rescue regime because the whole process is managed by the rescue practitioner whose remuneration comes from the distressed company. If it is suggested to the post-commencement financiers that they should offer inducements to the rescue practitioner, in order to speed up the proceedings, this could create conflicts of interest and could tempt the practitioner to favour the creditors' interests, rather than the interests of the company. The business rescue practitioner will usually be assured of the payment of his fee, regardless of the success or failure of the business rescue, but a "success fee" of some kind can be a strong motivating factor. The Act provides that, where there is to be additional remuneration for the practitioner, this can be negotiated, but is subject to approval by the holders of a majority of the creditors' voting interests<sup>560</sup> and they will therefore have to agree to any performance-based or other compensation package.<sup>561</sup>

#### **5.4.1 Payment Ranking of the Post-Commencement Financiers**

The Companies Act provides in s 135 for the ranking of creditors' claims against a company in business rescue.<sup>562</sup> Significantly, a preferential ranking is accorded to post-commencement finance.<sup>563</sup> In the rescue plan, the practitioner is required to set out the order of preference in which creditors will be paid<sup>564</sup> but no specific guidance, outside of the aforementioned provision of the Act, is given to the rescue practitioner in setting the order of preference.<sup>565</sup>

The judiciary has attempted to clarify this important issue. In *Redpath Mining South Africa (Pty) Ltd v Marsden NO and Others*<sup>566</sup> Kgomo, J. after acknowledging that s 135 of the Act

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<sup>560</sup> Section 143 (2) and (3) of the 2008 Act.

<sup>561</sup> Section 145 (1) of the Act 2008 allows creditors to informally propose inclusions in the rescue plan, and some suggestions be forthcoming after a creditor becomes a post-commencement financier.

<sup>562</sup> The payment ranking of creditors is among the factors that post-petition creditors take into consideration when deciding whether to inject funds into a company in business rescue; see Calitz, J. and Freebody, G., 'Is Post-commencement Finance proving to be the Thorn in the side of Business Rescue Proceedings under the 2008 Companies Act?', (2016), *De Jure*, (40), page 271.

<sup>563</sup> Section 135 of the 2008 Act.

<sup>564</sup> Section 150 (2) (b) (v) of the 2008 Act.

<sup>565</sup> Principle 2 and 3 of Part A of the World Bank Principles of Effective Insolvency and Creditor/Debtor Regimes, Revised 2016, available at <http://www.pubdocs.worldbank.org/en/919511468425523509/ICR-Principles-Insolvency-Creditor-Debtor-Regimes-2016.pdf> accessed on 11.05.2016 deals with movable and immovable securities and recommends that a country's insolvency (including corporate rescue) statute should have *clear provisions* governing the hierarchy of creditors' claims. On page 6 an executive summary gives advice on the *predictability* of the priority of claims in the established mechanism. The UNCITRAL Legislative Guide on Insolvency Law, (2005), para 13 of page 14 states that: "...*Clear rules for the ranking of priorities of both existing and post-commencement creditor claims are important to provide predictability to lenders, and to ensure consistent application of the rules, confidence in the proceedings and that all participants are able to adopt appropriate measures to manage risk...*" [Emphasis supplied]

<sup>566</sup>(18486/2013) [2013] ZAGPJHC 148 para 60.

provides for the ranking of creditors' claims, expressed the ranking in more expansive terms than does the Act (and, arguably, deviating from the Act<sup>567</sup>) as follows:

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

If Kgomo J. is correct in his view on the ranking of claims against a company in business rescue,<sup>568</sup> secured creditors will lack the incentive to provide post-commencement finance.<sup>569</sup>

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<sup>567</sup> This judgment endorses what was held in this regard in *Merchant West Working Capital Solutions (Proprietary) Limited v Advanced Technologies and Engineering Company (Proprietary) Limited and Another* [2013] ZAGPJHC 109 para 21. However, Delpont, P., and Others (eds.), *Henochsberg on the Companies Act 71 of 2008*, Durban: LexisNexis. (2011), page 478 points out that this order payment does not correspond to what is provided under Section 135 of the Act 2008 as nowhere in that provision are pre-petitioned secured creditors mentioned. See also Stoop, H. and Hutchison, A., "Post-Commencement Finance - Domiciled Resident or Uneasy Foreign Transplant?" (2017), PER / PELJ (20) at page 18 where the authors say that the judgment does not expressly consider the wording of the provision, nor the impact of the chosen interpretation, and in fact does not cite the legislation directly but instead relies exclusively on a single secondary source which is a book by Stein, C. and Everingham, G., *New Companies Act*, pages 420-421

<sup>568</sup> The ranking suggested by Kgomo J. was clearly obiter.

<sup>569</sup> A prospective post-commencement lender would not advance funds unless his claim, and the security for the loan, enjoyed priority over other creditors in the event of the company's default; see Zhang, H. and others, 'The Balance of Power in Insolvency Proceedings: The Case of China', (2011), 8, *International Corporate Rescue*, page 13 and United Kingdom Report of the Review Committee on Insolvency Law and Practice, Cork Report, (1982) para 1491. The terms of the loan would also have to provide assurance that other creditors could not interfere with the secured assets; see Hill, C., *Is Secured Debt Efficient?*, (2001-2002), 80, *Texas Law Review*, page 1119; Such security is in effect a form of insurance for the lender –see Finch, V., *Corporate Insolvency Law: Principles and Perspectives*, 2nd Edition, CUP, (2009), page 74; a secured creditor's claim is thus not merely to a proportionate amount of the free residue – see Goode, R.M., *Commercial Law*, 3<sup>rd</sup> Edition, Penguin Books; London, (2004) part 4.

Finch identifies the following reasons for a creditor of the company to seek collateral, namely,<sup>570</sup> a concern that the company will overpay dividends to its shareholders;<sup>571</sup> a concern that the company may take on further debt by borrowing from other sources; a concern that the company may conceal assets;<sup>572</sup> a concern that the company's management may exercise their powers to benefit themselves, and a concern that the company may invest in high risk ventures that diminish the entity's value.<sup>573</sup> In short,, financiers insist, from the outset, on stringent terms that will mitigate their loss if the borrowing company undergoes restructuring.

Where a company is in liquidation, a secured creditor retains the right to its security and if the security is adequate, has the prospect of its claim being be paid in full.<sup>574</sup> By contrast, where a company is undergoing business rescue, it is common for the rescue practitioner to propose a rescue plan that involves a dilution of secured creditors' rights<sup>575</sup> in the context of the ranking of claims imposed by Chapter 6 of the Act, which elevates post-commencement financier's claims and employees claims to high priority. As a result, the company's creditors, including its secured creditors, are likely to be in a worse position than before business rescue.<sup>576</sup>

This s the background to judicial interpretations regarding the ranking of claims in business rescue which have as their object the rehabilitation of financially distressed companies, even if this entails diluting the rights of the company's secured creditors

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<sup>570</sup> See further Finch, V., *Corporate Insolvency Law: Principles and Perspectives*, 2nd Edition, CUP, (2009), page 88-89.

<sup>571</sup> To similar effect, see Hill, C., *Is Secured Debt Efficient?*, (2001-2002), 80, *Texas Law Review*, page 1118.

<sup>572</sup> This was earlier observed in Bebchuk, L.A. and Fried, J.M., 'The Uneasy Case for the Priority of Secured Claims in Bankruptcy,' (1996), 105, *Yale Law Journal*, page 864. It has been observed that banks and other lending institutions prefer immovable security - see McDonald, C. and Schumacher, L., 'Financial Deepening in Sub-Saharan Africa: Empirical Evidence on the Role of Creditor Rights Protection and Information Sharing,' (2007), IMF Working Paper No. 203, page 12.

<sup>573</sup> See further Ronald, M., 'Explaining the Pattern of Secured Credit,' (1997), 110 (625), *Harvard Law Review*, pages 641-645. The issue of over-investment is discussed in Bebchuk, L.A. and Fried, J.M., 'The Uneasy Case for the Priority of Secured Claims in Bankruptcy,' (1996), 105, *Yale Law Journal*, page 864.

<sup>574</sup> Section 366 (1) (c) Companies Act 61 of 1973.

<sup>575</sup> Section 150 (2) (b) (ii) of the 2008 Act provides for the extent to which the company is to be released from the payment of its debts and debt conversation aspects.

<sup>576</sup> Calitz, J. and Freebody, G., 'Is Post-commencement Finance proving to be the Thorn in the side of Business Rescue Proceedings under the 2008 Companies Act?', (2016), *De Jure*, page 272, Section 134 (3) of the 2008 Act say that this provides protection to secured creditors in the event that the company wishes to dispose of any property over which another person has a security or title interest. Section 134 (3) is relevant in the event that "...the company wishes to dispose of any property over which another person has any security or title interest..."

