

RANKING OF CREDITORS IN BUSINESS RESCUE PROCEEDINGS:
A CRITICAL EVALUATION OF S 135(1) AND (3) OF THE COMPANIES ACT
71 OF 2008

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DECLARATION

I hereby declare that this thesis, presented to the UKZN, is my own original work and that, to the best of my knowledge, it contains no material previously published by another person or material which has been accepted for the award of any other degree at this or any other University, except where due acknowledgement has been made in the text.

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DEDICATION

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1. INTRODUCTION

1.1. Background

The culture of business rescue has existed for decades in South Africa. It was introduced by the Companies Act 46 of 1926 (hereinafter “the 1926 Act”) and was retained in the Companies Act 61 of 1973 (hereinafter “the 1973 Act”). At the time it was introduced, it was called judicial management. This was described as the process whereby a financially distressed company would be rescued in order to become successful.¹ However, judicial management was unpopular and was heavily criticised for its flaws.² This was due to the fact that it did not keep up with developments in the modern corporate world.³

The Companies Act No. 71 of 2008 (hereinafter “the Act”) which came into force in 2011 introduced the concept of business rescue. In terms of s 128 (1)(b) of the Act business rescue can be said to be the ‘proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for the temporary supervision of the company, and of the management of its affairs, business and property; a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other

¹ K. Tsatsawane “An Order for Judicial Management: When Should it be Granted?” (2000) 8 (4) *Juta’s Business Law* 154. Loubser, A. “Judicial Management as a Business Rescue Procedure in South African Corporate Law” (2004) 16 (2) *South African Mercantile Law Journal* 138. D. A. Burdette “Some Initial Thoughts on the Development of a Modern and Effective Business Rescue Model for South Africa (Part 1)” (2004) 16 (2) *South African Mercantile Law Journal* 246. J. Henning. In: H Rajak *Insolvency Law: Theory and Practice*. (1993) 305. P. M. Meskin, M. S. Blackman, M. D. Glaser, I. E. Konyn, & S. F. Mullins(ed). *Henocheberg on the Companies Act*. 4th ed. (1985) 753. J. T. Pretorius, P. A. Delpont, M. Havenga, & M Vermaas *Hahlos’s South African Company Law Through the Cases*. 5th ed. (1991) 735. J. T. R. Gibson ... et al. *South African Mercantile and Company Law*. 7th ed. (1997) 423. D. Shrand. *The Law and Practice of Insolvency, Winding-Up of Companies, and Judicial Management*. 3rd ed. (1977) 325. J. F. Coaker & W. P. Schutz. *Wille and Millin’s Mercantile Law of South Africa*. 16th ed. (1967) 626. R. D. Sharrock, K. Van Der Linde, & A. Smith. *Hockly’s Insolvency Law*. 7th ed. (2005) 232. H. R. Hahlo. *South African Company Law Through the Cases*. 4th ed. (1984) 644. J. L. Van Dorsten. *South African Business Entities: A Practical Guide*. 3rd ed. (1993) 327.

²E.P. Joubert” ‘Reasonable possibility’ versus ‘Reasonable prospect’: Did business rescue succeed in creating a better test than judicial management?” (2013) *Journal of Contemporary Roman-Dutch Law* 76 at 551. A. Smits” Corporate Administration: A Proposed Model” (1999) *De Jure* at 85.

³A. Loubser “Business Rescue in South Africa: A Procedure in Search of a Home” (2007) 40 (1) *Comparative and International Law Journal of Southern Africa* 152.

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.⁴

1.2. The Importance of Business Rescue

Given South Africa's high unemployment rate, it is important that companies survive in order to preserve jobs. When a company is liquidated, employees lose their jobs. Business rescue is a tool to help companies survive and thus prevent job losses. It does so in a manner that balances the rights of all relevant stakeholders.⁵ A company has impacts the economy and social well-being of communities through its employees, suppliers and distributors.⁶ Therefore, it can be said that it has power to promote economic growth. One can therefore submit that business rescue is intended to survive the company by providing rescue procedure where there is a reasonable prospect of rescuing such company or if there is going to be a better return for creditors.

1.3. Problem Statement

Once a company commences business rescue, consequences follow. One of these is post-commencement finance that refers to funding offered to a company after the commencement of the business rescue proceedings. These proceedings confer preference on claims in respect of such post-commencement financing.⁷

The ranking of creditors shifts from the ranking under insolvency law. Under insolvency law, the general ranking of creditors is that secured or preferent creditors are paid first, followed by concurrent creditors.⁸

Section 135 of the Act provides for its own ranking of creditors during business rescue.

⁴Section 128 (1)(b).

⁵Section 7 (k).

⁶ A. Loubser 'Some Comparative Aspects of Business Rescue in South African Company Law' (2010) *Unpublished Thesis.*, University of South Africa, Pretoria, <http://hdl.handle.net/10500/3575>. Accessed on 23/11/2018 pp 1.

⁷ P.A. Delpont (ed) *Henochsberg on the Companies Act 71 of 2008* Durban: LexisNexis South Africa, (2012), Chapter 18 para 18.8.

⁸ R. D. Sharrock. *Business Transactions Law. 8th ed.* (2011) 847.

Section 135 (1) states that ‘to the extent that any remuneration, reimbursement for expenses or other amount of money relating to employment becomes due and payable by a company to an employee during the company’s business rescue proceedings, but is not paid to the employee the money is regarded to be post-commencement financing; and will be paid in the order of preference set out in subsection (3)(a).’ Section 135 (3) states that ‘after payment of the practitioner’s remuneration and expenses referred to in section 143, and other claims arising out of the costs of the business rescue proceedings, all claims contemplated in subsection (1) will be treated equally, but will have preference over all claims contemplated in subsection (2), irrespective of whether or not they are secured; and all unsecured claims against the company; or in subsection (2) will have preference in the order in which they were incurred over all unsecured claims against the company.’