If the attempt at business rescue fails to achieve its statutorily defined objectives, the ranking of claims that will then apply will dilute the rights of secured creditors vis-à-vis the company and the company will inevitably go into liquidation. In such liquidation, the claims of post-commencement financiers will be ranked below the costs of the liquidation<sup>577</sup> and they may well be in a worse position than if the company had been liquidated immediately it became financially distressed, without the losses and costs incurred in the unsuccessful attempt at business rescue.

The judicial interpretation, outlined above, reflects what the government proposed in the Companies' Bill 2007 in which the employees' post-commencement claims were accorded preference over the claims of the company's secured creditors<sup>578</sup> but the proposal was omitted from the text in the enacted version of the 2008 Act.

Given the importance and sensitivity of this issue,<sup>579</sup> it is submitted that Chapter 6 of the Act should have provided in more detail for the ranking of claims against a company undergoing business rescue, instead of merely providing in detail in s 143 (5) of the Act 2008<sup>580</sup> for the preferential status accorded to the rescue practitioner's claim for remuneration and expenses.

It is suggested that *Section 135* would be improved if it was amended to rank the claims of creditors in the following order:

1. The practitioner, for remuneration and expenses and other persons (including legal and other professionals) for costs of business rescue proceedings.<sup>581</sup>

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<sup>577</sup> Section 135 (4) of the 2008 Act. The situation is otherwise under Chapter 11 where a post-commencement financier is granted super-priority status, ahead of any other claim against the company, ranking even ahead of administrative expenses.

<sup>578</sup> Section 138 (3) (ii) of the Companies Bill 2007 provides that after payment of the supervisor's remuneration and costs referred to in section 146, and other claims arising out of the costs of the business rescue proceedings, all claims contemplated -(a) in subsection (1) will have preference in the order in which they were incurred over: (i) all claims contemplated in subsection (2); and (ii) all *secured and unsecured claims* against the company. [Emphasis supplied].

<sup>579</sup> Section 25 of the Constitution of the Republic of South Africa, 1996. The Bill of Rights protects the right to property, and states that no one may be deprived of property except in terms of law of general application, and no law may permit arbitrary deprivation of property

<sup>580</sup> "To the extent that the practitioner's remuneration and expenses are not fully paid, the claim for those amounts will rank in priority ahead of the claims of all other secured and unsecured creditors."

<sup>581</sup> Section 135 (3) read with Section 143 of the 2008 Act.

2. Secured lenders or other creditors for any loan or supply made before business rescue began.<sup>582</sup>
3. Employees for any remuneration which became due and payable after business rescue proceedings began.<sup>583</sup>
4. Secured lenders or other creditors for any loan or supply made after business rescue proceedings began, i.e. post-commencement finance.<sup>584</sup>
5. Unsecured lenders or other creditors for any loan or supply made after business rescue proceedings began, i.e. post-commencement finance.<sup>585</sup>
6. Employees for any remuneration which became due and payable before business rescue proceedings began.<sup>586</sup>
7. Unsecured lenders or other creditors for any loan or supply made before business rescue proceedings began.<sup>587</sup>

### **5.5 Analysis of Binding Offer in Business Rescue Proceedings**

Allowing creditors of a company undergoing business rescue to sell their voting rights to other interested parties is a prudent step toward the goal of restructuring a financially distressed company.<sup>588</sup> Such a provision in corporate rescue legislation is aimed at balancing the need to get the company back on its feet quickly while allowing creditors to withdraw from an arrangement that does not have their support<sup>589</sup> and it is a potential way to remove unhappy creditors from the process.

The legislation attempts to facilitate the rescue of a distressed but potentially viable company even where some creditors dissent from the rescue plan.<sup>590</sup> Section 153 (1) (b) (ii) of the 2008 Act gives an affected person the right to make a binding offer to purchase the voting interests

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<sup>582</sup> As noted, above, section 25 (1) of the Constitution of the Republic of South Africa 1996 gives constitutional protection to the right to property..

<sup>583</sup> Section 135 (1) read with Section 135 (3) (a) of the 2008 Act.

<sup>584</sup> Section 135 (3) (a) read with Section 135 (2) of the 2008 Act.

<sup>585</sup> Section 135 (3) (a) read with Section 135 (2) of the 2008 Act.

<sup>586</sup> Section 144 (2) of the 2008 Act.

<sup>587</sup> Section 135 (3) (b) of the 2008 Act.

<sup>588</sup> Principle C14.2 of the World Bank Principles for Effective Insolvency and Creditor/Debtor Regime, (2016), this principle is that during the formulation and consideration of the rescue plan, there should be a flexible approach that is consistent with fundamental requirements designed to promote fairness and prevent commercial abuse.

<sup>589</sup> As envisaged in Section 7 (k) of the 2008 Act which promotes balancing the rights and interests of all the stakeholders involved in the rescue mechanism.

<sup>590</sup> Section 153 (1) (a) (ii), 153 (1) (b) (i) (bb) and 153 (7) of the 2008 Act deals with setting aside the results of the vote as inappropriate; Section 153 (1) (a) (i) and 153 (1) (b) (i) (aa) provides for a revision of the rescue plan.

of a dissenting creditor.<sup>591</sup> The value of voting interest will be independently and expertly determined on the basis of the amount that would have been received if the company were to be liquidated.<sup>592</sup> If the creditor disagrees with the valuation, he has the right to apply to court to review, reappraise and revalue the determination.<sup>593</sup>

The concept of a binding offer has been criticised. Loubser suggests that, firstly, the offer should be binding once it is made; secondly, that the offer should not be more than the liquidation claim, given that the concurrent creditors may receive little or nothing.<sup>594</sup> The treatment of the offeree after relinquishing the voting interest has been criticised.<sup>595</sup>

A business rescue plan must spell out the benefits of adopting the plan, compared with the benefits that would be received by creditors if the company were to be placed in liquidation.<sup>596</sup>

There is now clarity on the legal nature and consequences of binding offers made in the course of business rescue. In *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd and Others*<sup>597</sup> the Supreme Court of Appeal held that a binding offer made to a creditor who opposes a business rescue plan is not automatically binding on the offeree.

The binding offer provisions of Chapter 6 have come under constitutional challenge<sup>598</sup> on the basis that they impact on voting rights<sup>599</sup> and deny access to the court by way of review,<sup>600</sup> and that these provisions breach the constitutional right to equality.<sup>601</sup> The constitutional challenge

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<sup>591</sup> This provision states that “any affected person, or combination of affected persons, may make a binding offer to purchase the voting interests of one or more persons who opposed adoption of the business rescue plan, at a value independently and expertly determined, on the request of the practitioner, to be a fair and reasonable estimate of the return to that person, or those persons, if the company were to be liquidated”.

<sup>592</sup> Section 152 (1) (b) (ii) of the 2008 Act.

<sup>593</sup> Section 153 (6) of the 2008 Act.

<sup>594</sup> Loubser, A, *Some Comparative Aspects of Corporate Rescue in South African Company Law*, LLD Thesis, University of South Africa, (2010) page 138; see also Loubser, A. ‘*The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions (Part 2)*’ TSAR 689, (2010), pages 700-701

<sup>595</sup> Locke, N. and Esser, I., ‘Company Law and Stock Exchanges’ *Annual Survey of South African Law* 231, (2013), page 282.

<sup>596</sup> Section 150 (2) (b) (vi) of the 2008 Act states that the rescue plan must set out the benefits of adopting the business rescue plan as opposed to the benefits that would be received by creditors if the company were to be placed in liquidation.

<sup>597</sup> [2015] ZASCA 69; 2015 (5) SA 192 (SCA); [2015] 3 All SA 10 (SCA).

<sup>598</sup> 2013 (6) SA 471 (GNP) (since overturned on appeal and reported at [2015] ZASCA 69 )

<sup>599</sup> 2013 (6) SA 471 (GNP) para 43.

<sup>600</sup> 2013 (6) SA 471 (GNP) para 47.