It is clear that the ranking under s 135 is different from the general ranking of creditors. This section also provides for a business rescue practitioner, post-commencement creditors, and the costs of business rescue. However, the Act is not clear on the order of preference, especially when it comes to post- and pre-commencement creditors. As a result, courts have held different views on this issue once a company commences business rescue. It is against this background that this study examines creditors’ ranking as provided for by the Act. The aim is to highlight the difficulties that emerged as a result of the ambiguity of s 135 in relation to ranking of creditors and to make recommendations on the wording of this section. Further to section 135 there is section 150(2)(b)(v) which provide that “the order of preference in which the proceeds of property will be applied to pay creditors if the business rescue plan is adopted.”

1.4. Research Questions

The study aimed to answer the following research questions:

- Is the ranking of secured creditors fairly covered by the Act?
- How have the courts dealt with the issue of ranking of creditors in business rescue?
- Is there a need to amend the Act regarding the ranking of creditors in business rescue?

1.5. Methodology

The research was desk-based and used primary and secondary sources of law including academic commentary, journals, textbooks and internet sources. The aim was to critically analyse the judgments and how the courts reached their decisions. In doing so, academic commentary on such judgements is taken into account and practical examples are used to support and illustrate the arguments presented in this study.

2. BUSINESS RESCUE

2.1. Purpose and Definition

It is clear from the above discussion that s 128 (1) (b) has three main objectives, namely:

- ‘temporary supervision of the company, and of the management of its affairs, business and property;
- a temporary *moratorium* on the rights of claimants against the company or in respect of property in its possession; and
- 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 its likelihood of continuing to exist on a solvent basis or, if this is not possible, results in a better return for creditors or shareholders than would result from the immediate liquidation of the company.’

These objectives are to be read with s 7(k) of the Act which provides that the of the Act is ‘to provide effective rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders’ such as creditors.⁹ In *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd*, the court stressed the importance of striking a balance that protects the interests of creditors and stakeholders during business rescue. This means that the rights of all relevant stakeholders must be considered.¹⁰ The court emphasised that the aim of

⁹ Section 7(k)

¹⁰ *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 (Pt) Ltd* (15155/2011) [2011] ZAWCHC 442; 2012 (2) SA 423 (WCC) at 1.

business rescue is complete recovery of the company in order to achieve better returns for all stakeholders.¹¹ Cassim highlights that business rescue is defined as the rehabilitation of a business and a plan to rescue it in a way that increases its chances of financial survival.¹² In *Oakdene Square Properties (Pty) Ltd and others v Farm Bothasfontein (Kyalami) (Pty) Ltd; Farm Bothasfontein (Kyalami) (Pty) Ltd v Kyalami Events and Exhibitions (Pty) Ltd* the court was of the view that “rescuing a company” means achieving the goals set out in section 128(1)(b) of the 2008 Act.¹³ It is also important that the provisions of s 128 (1)(b)(iii)¹⁴ be taken into account. It is clear from this section that, a plan must be developed and implemented to rescue a company. There are two objectives, namely, ‘to maximise the likelihood of the company continuing in existence on a solvent basis or, if this is not possible, to obtain a better return for its creditors or shareholders than would result from immediate liquidation.’ It is therefore clear that the purpose of business rescue is not only to prevent a company from being liquidated; it includes restoration of the company for better returns for creditors and shareholders than would result under immediate liquidation.¹⁵

This was accepted by the court in *Propspec Investments (Pty) Ltd v Pacific Coast Investments 97 Ltd*¹⁶ where it was held that:

‘[a]goal in this context means a desired end or result. It follows that the goals set out in this definition are that the company continues in existence on a solvent basis or, if it is not possible for the company to so continue in existence, a better return for the company’s creditors or shareholders than would result from the immediate liquidation of the company.’

The court in *Koen v Wedgewood Village Golf & Country Estate (Pty) Ltd*¹⁷ concurred with this interpretation.

¹¹ *Ibid.*

¹² F.H.I. Cassim. et al... *Contemporary Company Law*. 2nd ed. (2012) at 781.

¹³ 2012 (3) SA 273 (GSJ) at 22.

¹⁴ Section 128 (1)(b)(iii)

¹⁵ *Oakdene Square Properties (Pty) Ltd and others v Farm Bothasfontein (Kyalami) (Pty) Ltd; Farm Bothasfontein (Kyalami) (Pty) Ltd v Kyalami Events and Exhibitions (Pty) Ltd* at para 23.

¹⁶ *Propspec Investments (Pty) Ltd v Pacific Coast Investments 97 Ltd and Another* (5000/2011) [2012] ZAFSHC 130; 2013 (1) SA 542 (FB) (28 June 2012) para 7.

¹⁷ *Koen and Another v Wedgewood Village Golf & Country Estate (Pty) Ltd and others* 2012 (2) SA 378 (WCC) para 17.

2.2. Procedure to Commence Rescue Proceedings

The Act provides for two ways to commence business rescue proceedings, namely, a resolution by the board of directors or an order of the court. Section 129(1) (a) (b) of the Act provides that the board of directors may take a resolution or decision to voluntarily launch business rescue proceedings in respect of the company if they have reasonable grounds to believe that it is financially distressed and there seems to be a realistic chance of rescuing it.¹⁸ In such a case, the process begins as soon as the resolution to place the company under supervision is filed with the Companies and Intellectual Property Commission.¹⁹ Loubser emphasises that a company should be permitted to enter into business rescue proceedings without delay, that is, at the first signs of financial distress.²⁰ She adds that if a company waits until it can provide reasonable evidence that it is really insolvent and unable to pay its debts; the chances of rescuing it will be significantly reduced.²¹

In terms of s 131(4) of the Act, ‘the court may make an order placing the company under supervision and commencing business rescue proceedings, if the court is satisfied that the company is financially distressed; 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 it is otherwise just and equitable to do so for financial reasons.’ This section thus cites failure to pay over amounts in respect of employment-related matters and the fact that it is just and equitable to commence business rescue due to financial reasons in addition to the circumstances provided for in s 129(1) (a) (b). It is not clear whether it was the intention of legislature not to include these requirements with respect to voluntary resolution. Furthermore, it is not clear why the legislature included “financial reasons” in the requirement “just and equitable to do so”. This does not add any value because the company’s financial situation can be dealt with under the requirement “financial distress”.

¹⁸Section 129(1) (a) (b).

¹⁹Section 132 (1)(a)(i).

²⁰ A. Loubser ‘Some Comparative Aspects of Business Rescue in South African Company Law’ (2010) *Unpublished Thesis.*, University of South Africa, Pretoria, <http://hdl.handle.net/10500/3575>. Accessed on 23/11/2018 pp 22.

²¹*Ibid.*

2.3. Requirements to Commence Business Rescue Proceedings

2.3.1. Financially distressed

According to the Act a company will be financially distressed if at any particular time, ‘it appears to be reasonably unlikely that the company will be able to pay all of its debts as they fall due and payable within the immediately ensuing six months or it appears to be reasonably likely that the company will become insolvent within the next six months.’²² The courts have interpreted “financially distressed” to mean a question of fact that the company is experiencing cash flow problems or failing to honour its financial obligations when due.²³

2.3.2. Reasonable prospect of rescuing the company

“Reasonable prospect” is not defined in the Act. The Act only provides the board only needs reasonable grounds to believe that there appears to be a reasonable chance or prospect of rescuing the company.²⁴ This requirement has been defined by the courts to mean a lesser requirement than “reasonable probability” under judicial management.²⁵

²²Section 128(1) (f).

²³*Oakdene Square Properties (Pty) Ltd and others v Farm Bothasfontein (Kyalami) (Pty) Ltd; Farm Bothasfontein(Kyalami) (Pty) Ltd v Kyalami Events and Exhibitions (Pty) Ltd* 2012 (3) SA 273 (GSJ) para 16-18. *A G Petzetakis International Holdings Ltd v Petzetakis Africa (Pty) Ltd* 2012 (5) SA 515 (GSJ) para 14. *Oakdene Square Properties (Pty) Ltd & Others v Farm Bothasfontein (KYLAMI) (Pty) Ltd & Others* 2013 (4) SA 539 (SCA) para 21. *Griessel and Another v Lizemore and Others* 2016 (6) SA 236 (GJ) para 57. *Nedbank Ltd v Bestvest 153 (Pty) Ltd; Essa & Another v Bestvest 153 (Pty) Ltd & Others* 2012 (5) SA 497 (WCC) para 29,36. *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, 15584/11) [2012] ZAWCHC 33 (18 April 2012) para 9. Levenstein E “An appraisal of the new South African business rescue procedure” (2015 Thesis SA) page 297 para 1. *Swart v Beagles Run Investments 25 (Pty) Ltd and others* (2011 (5) SA 422 (GNP) para 10. Bradstreet Richard, “Business rescue proves to be creditor-friendly: CJ Claasen J’s analysis of the new business rescue procedure in Oakdene Square properties”, (2013) 130 *The South African Law Journal*, pp 48. Levenstein E “Shifting mindsets” (October 2011), *Without Prejudice* 29. Beukes H, “Business rescue and moratorium on legal proceedings”, *De Rebus* (2012) issue 520, pp 34. Levenstein, E “Business Rescue: At Last, a Workable Solution for Formal Restructuring of Companies in Financial Distress? *The Corporate Report* 1 (2) 7-14.

²⁴Section 129(1) (b) of Companies Act 71 of 2008

²⁵*Oakdene Square Properties (Pty) Ltd & Others v Farm Bothasfontein (KYLAMI) (Pty) Ltd & Others* 2013 (4) SA 539 (SCA) para 29. *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd* 2012 (2) SA 423 (WCC) para 21. *Lidino Trading 580 CC v Cross Point Trading (Pty) Ltd, In re: Mabe v Cross Point Trading 215 (Pty) Ltd* (2130/2012) [2012] ZAFSHC 155 (23 August 2012) para 18. *Swart v Beagles Run Investments 25 (Pty) Ltd and others* (2011 (5) SA 422 (GNP) para 26. Smith Alastair, The major creditor’s wishes usually prevail: *Juta Business Law* Vol 9 part 4 (2001) pp 145. Kloppers Pieter, “Judicial management-A corporate rescue mechanism in need of reform?” (1999) *Stellenbosch Law Review* 10 (3) p 419. Smits Antony J, “Corporate administration”: A proposed

Academic commentators have noted that the usage of the term “prospect” is inappropriate as it infers two different meanings, a possibility or probability, although in this case it may mean possibility.²⁶

3. CONSEQUENCES OF BUSINESS RESCUE

After business rescue commences, legal consequences follow. These include, amongst others, the post-commencement finance and ranking of creditors.

3.1. Post Commencement Finance

Post commencement finance (hereinafter “PCF”) is the funding offered to the company during the commencement of business rescue proceedings which enables a distressed company to continue its daily operations.²⁷ The purpose of business rescue is to increase the chances of a financially distressed company existing on a solvent basis and to meet creditors’ needs more effectively.²⁸ Thus, in a sense, PCF may be regarded as finance or credit granted to the company when the business rescue proceedings have started. It is critical for the business rescue plan because many business rescue proceedings are unsuccessful due to a lack of funds or inability to secure sufficient PCF.²⁹ Thus, PCF protects and enables the company to remain a going concern during business rescue proceedings. Loubser and Levenstein note that the Act provides that post commencement funders’ claims have preference over existing unsecured claims against the company.³⁰ Therefore, it may be said that finance plays critical role in the success of the business rescue procedure as it provides for operational costs such as

model 32 (1) 1999, pp 85. Locke N & Essere I: *Corporate Law (Including stock exchange) (2012) Annual survey of South African law*, pp 215

²⁶Joubert, EP “‘Reasonable possibility’ versus ‘reasonable prospect’: Did business rescue succeed in creating a better test than judicial management?” (2013) pp 552. Loubser supra note 23. Burdette “Some initial thoughts on the development of a modern and effective business rescue model for South Africa (Part 1)” 2004 16 *SA Merc LJ* 249.