<sup>601</sup> 2013 (6) SA 471 (GNP) para 56.

was unsuccessful, and these provisions were held to be justifiable, given the objectives of the statutory scheme for business rescue.<sup>602</sup> Dissenting creditors' rights were held to be protected where they sold their voting interests.<sup>603</sup>

In *DH Brothers Industries (Pty) Ltd v Gribnitz NO and others*,<sup>604</sup> it was held that it was not the intention of the legislature that a binding offer, once made, would bind the offeree and that if this had been the intent, the legislation would have said so.<sup>605</sup> The court held that the offer only binds the offeror and has legal obligations if accepted by the other party.<sup>606</sup> I

Previously disputed issues were settled by the Supreme Court of Appeal in *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd and Others*.<sup>607</sup> Inter alia, the court was required to interpret the term "binding offer" in the context of Chapter 6 of the Act and whether such an offer binds the offeree once it is made. In this case, the respondent, who wanted the rescue plan to be approved, had presented an audited financial statement of seven years previously which indicated that the company had not carried on any business since then.<sup>608</sup> The creditor in question was reluctant to support the plan. In its judgment, the court cited the dictionary definition of the term "offer" and concluded that it is acceptance that creates rights and obligation.<sup>609</sup> The court held further

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<sup>602</sup>2013 (6) SA 471 (GNP) para 56 the judge said, "...Section 153(1)(b)(ii) of the Act serves a compelling and legitimate governmental purpose, and the deprivation of the voting interest in the company accompanied by compensation, which is expertly and independently determined, is not arbitrary."

<sup>603</sup>2013 (6) SA 471 (GNP) para 32.

<sup>604</sup> 2014 (1) SA 103 para 40.

<sup>605</sup> To the same effect, see *Absa Bank Limited v Caine N.O. and Another, In Re; Absa Bank Limited v Caine NO and Another* (3813/2013, 3915/2013) [2014] ZAFSHC 46, para 37.

<sup>606</sup> 2014 (1) SA 103 KZP para 39 and in para 40 the court held that, the Act had intended to create rights and obligations in itself, it is unlikely in the extreme that it would have used only the word 'offer'. It could and would have introduced a deeming provision of acceptance on the part of the offeree or have stated that the offer, once made, gave rise to binding obligations between the parties. This interpretation was endorsed in *Absa Bank Limited v Caine N.O. and Another, In Re; Absa Bank Limited v Caine NO and Another* (3915/2013) [2014] ZAFSHC 46, para 37 where the court stated that '...In my view the reference to "binding offer" should be regarded as an offer binding on the offeror and not the offeree who should be entitled to either accept or reject the offer at his will. However it is apparent that there is uncertainty and therefore the legislature is urged to consider the issue afresh and make the necessary amendments.'

<sup>607</sup> (228/2014) [2015] ZASCA 69, para 1.

<sup>608</sup>(228/2014) [2015] ZASCA 69, para 4.

<sup>609</sup> (228/2014) [2015] ZASCA 69. At para 18, the Supreme Court of Appeal referred to the *Concise Oxford English Dictionary* 12 edition, (2011) for a definition of the term "offer: as 'an expression of readiness to do or give something; [or] an amount of money that someone is willing to pay for something'. Van der Merwe, S.W. and others, *Contract: General Principles*, (2012), 4 edition, page 46 state that an offer is an invitation to consent to the creation of obligations between two or more parties and that hat distinguishes a true offer from any other proposal or statement is the express or implied intention to be bound by the offeree's acceptance.

that the language of *Section 153 (1) (b) (iii)* of the statute does not create a binding offer as the minimum conditions of a legal contract are lacking.<sup>610</sup> It was held that the term “binding offer” in this context is no different from the concept in South African contract law in terms of which an offer becomes a contract on acceptance by the other party;<sup>611</sup> the interpretation endorsed by court below was held to be contrary to business practice and impracticable.<sup>612</sup>

Now that these issues have been authoritatively resolved, Chapter 6 would be improved if it were amended to incorporate the principles laid down by the Supreme Court of Appeal in this regard.

The business rescue practitioner is required to exercise diligence. Upon appointment, the practitioner is required to assess whether the company can attain the objectives of business rescue.<sup>613</sup> If the answer is negative, the practitioner should move for the liquidation of the company and not waste time and resources on preparing any kind of business plan.<sup>614</sup> These principles were made clear by the court in *Kariba* where the company could not put forward any reasonable prospect for a successful rescue.<sup>615</sup>

Another issue that is a challenge with regard to binding offers is what will transpire if the offeror fails to make the payment due to the offeree for the acquisition of voting rights. The Act requires that, within five business days, the rescue practitioner has to produce a revision of the rescue plan that includes the amendment of the voting interest resulting from the binding offer.<sup>616</sup> The statute is silent as to whether the rescue practitioner has a duty to facilitate expeditious payment to the offeree to enable the approval and implementation of the rescue plan.<sup>617</sup> Chapter 6 would be improved if such a duty were imposed on the offeror. Also unclear

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<sup>610</sup>(228/2014) [2015] ZASCA 69, para 19.

<sup>611</sup> See High Court in *Gqwaru and Another v Magalela Architects CC and Another* (19959/2016) [2017] ZAGPJHC 32 para 14 where it was held that it would be absurd to consider whether the second respondent would accept the offer before one was made to him.

<sup>612</sup>(228/2014) [2015] ZASCA 69, para 25 where the court cites the decision in *Natal Joint Municipal Pension Fund v Endumeni Municipality* (920/2010) [2012] ZASCA 13; para 18 as support for the view that the respondent’s interpretation of the concept binding offer would lead to insensible and unbusinesslike. To the same effect, see *Panamo Properties (Pty) & another v Nel & others* NNO 2015 (5) SA 63 (SCA) para 27.

<sup>613</sup> Section 141 (1) of the 2008 Act.

<sup>614</sup> Section 141 (2) of the 2008 Act.

<sup>615</sup>(228/2014) [2015] ZASCA 69 para 5. Aside from the outdated audited financial report, the company failed to provide evidence of having machinery nor raw material to enable it to continue in business during the rescue proceedings.

<sup>616</sup> Section 153 (4) (a) of the 2008 Act.

<sup>617</sup> Section 153 (4) (b) of the 2008 Act.

at present is who is liable if the offeror defaults on his obligation, and whether the company is in any way involved in the consequential breach of contract. In *Kariba* it was held that this is not what the Act envisages.<sup>618</sup> As far as the principle of contract law was concerned, the agreement involved two parties, not including the company, although it is a beneficiary.<sup>619</sup> In this event the dissenting creditor will have to sue the offeror for the breach and this will not involve the company. However, this practice can be seen as effectively shifting debt from one party to another which in turn will result in inconvenience and costs to the dissenting creditor.

The concept of a binding offer in South Africa's Chapter 6 is a unique feature, not found in the business rescue legislation of other jurisdictions consulted in the course of this study.<sup>620</sup> Not surprisingly, such binding offers in South Africa are an invitation to litigation, especially in regard to the valuation of the subject matter.<sup>621</sup> Chapter 6 allows the vote at a creditors' meeting to be taken on review as "inappropriate". The court then gets the opportunity to evaluate the feasibility of the rescue plan and balance the interests of assenting and dissenting creditors.<sup>622</sup> A court order that a voting result was "inappropriate" serves two purposes. It prevents the approval of a flawed rescue plan and it allows the court to assess whether the rescue plan has a reasonable prospect of success. A strong case can be made for amending Chapter 6 to remove all references to a "binding offer".<sup>623</sup>

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<sup>618</sup> (228/2014) [2015] ZASCA 69 para 51.

<sup>619</sup> Save for some exceptions, the common law doctrine of privity of contract as stated in *Tweddle v Atkinson* [1861] EWHC QB J57 is that third parties to a contract do not derive any rights from an agreement, neither are they subject to any burdens imposed by it. This implies that only those who are party to the contract can sue or be sued on it. This was affirmed upheld in *Dunlop Pneumatic Tyre Co Ltd v Selfridge & Co Ltd* [1915] UKHL 1 and *Beswick v Beswick* [1968] AC 58.. Huyssteen L.F. and others, *Contract Law in South Africa*, Kluwer Law International, The Netherlands, (2010), page 312 states that: "There are no real exceptions to the doctrine of privity of contract in South African law, and there are no direct actions (such as exist in some other systems of law) by a contract in party against a third person or by a third person or by a third person against a contracting party". For instance the right of the beneficiary (in our case a 'company') is vested only upon acceptance by him or her to be involved in the contract. This was judicially confirmed in *Total SA (Pty) Ltd v Bekker NO* (1992) 1 SA 617 (A) and *Crookes v Watson* (1956) 1 SA 277 (A) 291.

<sup>620</sup> In *DH Brothers Industries (Pty) Ltd v Gribnitz NO and others* 2014 (1) SA 103, para 35 footnote number 34, Gorven J found no equivalent of Section 153 (1) (b) (ii) in USA, UK, Australian or German law.

<sup>621</sup> Section 153 (6) of the Act stipulates that a holder of a voting interest, or a person acquiring that interest in terms of a binding offer, may apply to a court to review, re-appraise and re-value a determination by an independent expert in terms of subsection (1)(b)(ii).

<sup>622</sup> Section 153 (7) of the 2008 Act.

<sup>623</sup> In *Absa Bank Limited v Caine N.O. and Another, In Re; Absa Bank Limited v Caine N.O. and Another* (3813/2013, 3915/2013) [2014] ZAFSHC 46, para 37 the uncertainty of the concept was noted, and it was suggested that the legislature should reconsider the issue and make the necessary amendments to the Act.

## **5.6 Conclusion**

Once a company has commenced business rescue it is protected by an automatic moratorium that gives it an opportunity to arrange its affairs without creditors pressing for payment of their claims. This stay on legal proceedings is essential to facilitate the recovery of a distressed company. The creditors are not absolutely barred from enforcing their rights during this period, but they need the consent of the practitioner or the leave of the court to do so

The concept of a “binding offer” in Chapter 6 of the Act seems unique to South Africa’s business rescue regime, and this is one reason why it has given rise to difficulties of interpretation.

## CHAPTER SIX

### CONCLUSIONS

#### 6.1 Introduction

The focus of this study has been to analyse creditors' rights under South Africa's business rescue statutory regime laid down in Chapter 6 of the Companies Act 2008. It was necessary to investigate creditors' powers in the commencement stages of the business rescue procedure as well as the position of creditors during the operation of the process.<sup>624</sup> The analysis of creditors' rights was followed by proposals for amendments to the legislation.<sup>625</sup>

This chapter gives an overview of the main issues regarding the role of creditors in business rescue proceedings, and evaluated possible legislation reforms. Well-functioning business rescue regimes contribute to a healthy global economy.<sup>626</sup>

#### 6.2 General Summary of the Findings

This study has found that business rescue legislation is implicitly based on assumptions regarding the proper balance in the relationship between a company and its creditors and other stakeholders. The provisions of Chapter 6 attempt to protect the rights of creditors while at the same time focusing on the rehabilitation of financially distressed companies.

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<sup>624</sup> My analysis has been particularly influenced and inspired by the writings of Franken, S., 'Creditor- and Debtor-Oriented Corporate Bankruptcy Regimes Revisited', (2004) *European Business Organization Law Review*, 5 (4), page 652 and 653; Qian, J. and Straha, P.E., 'How Laws and Institutions Shape Financial Contracts: The Case of Banks Loans', 62 (6), *The Journal of Finance*, (2007), page 2804; and Claessens, S. and Klapper, L.F., 'Bankruptcy Around the World: Explanations of its Relative Use,' (2002), World Bank Policy Research Working Paper 2865 Control and Corporate Rescue, page 2, available at <http://www.univie.ac.at/bwl/ieu/lehre/ss06/.../debtorinpossession.pdf>, accessed in 23.11.2013.

<sup>625</sup> Despite the significant amendments to the Companies Act 71 2008 by the Companies Amendment Act 3 of 2011, business rescue still has a number of lacunae that hinder its efficient implementation. This has been judicially commented on in several decisions, inter alia: *Van Rensburg N.O. and Another v Cardio-Fitness Properties (Pty) Ltd and Others* [2014] ZAGPJHC 40 para 6; *Absa Bank Limited v Caine N.O. and Another*, In Re; *Absa Bank Limited v Caine N.O. and Another* (3813/2013, 3915/2013) [2014] ZAFSHC 46, para 25; *DH Brothers Industries (Pty) Ltd v Gribnitz NO and Others* 2014 (1) SA 103 (KZP), para 25; *African Banking Corporation of Botswana v Kariba Furniture Manufacturers & Others* (228/2014) [2015] ZASCA 69 para 43; *JVJ Logistics (Pty) Ltd v Standard Bank of South Africa Ltd and Others* (7076/2015) [2016] ZAKZDHC 24 para 18. See also Loubser, A., 'The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions (Part 2),' TSAR, (2010), page 700-701.

<sup>626</sup> Corporate restructuring features in publications such as the World Bank Principles for Effective Insolvency and Creditor/Debtor Regime, (2016), the United Nations Commission on International Trade Law: Legislative Guide on Insolvency Law (2005), INSOL International, Statement of Principles for a Global Approach to Multi-Creditor Workouts, (2000), UNCITRAL Model Law on Cross-Border Insolvency with Guide to Enactment (1997) and International Labour Organisation, Protection of Workers' Claims (Employer's Insolvency) Convention, 1992 (No. 173).

Judicial decisions have recognised and tried to give effect to the objectives of the statutory business rescue regime, and have accepted the desirability of trying to rescue financially ailing companies. The central problem is to maintain a balance between the interests of the company on the one hand, and its creditors on the other, with due regard for the wider socio-economic issues.

### **6.3 South African Corporate Rescue Culture**

This study has ascertained that countries whose legal system is based on common law tend to adopt a pro-creditor approach to the attempted rescue of financially distressed companies.<sup>627</sup> This was evident in South Africa's failed experiment with judicial management.<sup>628</sup>

Jurisdictions with a civil law basis tend to favour a struggling company over its creditors when it comes to corporate restructuring.<sup>629</sup>

The business rescue regime established in Chapter 6 of South Africa's Companies Act 2008 marked an abandonment of judicial management<sup>630</sup> and in important respects was a movement from a creditor-friendly statutory regime to a debtor-friendly regime. Chapter 6 needed to take account of the interests of all other affected parties involved including the company's employees. A balance had to be struck between the competing interests, but overall, the objective of facilitating a rescue of financially distressed companies had the inevitable result of giving significant priority to the interests of the company (and its employees) over the interests of the company's creditors.<sup>631</sup>

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<sup>627</sup> As regards the United Kingdom, Australia, India, Germany and New Zealand, this was revealed in an empirical survey by La Porta, and others, 'Investor Protection and Corporate Governance,' *Journal of Financial Economics*, 58 (2000), page, 3-27: and in La Porta and others, *Law and Finance*, pages 1132-1133. This study of creditor protection examined how law affects lending in various countries on different continents and the impact on creditors' rights. The conclusion was that common law jurisdictions tend to stronger creditor protection than civil law jurisdictions. The preamble to the World Bank Principles on insolvency. (The World Bank Principles for Effective Insolvency and Creditors Rights Systems, (Revised), 2016) states at pages 2-3 that "...effective systems respond to national needs and problems. As such, these systems must be rooted in the country's broader cultural, economic, legal, and social context."

<sup>628</sup> See Chapter 2 sub-chapter 2.12.

<sup>629</sup> Such as France and the USA (the latter has a mix of civil and common law) and Scandinavia; see La Porta, and others, 'Investor Protection and Corporate Governance,' *Journal of Financial Economics*, 58 (2000), pages, 3-27.

<sup>630</sup> See, *supra*, Chapter 2 sub-chapter 2.12.

<sup>631</sup> In *Absa Bank Limited v Caine N.O. and Another, In Re; Absa Bank Limited v Caine N.O. and Another* (3813/2013, 3915/2013) [2014] ZAFSHC 46, para 40 the court commented that business rescue proceeding are more of a debtor-friendly regime and more flexible than was judicial management. See, above, Chapter 3 sub-chapter 3.3.

## 6.4 Initiation Stage of the Business Rescue Proceedings

Chapter 6 of the Act gives creditors the right to initiate business rescue proceedings if the board of directors has not yet done so.<sup>632</sup>

In terms of Chapter 6, creditors are, from the outset of the business rescue process, significantly involved; this is an implicit recognition of the key role they will play.<sup>633</sup> In order to fulfil that role, creditors require access to information regarding the financial affairs of the company.<sup>634</sup> Even then, lay creditors may have difficulty interpreting the company's financial information, and only those creditors that are financial institutions may have the expertise to do so. The process also needs to take account of the interests of secured, unsecured and preferential creditors.<sup>635</sup> It is somewhat contradictory for secured creditors to become engaged in business rescue when their claims against the company could more easily, more quickly, more inexpensively and more certainly, be met in an immediate winding-up of the company.<sup>636</sup>

To be effective, the business rescue legislation must take proper account of all these considerations.

The research for this study revealed that most applications to commence business rescue are made by companies in respect of which a winding up order has already been made, and the applicants are usually directors or shareholders of the company.