²⁷P.A. Delpont (ed) *Henochsberg on the Companies Act 71 of 2008* (2012), Chapter 18. E Levenstein supra note 22 at 482.

²⁸Levenstein E and Barnett L, Werkmans Legal Brief July 28, 2012. The Basics of Business Rescue: Post Commencement Finance. <https://www.werkmans.com/legal-updates-and-opinions/the-basics-of-business-rescue-post-commencement-finance/Accessed> on 19/11/2018.

²⁹Cipc Annual Report

2012. <https://www.bing.com/search?q=Cipc+Annual+Report+2012&qs=n&form=QBRE&sp=-1&pq=&sc=0-0&sk=&cvid=1483EB95ABE74561844F782D4CB1A29>. Accessed on the 20/11/2018.

³⁰A. Loubser “Post Commencement Financing and Ranking of Claims: A South African Perspective” in Parry (ed) *European Insolvency Law: Current Issues and Prospects for Reform* (2014) 29.

labour and materials, etc. It is thus submitted that if sufficient PCF (turnaround finance) is secured, this strengthens the chances of successfully rescuing the business, which is the main purpose of business rescue.

3.2. Ranking of Creditors During Business Rescue

Post commencement finance is a relatively new concept in South Africa and the Act has been in force for less than 10 years. Given this situation, investors are reluctant to commit funds to rescue a company. To make matters worse, the Act is unclear on how PCF should be dealt with once granted, and how it affects the ranking of pre-business rescue creditors. It is therefore important to deal with s 135 and s 150 (2)(b)

3.2.1 Section 135

Post commencement finance can be obtained from existing creditors or external funders who are willing to assess the existing risk.³¹ However, this becomes a problem when it comes to the ranking of claims. Section 135 (1)-(3) of the Act stipulates an order of preference for the payment of claims where a company has embarked on business rescue. This section provides an overview of the different viewpoints.

In summary the Act provides as follows:

- ‘The business rescue practitioner’s remuneration which includes all business rescue expenses will be first in the ranking order over all secured or unsecured creditors before or after the business rescue process.’³²
- Employees’ remuneration, including outstanding reimbursement of expenses and other employment pay-outs such as bonuses, receive preference over secured or unsecured creditors immediately before or after the business rescue processes; in other words, employees become a preferred unsecured creditor.³³
- Finally, all other claims will be treated equally. However, there are certain exceptions that do not make sense.’³⁴

³¹W Du Preez ‘The status of post-commencement finance for business rescue in South Africa’ (2012) MBA dissertation, University of Pretoria, Pretoria, viewed 2018/11/23.
<http://hdl.handle.net/2263/29597> pp 13.

³²Section 135(1).

³³Ibid

³⁴Section 135(2), Stein C and Everingham G, *The New Companies Act Unlocked: A Practical Guide* (Siberink 2016) pp 420-421.

The ranking by s135 has been subject of much debate among academics and the courts. The uncertainty surrounding claims other than those of the business practitioner and employees has led to different court judgments and academic views on the ranking of creditors. Since the coming into force of the Act, the ranking of claims has been dealt with in two court judgments, namely, *Merchant West Capital Solutions (Pty) Ltd v Advanced Technologies & Engineering Company (Pty) Ltd & Another*³⁵ and *Redpath Mining South Africa (Pty) Ltd v Marsden N.O. & Others*.³⁶

Merchant West Capital Solutions (Pty) Ltd v Advanced Technologies & Engineering Company (Pty) Ltd & Another

While the issue before the court did not relate to the ranking of creditors, the court nevertheless dealt with this matter. The facts of the case were briefly that the first respondent was indebted to the applicant for an amount of R2 824 513.01. The business rescue application was approved on 9 April 2013 for the amount due and payable of R2 584 000.00. The board passed a resolution on 26 September 2011 to file for business rescue for the first respondent. The first respondent passed another resolution on 5 June 2012 in terms of section 129(1) of the Act to place it under business rescue.

Kgomo J ranked claims by creditors in the following order:

- ‘the business rescue practitioner and other professionals, for remuneration and expenses;
- employees for any remuneration which became due and payable after business rescue proceedings began, i.e., Post Commencement Financiers;
- secured lenders or other creditors for any loan or supplies made after business rescue proceedings began, i.e., Post Commencement Financiers;
- unsecured lenders or other creditors for any loan or supplies made after business rescue proceedings began, i.e., Post Commencement Financiers;
- secured lenders or other creditors for any loan or supplies made before business rescue proceedings began;
- employees for any remuneration which became due and payable before business rescue proceedings began; and

³⁵[2013] ZAGPJHC 109 (10 May 2014).

³⁶[2013] ZAGPJHC 148.

- unsecured lenders or other creditors for any loan or supplies made before business rescue proceedings began.³⁷

Redpath Mining South Africa (Pty) Ltd v Marsden N.O. & Others

The same judge dealt with the ranking of claims in this case. The facts were briefly that Redpath Mining launched an application for liquidation against Umnotho we Sizwe on 7 January 2013 for an outstanding debt. A few days later, on 24 January 2013 a shareholder of Umnotho we Sizwe launch a court application for the company to be placed under business rescue. The launch of the business rescue proceedings suspended the liquidation proceedings. The applicant's claim was hotly contested. Among other arguments, the business rescue practitioner contested that the applicant enjoyed a lien and disputed the claim by the applicant that it enjoyed sufficient factual possession to constitute a lien. In this case, the ranking of creditors confirmed that set out in *Merchant West*.³⁸

The court reasoned that the applicant was not showing any interest in assisting the company to institute business rescue, or did not provide a reasonable alternative that would be fair to all stakeholders.³⁹ The court was also not persuaded by the applicant's argument that the business rescue proceedings would negatively affect his creditors' interests. The applicant was seen as a creditor who wanted to use liquidation proceedings as a short cut to claim his interests without considering other creditors' interests. Consequently, the court confirmed that the ranking of creditors should be similar to that in *Merchant West*. Since in both cases, the issue was not related to the ranking of creditors, the ranking of creditors by Kgomo J is an obiter.⁴⁰ This *obiter* is very important as no other case judgments have dealt with the ranking of creditors.

³⁷*Merchant West Capital Solutions (Pty) Ltd v Advanced Technologies & Engineering Company (Pty) Ltd & Another* supra 40 para 21.

³⁸ (18486/2013) [2013] ZAGPJHC 148 (14 June 2013) at para 60.

³⁹*Merchant West Capital Solutions (Pty) Ltd v Advanced Technologies & Engineering Company (Pty) Ltd & Another*, supra 40 para 86.

⁴⁰ E Levenstein supra note 22 at 482.

This case confirms Kgomo J's previous case *Merchant West* in clarifying the ranking position of creditors' claims in business rescue proceedings.⁴¹

It is imperative to compare the claims' ranking of the two cases in order to evaluate whether the judge did confirm the first case matter when he pass the judgement on the second matter. Although Kgomo J have commented on these two matters about the ranking of creditors but the crucial point about these matters were not related to the ranking claims that why it referred as obiter dicta. However based on this obiter scholars have made their arguments on how the ranking claims should be.

Stoop and Hutchinson question whether the ranking in the judgement is in line with the wording of section 135. They argue that there is no mention in this section of the claims of pre-commencement secured creditors.⁴²

These academics are thus of the view that the judgement by Kgomo J does not properly apply section 135 as this ruling ranks the claims of secured lenders prior to the commencement of business rescue proceedings after those of both secured and unsecured post-commencement financiers' claims.⁴³ It is submitted that this view is correct as the court seems to prioritise post commencement financiers.

The question that need to be clearly answered is whether post commencement secured and unsecured creditors should be ranked higher than pre commencement secured creditors.⁴⁴ Delpport argues that the court failed to apply section 135 (3) as there is no reference in the subsection to secured claims prior to business rescue began, as stipulated in section 134.⁴⁵ According to Delpport, 'there is no reference in that particular

⁴¹ *Redpath Mining South Africa (Pty) Ltd v Marsden No and Others* (18486/2013) [2013] ZAGPJHC 148 (14 June 2013) at para 60.

⁴² Stoop H & Hutchison A "Post-Commencement finance - Domiciled resident or uneasy foreign transplant?" (2017) *PELJ* at 17 http://www.scielo.org.za/scielo.php?script=sci_arttext&pid=S1727-37812017000100021 Accessed 26/02/2019. Delpport et al *Henochsberg on the Companies Act 71 of 2008* (2011) (Loose-leaf Edition) 478(10)-(12). Calitz & Freebody "Is post-commencement finance proving to be the thorn in the side of business rescue proceedings under the 2008 Companies Act?" 2016 *De Jure* at 273.

⁴³ Levenstein E supra note 22 at 482.

⁴⁴ Stoop H & Hutchison A supra note 47 at 17.

⁴⁵ Delpport et al *Henochsberg on the Companies Act 71 of 2008* (2011) (Loose-leaf Edition) 478 (10)-(12). Stoop H & Hutchison A supra note 47.

section to claims by pre commencement secured lenders'⁴⁶. Therefore, it can be argued that pre commencement secured financiers have been outranked in the judgement. This could result in such creditors opposing business rescue as they feel that their interests will be neglected.

Stoop and Hutchison note that, Kgomo J used the same ranking in *Redpath Mining*, but referred to the rights of "secured" financiers as stipulated in section 134 (3).⁴⁷ They observe that while the ruling that secured post commencement creditors should outrank pre commencement creditors should be questioned, what is even more questionable is whether unsecured post commencement creditors can also be ranked above secured pre commencement creditors.⁴⁸ The authors add that this matter should be put before the Constitutional Court for clearer interpretation.⁴⁹ It is submitted that the Kgomo J judgement is not in line with the provisions of the Act. To become a secured creditor, the creditor is required to make additional financial commitments. It is thus unfair to rank such creditors in this manner. Furthermore, unhappy pre commencement creditors can frustrate the efforts of the business practitioner to rescue the company from business distress by voting against the business rescue proceedings. It is thus important that the Act clearly defines the ranking of creditors. Section 135 (3) clearly stipulates the protection of secured creditors' rights prior to and during business rescue proceedings.⁵⁰ One might thus say that it requires that the company obtains consent from security holders if it wants to realise an asset that has been ceded or used as collateral or use the proceeds of the sale to pay out in full the attached security on the assets.

According to Levenstein, Kgomo J failed to take into consideration the position of secured lenders both before and during business rescue proceedings.⁵¹ He adds that the court failed to acknowledge the simple distinction between encumbered assets and free residue, thus prejudicing the rights of secured creditors.⁵² This argument is correct as s

⁴⁶ Delport et al supra note 50 at (10-12).

⁴⁷ Stoop H & Hutchison A supra note 47.

⁴⁸ Ibid

⁴⁹ Ibid

⁵⁰ Section 135 (3).