As was noted, earlier, a resolution by the board of directors is an easier route into business rescue than an application for a court order.<sup>637</sup> The primary factual basis for the commencement of business rescue, namely that the company is "financially distressed", is usually first apparent to the board, as is the answer to the question whether there is a reasonable prospect of a

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<sup>632</sup> Section 131 of the 2008 Act.

<sup>633</sup> See Chapter 3 sub-chapter 3.2.4.

<sup>634</sup> See Chapter 3 sub-chapter 3.2.4.

<sup>635</sup> PC Osode, 'Judicial Implementation of South Africa's New Business Rescue Model: A Preliminary Assessment,' 4 Penn. St. J.L. & Int'l Aff. 459 (2015), page 480.

<sup>636</sup> Section 344 (f) and s 345 of the Companies Act 61 of 1973 provide for the winding up of a company and remain in force in the winding up of insolvent companies in terms of the transitional arrangements in Sch 5 of the Companies Act 2008.

<sup>637</sup> See, Chapter 3 sub-chapter 3.2.1.

successful business rescue.<sup>638</sup> The board resolution route into business rescue is one of the factors that characterise South Africa's business rescue regime as being pro-debtor, rather than pro-creditor.<sup>639</sup>

As was noted, earlier, the legislation tries to maintain an appropriate balance by giving the company's creditors the right to apply to court for an order setting aside a board resolution to commence business rescue.<sup>640</sup> This is a prudent safeguard against the abuse of the corporate rescue provisions by companies whose financial plight is in reality hopeless.<sup>641</sup> Applications by creditors to set aside a board resolution for the commencement of business rescue are likely to become commonplace, giving the judiciary the opportunity to play a significant gatekeeper role in the business rescue regime.<sup>642</sup>

Reported judgments suggest a prima facie reluctance by the South African courts to set aside a board resolution for the commencement of business rescue<sup>643</sup> and the incidence of the onus of proof in such applications is of course crucial.<sup>644</sup> Aside from contesting the merits of the

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<sup>638</sup> Companies and Intellectual Property Commission, Business Rescue Status Quo Report, prepared by M Pretorius of Business Enterprises at University of Pretoria (Pty) Ltd, 2015. At page 84 it is reported that banks are criticising business rescue practitioners for attempting the business rescue of companies in circumstances where there is no reasonable prospect of a restoration to viability or securing a better return for shareholders and creditors than would be secured from immediate liquidation. To similar effect, see also Loubser, A., 'Tilting at windmills? The Quest for an Effective Corporate Rescue Procedure in South African Law' 2013 *SA Merc LJ* 456..

<sup>639</sup> Entry into business rescue via a board resolution can be used to as a tactic to delay the payment of creditors. Even if the resolution is set aside by the court, a moratorium of some brief duration will have been secured. In short, this easy route into business rescue can operate to the prejudice of creditors; see, above, Chapter 3 sub-chapter 3.2.1 and 3.2.2

<sup>640</sup> Section 130 of the 2008 Act.

<sup>641</sup> Chapter 3 sub-chapter 3.2.2.

<sup>642</sup> The creditors' response to a board resolution for the commencement of business rescue will depend on their assessment of the benefit they will gain if the company remains in business; see Omar, P., 'Insolvency, Security Interests and Creditor Protection,' The International Insolvency Institute, page 7 available in <http://.iiiglobal.org/component/attachments/viewcategory/647.html> accessed on 21.04.2016

<sup>643</sup> Section 5 (1) of the 2008 Act requires the courts to interpret and apply the legislation in a manner that gives effect to the objectives set out in Section 7 of the Act 2008. In interpreting the business rescue provisions of the Act, the courts will have to consider the wording, context and purpose of the legislative provisions, and the underlying premise that viable companies should be rescued rather than liquidated; in this regard, see *Re Absa Bank Ltd v Caine NO and another* ZAFSHC 46 para 47. Further it was cemented in *Copper Sunset Trading 220 (Pty) Ltd v Spar Group Limited and Another*. In *DH Brothers Industries (Pty) Ltd v Gribnitz NO and others* at para 54 the court said that the rights of creditors should be respected and that "...if the rights of creditors were to be ridden over roughshod, this would undoubtedly detract from other overarching purposes of the Act, such as promoting the development of the South African Economy, promoting investment in the South African markets, creating optimum conditions for the investment of capital in enterprises and providing a predictable and effective environment for the efficient regulations of companies, to mention only few..."

<sup>644</sup> Section 130 of the 2008 Act.

application, creditors can invoke procedural irregularities when applying for the setting aside of a board resolution in this regard.<sup>645</sup>

## 6.5 Objectives of Business Rescue Proceedings

The objectives of the business rescue provisions of the Act are a key factor in their judicial interpretation.<sup>646</sup> As was noted earlier, there have been some judicial differences of opinion as to whether the two alternative objectives of business rescue carry equal weight, or whether the objective of returning the company to viability predominates over the objective of securing a better return for shareholders and creditors than would be achieved by immediate liquidation. It seems now to be established that the second objective comes into consideration only if the first objective will be impossible to achieve.<sup>647</sup> This is yet another factor that establishes South Africa's business rescue regime as being pro-debtor.

In *Cape Point Vineyards (Pty) Ltd v Pinnacle Point Group Ltd and Another (Advantage Project Manager (Pty) Ltd Intervening)*<sup>648</sup> it was held that the objective of the business rescue provisions is to rescue a company, where liquidation can be avoided. Prior to the coming into force of the business rescue provisions, the judiciary took a markedly pro-creditor approach. Thus, for example in *Bahnemann v Fritzmere Exploration (Pty) Ltd*,<sup>649</sup> the court held that, if a company fails to meet its obligations toward a creditor, the only proper course of action is to liquidate the company, and that judicial management can be considered only if the company produces evidence that the process would enable it to pay all of its creditors in full, thus taking the view that the interests of creditors come first in judicial management. In *De Jager v Karoo KoeldrankeenRoomys (Edms) Bpk*,<sup>650</sup> the court expressed the view that only in very rare circumstances would the court go against the wishes of creditors who seek to enforce the immediate payment of their claims.

It seems that the board is within its rights to resolve on business rescue on the ground that this will provide a better return to creditors of the company than would immediate liquidation.<sup>651</sup>

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<sup>645</sup> See Chapter 4.7.

<sup>646</sup> See Chapter 3.3.

<sup>647</sup> Section 128 (1) (b) (iii) of the Act 2008

<sup>648</sup> 2011 (5) SA 600 (WCC) at 603 E-F.

<sup>649</sup> 1963 (2) SA 249 (T).

<sup>650</sup> 1956 (3) SA 594 (C).

<sup>651</sup> Section 129 (7) of the 2008 Act.

Indeed, the legislation requires that the board provide reasons why it has not resolved on business rescue if the company is indeed financially distressed.

It has already been noted that secured creditors are unlikely to view business rescue favourably, since it will not improve their position and may deplete the reservoir of funds from which their claims will be paid if the company was simply liquidated..<sup>652</sup>

Corporate rescue regimes that are debtor-oriented stand a better chance of reviving an ailing company than those that are creditor oriented and which consequently resort to liquidation more readily.<sup>653</sup>

Business rescue legislation that downplays creditors' rights, and relentlessly emphasises the salvation of financially distressed companies can have a dampening effect on the national economy.<sup>654</sup> The corporate rescue system in the UK is creditor-oriented and the literature suggests that significant numbers of companies have migrated to England when they intend to implement some restructuring so as to ease their financial situation.<sup>655</sup> Many companies apparently seek to fall under the jurisdiction of English law by establishing their head offices

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<sup>652</sup> Creditors (at best) suffer a delay in the payment of their claims if a company commences business rescue. Their interests are to some extent protected by section 134 (3) of the 2008 Act which states that:

"If, during a company's business rescue proceedings, the company wishes to dispose of any property over which another person has any security or title interest, the company must:

- (a) Obtain the prior consent of that other person, unless the proceeds of the disposal would be sufficient to fully discharge the indebtedness protected by that person's security or title interest; and
- (b) Promptly:
  - (i) pay to that other person the sale proceeds attributed to that property up to the amount of the company's indebtedness to that other person; or
  - (ii) provide security for the amount of those proceeds, to the reasonable satisfaction of that other person"

<sup>653</sup> Harmer, 'Comparison of Trends', page 147-148.

<sup>654</sup> Qian, J. and Strahan, P.E., 'How Laws and Institutions Shape Financial Contracts: The Case of Banks Loans,' 62 (6), *The Journal of Finance*, (2007), page 2804 states that creditors tend to provide loans with lower interest rates, longer maturity and concentrated ownership where they are protected by the laws of the country. Under these circumstances, creditors are willing to provide loans on more favourable terms than in countries with stronger debtor protection.