⁵¹ Levenstein E supra note 22 at 482.

⁵² Ibid

134 (3) states that secured creditors' assets can be released from security through full settlement with the creditor or his/her consent. It is thus of concern that the court held that they should be ranked below post commencement financiers with no security.

Not all academics dispute Kgomo J's judgments. For example, Davis argues that the ranking makes sense because a creditor who is willing to finance a company that is in financial distress must have some assurance that he/she will recover his/her money.⁵³ Calitz and Freebody also argue that if the ranking of creditors is not clearly defined, it will be difficult for the business practitioner to secure post commencement creditors.⁵⁴ These commentators are correct that uncertainty with regard to the ranking of financiers will result in challenges in raising post commencement finance for the business rescue proceedings.

Pretorius and Du Preez raise the concern that post commencement creditors rank below employee benefits as stipulated by legislation. They note that, in other countries, priority is given to post commencement financiers. If this is not the case, it will be difficult to raise funds for business rescue, as the investment risk will be too high.⁵⁵

It is clear that the problem lies with PCF and whether pre business rescue creditors' right to security is compromised.⁵⁶ The court's ranking of creditors during business rescue proceedings reflects that creditors that were regarded as secured during pre-commencement, have lost their crucial ranking position stipulated in s 135. It is not clear whether or not this is what the legislature intended and this issue needs to be addressed by lawmakers. The fact that the Act has not been amended could be due to the fact that it is still relatively new. Until such time as the legislature acts, debate will continue to rage over s 135 and Kgomo J's judgments.

⁵³ Davis et al *Companies and other Business Structures in South Africa* (2011) pp 170. Calitz & Freebody supra note 47 at 270.

⁵⁴ Calitz & Freebody supra note 47.

⁵⁵ Pretorius M and Du Preez W "Constraints on Decision Making Regarding Post-Commencement Finance in Business Rescue" (2016) *The South African Journal of Entrepreneurship and Small Business Management*, p 185.

⁵⁶ Jones & Webster "The elephant in the room post commencement financing and whether pre business rescue creditors' rights to their security are compromised" at 1.
<https://www.cliffedekkerhofmeyr.com/en/news/publications/2016/dispute/dispute-resolution-alert-20-july-the-elephant-in-the-room-post-commencement-financing-and-whether-pre-business-rescue-creditors-rights-to-their-security-are-compromised.html>. Accessed on 28/02/2019.

Academics such as Pretorius, Du Preez and Levenstein criticised the judgments on the grounds that they did not consider that pre-commencement creditors supported the company before rescue but when financial relief is available they are ranked below practitioners' fees, employees' salaries, post commencement secured creditors, unsecured post commencement creditors and pre business rescue secured creditors.⁵⁷ Van der Linde concurs and adds that the Act clearly states that employees' claims post-commencement enjoy priority over post-commencement claims, whether secured or not.⁵⁸

Employees could abuse a business rescue process. Loubser observes that labour unions may pursue their own agenda which can undermine efforts to rescue a company in distress.⁵⁹ This could take the form of demanding unreasonable benefit packages for employees without considering the financial distress the company is experiencing. In turn, this could discourage post commencement financiers from assisting the company, as they need to be sure that the funds they inject will be primarily used to revive it and not be misused on unnecessary expenditure which won't save the company. While employees' rights and needs should be considered, allowing them to rank above all other creditors, with the exception of the business rescue practitioner, can create problems. It suggests that employees should receive the payments set out in their employment contract, which may include perks and bonuses, without considering that there are other creditors. It is submitted that Act should have specified that benefits such as bonuses should not rank above creditors as this practice may not sit well with such creditors. This could result in lengthy court processes to challenge the provisions of the Act. It is therefore submitted that the Act should stipulate that only salaries will be covered during the business rescue process and that bonuses should be excluded as they are based on performance when the company is doing well, rather than fighting to survive.

⁵⁷Pretorius & Du Preez, (2013). "Constraints on decision making regarding post-commencement finance in Business rescue." *International Journal of Entrepreneurship and Small Business* 6 at 171.10.4102/sajesbm.v6i1.39. E Levenstein supra note 22 at 482.

⁵⁸Van der Linde "Priority issues in post-commencement financing - a view from South Africa" in Wessels & Omar (eds) *The Intersection of Insolvency and Company Laws (2008) - Papers from the INSOL Europe Academic Forum Annual Conference Barcelona, Spain, 1-2 October 2008* 41. Van der Linde "Company and Insolvency Law Update" *2014 Annual Banking Law Update* 15.

⁵⁹ Loubser A supra note 19 at 381.

Delport also disagrees with Kgomo J's decision in the *Merchant West* case, and argues that this ranking does not seem to be in accordance with the wording of section 135, since there is no reference in that particular section to claims by pre-commencement secured lenders.⁶⁰

The critiques discussed above may be correct but the Act can only be improved or developed if the courts intervene with land mark judgments. This case provides a new platform for law makers, academics and the courts to review the ranking of creditors and thus remove uncertainty, because the success of a business rescue is intricately linked to the company's ability to raise PCF. Commentators have also shared their views on how claims should be ranked. Prins was one of the first to submit an alternative ranking of creditors and others followed.

Stein produced the first published ranking of creditors in 2011 as an enhancement of the Companies Act. Stein proposed the following ranking of creditors:⁶¹

1. 'the practitioner, for remuneration and expenses, and other persons (including legal and other professionals) for the costs of the 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 supplies made after business rescue proceedings began (i.e., post-commencement finance);
4. unsecured lenders or other creditors for any loan or supplies made after business rescue proceedings began (i.e., post-commencement finance);
5. secured lenders or other creditors for any loan or supplies made before business rescue proceedings began;
6. employees for any remuneration which became due and payable before business rescue proceedings began; and
7. unsecured lenders or other creditors for any loan or supplies made before business rescue proceedings began.'

⁶⁰Delport *et al* *supra* 50.

⁶¹ Stein & Everingham *'The New Companies Act Unlocked: A Practical Guide'* (Siberink 2011).

Levenstein prioritised creditors as follows:-⁶²

1. 'Remuneration of the Business Rescue Practitioner including the cost of the proceedings
2. Remuneration of the Employees from date of commencement
3. Secured Post Commencement Finance /Creditors
4. Unsecured Post Commencement Finance /Creditors
5. Pre Commencement Secured Creditors
6. Employees' Remuneration Prior to Business Rescue Proceedings
7. Unsecured Pre Commencement Creditors'

Pretorius and Du Preez ranked creditors as follows:⁶³

1. 'The business rescue practitioner's remuneration and costs (as per section 143) arising from business rescue proceedings (section 135(3));
2. All other claims from the costs of business rescue proceedings;
3. All PCF claims related to employment once business rescue has commenced;
4. Secured lenders/creditors pre-business rescue;
5. All secured PCF claims related to third-party lenders/creditors (section 135(3)(a)(i));
6. Insolvency Act preferences;
7. Unsecured claims by post commencement financiers or lenders/creditors during business rescue in the order in which they were incurred (section 135(3)(b));
8. Remuneration of employees which became due and payable before business rescue commenced (section 144(2)); and
9. All unsecured claims against the company.'⁶⁴

As per above ranking of creditors that has been stipulated by the commentators, it worthy to recognised that Stein and Levenstein corresponds with what Kgomo J mentioned in his judgements both Merchant West and Redpath cases. However Pretorius and Du Preez differs from Stein and Levenstein ranking as they acknowledge pre business rescue secured creditors prior secured post commencement funding. In

⁶²Levenstein, E supra note 22.

⁶³Pretorius & Du Preez, supra note 62.

⁶⁴ Ibid

other words, Pretorius and Du Preez believes that secured creditors before business rescue proceedings must still retain their preferential ranking as highlighted on Section 134(3) which stipulates the rights of secured creditors during the business rescue proceedings that if property of the business is sold the proceeds from the sale must be used to promptly settle the secured claim or security for its payment must be provided for the secured creditor.⁶⁵

Kgomo J's judgements and on-going debate among legal scholars have heightened the uncertainty surrounding this issue. Regrettably, the judgments do not indicate how Kgomo J who decided both cases, reached the decision. If one were to apply the ranking set out in the judgements, pre-business rescue creditors who hold security would be ranked below post-commencement financiers regardless of whether or not the latter hold security. This leads to the illogical situation where post-commencement financiers who hold no security would receive their payment first from the proceeds of the security held by pre-secured business rescue creditors.⁶⁶ Although Kgomo J's ranking secures post-commencement creditors, it cannot be justified by the wording employed in s135. While Kgomo J referred to the provisions of section 134(3) in the *Redpath Mining* case, he ignored the prescriptions as to the sequence of secured creditors.⁶⁷ The comment by Kgomo J is somewhat correct. The court could have considered the uncertainty and ambiguity which still exists regarding the ranking of creditors or interpretation of the Act. There is therefore a need to develop case law or precedents with the aim of attracting new post commencement funders while trying to save the distressed business. Prioritising pre commencement secured creditors that are already in a difficult position is not helpful. Rather priority should be given to new funders who are willing to take a risk to save the distressed business. Therefore, it submitted that post commencement financiers should only be ranked above all unsecured creditors and that pre-business rescue creditors' right to their security should be upheld in terms of section 134(3) of the Act. They should not be ranked below any post commencement financiers that hold no security. The downside is that this option secures the rights of pre-business rescue creditors, but increases the level of risk that post commencement financiers are exposed

⁶⁵ Section 134(3) of the Companies Act of 2008.

⁶⁶ Levenstein, E supra note 22.

⁶⁷ *Redpath Mining South Africa (Pty) Ltd v Marsden N.O. & Others* [2013] ZAGPJHC 148 at para 56

to, as it is possible that they will not be paid if secured creditors assert their right to their security.⁶⁸

Although the *obiter* by Kgomo J has been criticised, it is submitted that it secures post commencement creditors. The ruling provides some form of security to post commencement creditors on this highly contested matter of the ranking of creditors' claims before the commencement of the business rescue. Levenstein and Becker argue that, while uncertainty persists with regard to the ranking of creditors' claims, until another court issues a new judgment, the *Merchant West* judgement by Kgomo J stands.⁶⁹ Levenstein and Barnett concur that this is the case.⁷⁰ The judgment has clarified the ranking of secured creditors and unsecured creditors before and during business rescue.⁷¹

It is therefore imperative that the Act be amended to address the uncertainty created by section 135, especially with regard to pre-business rescue secured creditors and post commencement secured creditors and creditors. The judgement favours post commencement creditors over pre-business rescue creditors. For example, a credit supplier that has delivered goods worth millions to the company who finds out a few days down the line that the company is under business rescue and that he/she will be ranked below post commencement finance unsecured creditors, will not be convinced to vote for the business rescue plan. Indeed, such a creditor is likely to lobby for the company to be liquidated in the hopes of recouping better proceeds.

It is therefore submitted that the ranking must rank pre and post-secured creditors on the same level, which is above pre and post unsecured claims because both hold security against the company as emphasised by Section 134 (3). The post employee's

⁶⁸Jones & Webster "The elephant in the room-post-commencement financing and whether pre-business rescue creditors' rights to their security are compromised"
<http://www.cliffedekkerhofmeyr.com/en/news/publications/2016/dispute-resolution-alert-20-july-the-elephant-in-the-room-post-commencement-financing-and-whether-pre-business-rescue-creditors-rights-to-their-security-are-compromised.html>, accessed on 20/9/2017 pp 4.