<sup>655</sup>Becht, M. and others, 'Corporate Mobility Comes to Europe,' University of Brussels Working Paper, 2005, a paper records that between 2002 and 2005, about 300 companies moved to UK each year for restructuring purposes.

in the UK.<sup>656</sup> Access to loan finance is predictably easier in jurisdictions that offer strong creditor protection,<sup>657</sup> and this is a drawcard for international investors.<sup>658</sup>

The philosophy of corporate rescue has gained wide acceptance internationally and creditors have become more confident that their rights enjoy reasonable protection,<sup>659</sup> even though many other interested parties have a voice in the process, with the court having the final say in key respects.<sup>660</sup>

## 6.6 Operation of Business Rescue Proceedings

After the commencement of business rescue, overall control of the company is in the hands of the business rescue practitioner.<sup>661</sup> Where the practitioner was appointed by the board, there is a significant risk that he or she will not have the support of creditors and other interested parties who may then apply to court for the appointment to be set aside, and another person appointed.<sup>662</sup> In this regard, creditors of course want to be sure that the appointee will protect their interests. The incumbent board of directors remains in office – again a feature that marks South Africa’s business rescue regime as debtor-friendly.<sup>663</sup>

The creditors’ right to apply for the setting aside of the appointment of the business rescue practitioner, and the appointment of another person, provides an opportunity for the creditors to attempt to gain indirect control of, or at least a significant influence over, the business rescue

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<sup>656</sup> In *Hellas Telecommunications (Luxembourg) II SCA* [2009] EWHC 3199 (Ch), the English High Court said that companies migrate to that country so as to take advantage of more beneficial restructuring practices. In particular, pre-packaging sales effected in the context of the administration proceeding offers benefits to financially distressed companies.

<sup>657</sup> Loan terms tend to be tighter in weaker judicial system than in stronger ones; see Galindo, A. J. and Micco, A., *Creditor Protection and Credit Response to Shock*, World Bank Economic Review, 21 (3), (2007), page 417.

<sup>658</sup> Qian, J. and Straha, P.E., *How Laws and Institutions Shape Financial Contracts: The Case of Banks Loans*, 62 (6), *The Journal of Finance*, (2007), page 2803.

<sup>659</sup> In Baird, D. and Rasmussen, R., ‘Chapter 11 at Twilight,’ (2003), 56, SLR, page 103 it is said that in the United States of America, where a company undergoes reorganisation, it is the creditors who decide whether to sell the company or make a prearranged deal. On pages 675-685 the authors discuss the consequences of the sale of the company from the viewpoint of the shareholders, the directors and the employees.

<sup>660</sup> Such as the power, on application by an affected person, to set aside; the power to set aside the appointment of the business rescue practitioner; the power to set aside the result of a vote by creditors as being inappropriate; granting extensions of time for various steps in the process;; terminating the business rescue proceedings; and determining the value of an interest that is the subject of a binding offer.

<sup>661</sup> Among the significant powers granted to the business rescue practitioner is the sale of the company’s assets, where affirmed by court order. Encumbered assets can be sold only with the consent of the relevant creditor.

<sup>662</sup> See, above, Chapter 3.4.

<sup>663</sup> Bradstreet, R ‘The Leak in the Chapter 6 lifeboat: Inadequate Regulation of Business Rescue Practitioners may Adversely Affect Lenders’ Willingness and Growth of the Economy’ (2010) 22 SA Merc L.J., page 198; the author is of the view that leaving the incumbent management in office facilitates the revival of the company.

process.<sup>664</sup> The business rescue practitioner is as an officer of the court and is under a duty to act independently and impartially, but the potential and tacit influence of the creditors who secured his or her appointment cannot be gainsaid.<sup>665</sup>

The creditors have the right to form a creditors' committee, inter alia to ensure that their interests are respected.<sup>666</sup> Such a committee is expected to act as an intermediary between the creditors and the business rescue practitioner. The composition of the creditors' committee can be an awkward issue, given the divergent interests, and perhaps conflicting class interests, of the creditors.<sup>667</sup>

The creditors will be consulted by the business rescue practitioner when the latter prepares a business rescue plan.<sup>668</sup> The consultation can either be done formally, via creditors' committee meetings, or informal proposals can be made by the committee or by individual creditors in regard to a proposed business rescue plan;<sup>669</sup> but the practitioner is expected to bring an independent mind to bear in this regard, and of course the final decision will be made in a voting process.

The divergent influences that are brought to bear in the formulation of a proposed business plan may affect whether its final form is a pro-debtor – that is to say, favouring the interests of the company and its employees– or pro-creditor, that is to say, favouring the interests of the creditors.<sup>670</sup>

The creditors' influence extends through to the voting on the proposed rescue plan. Even though the business rescue practitioner is required to notify voters where the terms of the draft rescue plan have been suggested by the creditors (and presumably are slanted in their favour), and it will then be clear that the plan will be supported by the creditors.<sup>671</sup> Controversy

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<sup>664</sup> See Chapter 3.4.

<sup>665</sup> See Chapter 3.4

<sup>666</sup> Section 145 (3) of the 2008 Act.

<sup>667</sup> See Chapter 4.3.

<sup>668</sup>, Section 145 (1) (d) of the 2008 Act.

<sup>669</sup> See Chapter 4.4.

<sup>670</sup> McCormarck, G., *Corporate Rescue Law- An Anglo-American Perspective*, Edward Elgal Publishing Ltd., (2008), page 293.

<sup>671</sup> See, above, Chapter 4.4.

regarding the terms of the business plan is likely where the creditors fall into different classes, with competing interests.<sup>672</sup>

The influence of the company's creditors on the terms of the proposed business plan can be balanced by the power of the court to set aside the voting on the plan as inappropriate.<sup>673</sup>

In the legislative drafting of the business rescue provisions, it seems that the generally negative experience of judicial management, which was a process in which the interests of creditors were overwhelming, was a considerable influence, given that secured creditors will almost always favour immediate liquidation,<sup>674</sup> to the potential prejudice of other interested parties and the company itself.

The courts have shown an appreciation of the important role played by creditors in business rescue and the respect that their interests deserve where the terms of a business rescue plan are contentious. In *Oakdene Square Properties (Pty) Ltd and Others*,<sup>675</sup> the Supreme Court of Appeal said that creditors have the right to oppose the plan and their intentions in this regard should be respected by other stakeholders in business rescue proceedings. The court went on to say that –

“If the statement is intended to convey that the declared intent to oppose by the majority creditors should in principle be ignored in considering business rescue, I do not agree. As I see it, *the applicant for business rescue is bound to establish reasonable grounds for the prospect of rescuing the company*. If the majority creditors declare that they will oppose any business rescue scheme *based on those grounds*, I see no reason why that proclaimed opposition should be ignored. *Unless, of course, that attitude can be said to be unreasonable or mala fide...*” [Emphasis supplied].

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<sup>672</sup> La Porta, Law and Finance, page 1134 notes that an excessive focus on a particular group of creditors may compromise the interests of other groups.

<sup>673</sup> Section 153 (1) (b) (bb) of the 2008 Act.

<sup>674</sup> See Pretorius, M., “Addressing Principal-Agent Conflict in Business Rescue” in Goldman, G.A and Others (eds) *Contemporary Management in Theory and Practice* (2014) at page 321 where it is noted that secured creditors such as banks naturally prefer liquidation and have the financial resources to press for this outcome.

<sup>675</sup> (609/2012) [2013] ZASCA 68; para 38.

This dictum suggests that the creditors' opposition to business rescue must be based on the prospects of a successful rescue and not on other considerations.<sup>676</sup>

A duly approved rescue plan, where the vote is not later set aside by the court as inappropriate, binds all the creditors, including those who voted against it<sup>677</sup> and the rescue practitioner is then obliged to implement the plan according to its terms. Implicitly, the plan will give appropriate benefits to all parties, otherwise the voting result would not have been appropriate.<sup>678</sup>

The need for the legislation to include "binding offer" provisions to enable a business rescue plan to gain the requisite voting majority has been questioned.<sup>679</sup> The rationale of the binding offer provisions was to allow disgruntled creditors to opt out of the business rescue process and leave it in the hands of those who want to adhere to it and try to make it succeed. But a disputed binding offer results in delays and escalates the legal costs of the process, particularly in relation to invoking expert opinion on issues of valuation.<sup>680</sup>

The automatic statutory moratorium on claims against the company, and on enforcement action, that endures from commencement to termination of the business rescue process is central to the legislative scheme.<sup>681</sup>

The statutory moratorium is not absolute and all-encompassing, and this flexibility is intended to be a positive feature of the process. The protection extends to the situation where the company has bound itself as surety.<sup>682</sup> The legislation is however silent in regard to the legal position of a person who has bound himself as surety for a company that has later entered into business rescue..<sup>683</sup> The judiciary have interpreted this issue inconsistently. Some judgments have applied the common law principle that where a principal debtor has been discharged, the surety is automatically released.<sup>684</sup> Others judgments have viewed the legislation as granting

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<sup>676</sup> Section 153 (7) of the 2008 Act.

<sup>677</sup> Section 152 (4) of the 2008 Act.

<sup>678</sup> See Chapter 4.5.1.

<sup>679</sup> Section 153 (b) (ii) of the 2008 Act.

<sup>680</sup> See Chapter 5.5.

<sup>681</sup> Section 133 of the 2008 Act.

<sup>682</sup> Section 133 (2) of the 2008 Act.

<sup>683</sup> See, Chapter 5.3.

<sup>684</sup> *Tuning Fork (Pty) Ltd T/A Balanced Audio* [2014] 3 All SA 50 (WCC) para 14 and *Absa Bank Limited v Du Toit and Others* [2013] ZAWCHC 194.

protection only to the company and not to a surety for the company, leaving the creditor free to enforce the suretyship.<sup>685</sup>

This study has suggested amendments to the legislation in this regard that will be in harmony with the objectives of the business rescue process.<sup>686</sup>

The business rescue legislation accords priority to the unpaid claims of the employees after the costs and expenses of the business rescue practitioner have been settled.<sup>687</sup> In this respect the legislation takes account of the positive socio-economic aspects of business rescue.<sup>688</sup> Such prioritisation of course impacts negatively on unsecured creditors and unsecured post-commencement financiers, and the impact of such prioritisation is felt acutely if the attempted rescue fails and the company is liquidated.

This study has proposed an amendment to Chapter 6 of the legislation in regard to the ranking of creditors' claims.<sup>689</sup>

## 6.7 Regime and Company Size

The literature suggests that the efficiency of pro-debtor or pro-creditor corporate rescue regimes differs according to the size of the enterprise in question..<sup>690</sup> In South Africa, business rescue is available to close corporations registered in terms of the Close Corporations Act 69 of 1984. By contrast, judicial management was available only to companies.<sup>691</sup>

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<sup>685</sup>*Investec Bank Ltd v Bruyns* 2012 (5) SA 430 (WCC) para 25 and *Kariba Furniture Manufacturers (Pty) Ltd and Others* 2013 (6) SA 471 paras 68-73

<sup>686</sup> See, Chapter 5.3.

<sup>687</sup> Section 135 of the 2008 Act.

<sup>688</sup> This concern was also raised in *Copper Sunset Trading 220 (Pty) Ltd v Spar Group Limited and Another* [2014] ZAGPPHC 688 para 36 where the High Court considered the problem of unemployment in the country when justifying the reason not to put a company under liquidation which will result to more than 52 workers to lose their jobs. Also the welfare of employees in corporate restructuring was also considered in India as it was feared that the severe entrenchment of workers might have an impact on the national political election, in Vig, V., *Creditors Rights and Corporate Debt Structure*, (2011), page 9 available at [http://isites.harvard.edu/fs/docs/icb...files/Collateral\\_Vig\\_HEcon.pdf](http://isites.harvard.edu/fs/docs/icb...files/Collateral_Vig_HEcon.pdf) accessed on 11.05.2015

<sup>689</sup> See Chapter 5.4.1.

<sup>690</sup> Franken, S., 'Creditor- and Debtor-Oriented Corporate Bankruptcy Regimes Revisited,' (2004), 4, *European Business Organization Law Review*, page 675.

<sup>691</sup> South Africa is as described as an emerging economy dominated by small and medium businesses which all need to be promoted in order to grow, see Stein, C. and Everingham, G., *The New Companies Act Unlocked*, Cape Town, Siber Ink, (2011), page 409-411. Consequently, the dominance of debtor corporate rescue features would seem to be an inevitable result. Le Roux, I. & Duncan, K., 'The naked truth: Creditor understanding of business rescue. A small business perspective', 2013, *SAJESBM*, 6, pages 57-74, the authors, however, found out that in general, small business entrepreneurs and owners were unaware of business rescue proceedings as an option

The literature suggests that corporate rescue systems that are debtor-oriented are particularly effective in saving small enterprises from liquidation.<sup>692</sup>

### **6.8 Judiciary in Business Rescue Proceedings**

The judiciary plays a key role in the functioning and development of a statutory corporate rescue regime.<sup>693</sup> The role of the judiciary is particularly important in the protection of the company's creditors, by ensuring that companies that are unsalvageable cannot gain shelter, albeit temporarily, within the business rescue regime.

The interpretation of the business rescue legislation, which in South Africa is not in all respects a model of clarity, is of course a matter for the judiciary, and judges need to look beyond the literal words of the legislation and take account, inter alia, of the broad policy objectives of the legislation, whilst giving effect to the legal rights of all affected parties. It has been said however, that the consistent enforcement of the law is more important than the quality of the law.<sup>694</sup>

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to embark on in time of financial distress. The discovery of this ignorance is a result of the empirical investigation that led to publication of their study. However it should be noted that this study was done a short time after the statute came to force.

<sup>692</sup> Padilla, J.A. and Requejo, A., 'The Costs and Benefits of the Strict Protection of Creditor Rights: Theory and Evidence,' Latin America Research Network, Research Network Working Paper No R-384, (2000) page 1.

<sup>693</sup> The Supreme Court of Appeal showed concerned on the development of the business rescue proceedings in South Africa in *FirstRand Bank Ltd v KJ Foods CC (In business rescue) (734/2015) [2017] ZASCA 50* para 44. In this case the court was called upon to determine whether a vote by a creditor against the adoption of a proposed business rescue plan was inappropriate and hence be set aside. Before the court made a decision the parties were able to amicably settle their differences. However, a councillor argued on behalf of both parties that "the industry can greatly benefit from a judgement dealing with section 153 (1) read with section 153 (7) of the Act, the Honourable Court with the greatest respect requested to, notwithstanding the settlement reached, deliver judgement in the matter...". The court agreed to the request and delivered judgement despite of the existed settlement agreement.

The credits should not only be given to the judiciary but also the stakeholders in this case lawyers and parties to the dispute who together wished to see the existing controversy on the concept of inappropriateness is solved by the supreme court of the land for the betterment of the corporate rescue industry. With the existing lacuna surrounding Chapter 6 of the legislation this kind of cooperation among stakeholders is of vital importance.

<sup>694</sup> Berkowitz, D., Katharina, P. and Jen-Francois, R., *Economic Development, Legality and the Transplant Effect*, (Forthcoming in the *European Economic Review*) (2002), they commented that what matters is the enforcement of the laws and not the quality of law that has been put in place.

The judiciary in South Africa has had to change its mind-set from a previously rigid bias in favour of creditors and their rights, and to now take a broader perspective.<sup>695</sup>

An efficient judicial system inculcates confidence in both creditors and debtors in relying on the courts when settling their disputes.<sup>696</sup> Claessens and Klapper say that a weak judicial system can be a catalyst in accelerating out of court settlements, particularly where distressed companies believe that the court will favour creditors rather than debtors in matters of business rescue.<sup>697</sup> The literature indicates that even in flagship jurisdictions for business rescue, informal arrangements predominate over those arrived in a formal setting.

For example, the corporate restructuring provisions of the English Insolvency Act 1984 and Chapter 11 in the USA are known to have inspired the legislation of other jurisdictions, and the legal enforcement processes of these jurisdictions are regarded as of the highest standard. Nonetheless, the literature suggests that informal arrangements for corporate rescue predominate in these jurisdictions. This suggests that effective corporate rescue is not solely determined by the letter of the law.<sup>698</sup>

Potentially, business rescue may involve applications to court of various kinds, seeking different forms of relief.

This study has suggested that a specialist commercial court should be assigned the adjudication of business rescue litigation,<sup>699</sup> particularly since many business rescue applications are brought on an urgent basis in which judgment must be given very quickly. An argument can thus be made for the establishment of a specialist division of the High Court to adjudicate in

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<sup>695</sup>Froute, P., Theoretical Foundation for a Debtor Friendly Bankruptcy Law in Favour of Creditors, *European Journal of Law and Economics*, (24)(2007), page 201-214; and Finch, V., *Corporate Insolvency Law: Principles and Perspectives*, 2<sup>nd</sup> Edition, CUP (2009) page 227 provided that the court is an organ that should to analyse the fairness of the proceeding with consideration of the particular material facts

<sup>696</sup>Claessens, S. and Klapper, L.F., 'Bankruptcy around the World: Explanations of its Relative Use,' (2002), World Bank Policy Research Working Paper 2865, page 8

<sup>697</sup>Claessens, S. and Klapper, L.F., 'Bankruptcy around the World: Explanations of its Relative Use,' (2002), World Bank Policy Research Working Paper 2865, page 11. Also the outcome of this method is likely to provide advantage to creditors, as they are now more likely to be in control of the business decisions of the company.

<sup>698</sup> It was stated the act of labelling an insolvency procedure to be either a debtor or creditor oriented regime with reference to what the legislation provides is not sufficient enough, Franken, S., 'Creditor- and Debtor-Oriented Corporate Bankruptcy Regimes Revisited,' (2004), 4, *European Business Organization Law Review*, page 672.

<sup>699</sup> These specialised courts should also have judges who are specialist in corporate restructuring.

such matters,<sup>700</sup> as this would ensure that the presiding judge has specialist knowledge in this area of the law.<sup>701</sup>

## **6.9 Proposed Law Reform to Enhance the Protection of Creditors Rights in Business Rescue Proceedings under Chapter 6 of the Companies Act 71 of 2008**

This study proposes the following amendments to Chapter 6 of the Companies Act 2008.

Key: Deleted Text is in square brackets and insertions are underlined

### **Section 128. Application and definitions applicable to Chapter**

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

(1)(e) “courts”, depending on the context, means either-

(i) the Division of the High Court that has jurisdiction over personal and commercial insolvency and business rescue matters; or

(ii) either-

(aa) a designated judge of the aforesaid Division, if the Judge President has designated any judges in terms of subsection (3); or

(bb) a judge of the aforesaid Division, as assigned by the Judge President to hear the particular matter, if the Judge President has not designated any judges in terms of subsection (3);

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<sup>700</sup> For instance what is exercised in USA where original and exclusive jurisdiction over all cases arising under the Bankruptcy Code is held by specialist United States bankruptcy courts, these are created under Article I of the United States Constitution and function as units of the United States district courts.

<sup>701</sup>This special court can be given power to handle all the matters regarding insolvency proceedings from corporate rescue to winding up of companies. Moreover, the court can entertain issues involving individual sequestration since there a number of provisions available under Insolvency Act are applied when liquidating a company. Even in number of time courts have referred to sequestration cases when adjudicating liquidation proceedings.

Moreover, M. Pretorius, page 74 in dealing with the limited time provided by the statute in business rescue proceedings the interviewees suggested for alternative legal dispute procedure to be applied

(1)(h) “rescuing the company” means achieving either one or both of the goals set out in the definition of “business rescue” in paragraph (b);

(3) For the purposes contemplated in subsection (1)(e) or in any other law, the Judge President of a High Court may designate any judge of that court generally as a specialist to determine issues relating to [commercial matters,] personal and commercial insolvencies and business rescue in that division of the High Court

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### **Section 129. Company resolution to begin business rescue proceedings**

(2) (b) has no force or effect until it has been filed and approved by the Commission.

### **Section 130. Objections to company resolution**

(5) (b) afford an independent expert [the practitioner] sufficient time to form an opinion whether or not-

### **Section 131 Court order to begin business rescue proceedings**

(4) After considering an application in terms of subsection (1), the court may-

(a) make an order placing the company under supervision and commencing business rescue proceedings, if the court is satisfied that-

(i) the company is financially distressed;

(ii) the company has failed to pay over any amount in terms of an obligation under or in terms of a public regulation, or contract, with respect to employment-related matters; [or] and

(iii) it is otherwise just and equitable to do so for financial reasons, and there is a reasonable prospect for rescuing the company;

### **Section 133. General moratorium on legal proceedings against company**

(4) A creditor may only enforce a remaining balance of the principal debt to be upon the implementation of the business rescue plan against a surety who favoured a company in business rescue proceedings.

### **Section 135. Post-commencement finance**

(2) (a) may be secured to the lender by utilising any asset of the company to the extent that it is not otherwise fully encumbered; and

(3) After payment of the practitioner`s remuneration and expenses referred to in section 143, [and] other claims arising out of the costs of the business rescue proceedings, and pre-petition secured creditors all claims contemplated-

### **Section 136. Effect of business rescue on employees and contracts**

(4) If liquidation proceedings have been converted into business rescue proceedings, the liquidator is a preferred unsecured creditor of the company to the extent of any outstanding claim by the liquidator for any remuneration due for work performed, or compensation for expenses incurred, before the business rescue proceedings began.

### **Section 139. Removal and replacement of practitioner**

(3) The company, or the creditor who appointed or nominated the practitioner, as the case may be, must appoint a new practitioner if a practitioner dies or resigns [or is removed from office], subject to the right of an affected person to bring a fresh application in terms of section 130(1) (b) to set aside that new appointment.

(4) The creditor other than the creditor who nominated the practitioner, as the case may be, must appoint a new practitioner, if a practitioner is removed from office, subject to the right of an affected person to bring a fresh application in terms of section 130(1) (b) to set aside that new appointment.

### **Section 146. Participation by holders of company`s securities**

(f) The holders of company`s securities are entitled to form a holders of company`s securities committee, and through that committee are entitled to be consulted by the practitioner during the development of the business rescue plan.

### **Section 146 (A). First meeting of holders of company`s securities**

(1) Within 10 business days after being appointed, the practitioner must convene, and preside over, a first meeting of holders of company`s securities, at which-

(a) the practitioner-

(i) must inform the holders of company`s securities whether the practitioner believes that there is a reasonable prospect of rescuing the company; and

(ii) may receive proof of claims by creditors; and

(b) the holders of company`s securities may determine whether or not a committee of holders of company`s securities should be appointed and, if so, may appoint the members of the committee.

(2) The practitioner must give notice in a prescribed manner of the first meeting of holders of company`s securities to every holders of company`s securities, setting out the-

(a) date, time and place of the meeting; and

(b) agenda for the meeting.

### **Section 149. Functions, duties and membership of committees of affected persons**

(1) A committee of employees, or of creditors, or of holders of company`s securities appointed in terms of section 146, 147 or 148, respectively-

(b) may, on behalf of the general body of creditors, holders of company`s securities or employees, respectively, receive and consider reports relating to the business rescue proceedings; and

(c) must act independently of the practitioner to ensure fair and unbiased representation of creditors`, holders of company`s securities or employees` interests.

(2) A person may be a member of a committee of creditors, holders of company`s securities or employees, respectively, only if the person is-

(a) an independent creditor, holder of company`s securities or an employee, of the company;

(b) an agent, proxy or attorney of an independent creditor, holder of company`s securities or employee, or other person acting under a general power of attorney; or

(c) authorised in writing by an independent creditor, holders of company`s securities or employee to be a member.

(3) Composition of a committee of holders of company`s securities, or employees, or of creditors-

(a) Employees committee should be composed of uneven number of members

(b) Holders of company`s securities committee should be composed of uneven number of members

(c) Creditors committee members should represent each class of creditors

### **Section 152. Consideration of business rescue plan**

(8) When the business rescue plan has been [substantially] fully implemented, the practitioner must file a notice of the [substantial] fully implementation of the business rescue plan in a prescribed manner to every affected person, including with the notice a sworn statement of the facts relevant regarding the rescue of the company.

### **Section 153. Failure to adopt business rescue plan**

[ (1) (b) (ii) any affected person, or combination of affected persons, may make a binding offer to purchase the voting interests of one or more persons who opposed adoption of the business rescue plan, at a value independently and expertly determined, on the request of the practitioner, to be a fair and reasonable estimate of the return to that person, or those persons, if the company were to be liquidated.]

[(4) If an affected person makes an offer contemplated in subsection (1)(b)(ii), the practitioner must-

(a) adjourn the meeting for no more than five business days, as necessary to afford the practitioner an opportunity to make any necessary revisions to the business rescue plan to appropriately reflect the results of the offer; and

(b) set a date for resumption of the meeting, without further notice, at which the provisions of section 152 and this section will apply afresh.]

[(6) A holder of a voting interest, or a person acquiring that interest in terms of a binding offer, may apply to a court to review, re-appraise and re-value a determination by an independent expert in terms of subsection (1)(b)(ii).]

#### **Section 154. Discharge of debts and claims**

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

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