⁶⁹ Levenstein E & Becker L; "In Business Rescue, Where do you rank?" Jun 4, 2013 / News / Legal Brief: <https://www.werksmans.com/legal-updates-and-opinions/in-business-rescue-where-do-you-rank/> Accessed on 26/02/2019.

⁷⁰ Levenstein, E and Barnett, L. Werkmans Legal Brief July 28, 2012. The Basics of Business Rescue: Post Commencement Finance. <https://www.werksmans.com/legal-updates-and-opinions/the-basics-of-business-rescue-post-commencement-finance>. Accessed on 19/11/2018.

⁷¹ Ibid

remuneration can follow immediately after pre and post secured creditors of the company as they play pivotal role to generate income for the business. Employee's bonuses are paid on the discretion of the business rescue practitioner (employer) but there are not compulsory especially if the company is experiencing financial distress.

3.2.2 Section 150 of the Act

Section 150 deals with the enforcement of the business rescue plan once adopted by relevant parties such as management, creditors and all other affected persons.⁷² An argument may come if the plan adopted is not in line with section 135 ranking of claims.

It's worth to acknowledge s 150(2)(b)(v) in the business rescue proceedings as it state that, "the order of preference in which the proceeds of property will be applied to pay creditors if the business rescue plan is adopted."⁷³ In a case of *CSARS v Beginsel* where SARS was arguing about the preference order as it considered SARS as a concurrent creditor instead of being treated as preferred creditor.⁷⁴ Business Rescue Plan stated that the claim were treated in the usual order of preference such as remunerations of business rescue practitioner, employees, secured creditors.⁷⁵ The court dismissed SARS application and upheld the preferential order of the business rescue plan that was adopted.⁷⁶ In reaching the decision, the court applied s 150 which emphasizes the order of preferences in the business rescue plan. It is submitted that the court was correct in dismissing SARS application. Even if the court was to consider s 135, this would not have made any difference as SARS would still not going to be considered a preferential creditor. This is because the s 135 ranks post commencement funding claims higher than the pre commencement claims.

⁷² Section 150

⁷³ Section 150(2)(b)(v)

⁷⁴ *Commissioner, South African Revenue Services v Beginsel NO and Others* 2013 (1) SA 307 (WCC).

⁷⁵ *ibid*

⁷⁶ *Ibid* para 66

3.3. Ranking of creditors when Business Rescue Proceedings have failed and Business is in Liquidation

Although s 150 provides that one must look at the plan to determine the ranking of creditors, such ranking may change if business rescue proceedings fail and the company is liquidated. This was illustrated by the courts in *Diener NO v Minister of Justice and Correctional Services*, *Razzmatazz Trading Investments 19 (Pty) Ltd v Q-Civils (Pty) Ltd and Another (FB)* and *Van Jaarveld NO v Q-Civils (Pty) Ltd and Another (FB)*.⁷⁷

In the case of *Diener NO v Minister of Justice and Correctional Services*⁷⁸ the Constitutional Court confirmed the decision made by Supreme Court of Appeal. Mr Diener, who was a business practitioner, wanted his remuneration to be treated as special preference claims. He argued that according to s 135 (4) and 143(5) his remuneration claims could not be treated as concurrent creditors but must have been regarded as special preference claim as mentioned in s 135(4).⁷⁹ Constitutional Court rejected this argument emphasised that “s 143 of the Companies Act does not allow for the claims of practitioners to usurp the claims of all creditors.”⁸⁰ The court held that super preference of the business rescue practitioner remuneration only applies when the business rescue proceedings are still in force but once they are converted to liquidation that preference falls away.⁸¹

However, the Constitutional Court did acknowledge some difficulty with the wording of sections 135(4) and 143(5), when one considers the purpose of business rescue and the overall context of the relevant sections.⁸² The court mentioned the ambiguity when these two sections are read together but tried to provide interpretation by concluding that it importance to look at the purpose that is in sync with the objects of the Act which

⁷⁷ *Diener NO v Minister of Justice and Correctional Services and Others 2019 (4) SA 374 (CC)*; *Razzmatazz Trading Investments 19 (Pty) Ltd v Q-Civils (Pty) Ltd and Another (FB)* (case no 6115/2017, 7-12-2017) (Jordaan ADJP) and *Van Jaarveld NO v Q-Civils (Pty) Ltd and Another (FB)* (case no 675/2017,30-3-2017

⁷⁸ *Diener NO v Minister of Justice and Correctional Services and Others 2019 (4) SA 374 (CC)*.

⁷⁹ *Ibid* para 17

⁸⁰ *Ibid* para 49

⁸¹ *Ibid* Para 44.

⁸² *Ibid* Para 71.

ensures the company is rescued and recovered from financially distressed condition in a manner that balance all stakeholders' rights and interests.⁸³

One may argue that for the successful execution of the business rescue proceedings the courts must further clarify the current situation and give guidance to all relevant parties about the ranking of business rescue practitioner's expenses acquired during the lodgement of liquidation application as stipulated in s 141(2)(a)(ii) of the Companies Act.⁸⁴

If the courts take into account the matter which involves *Q-Civils* cases, in a matter of *Van Jaarveld v Q-Civils* it was adopted for the company to be placed under business rescue as stated in s 129 of Companies Act. The Business Rescue Practitioner realised that there are no chances to save the company therefore applied to the court in term of s 141(2)(a)(ii) but the company director decided to oppose the application. The court sided with Business Rescue Practitioner for the company to be liquidated but the director applied for a leave to appeal which was granted to SCA. In the meantime, while the SCA matter was pending, another creditor Razzmatazz unaware that *Q-Civils* is under business rescue applied for the liquidation that was eventually granted towards Razzmatazz as a liquidating creditor not the Business Rescue Practitioner. This means that Business Rescue Practitioner have slim chances to recover his costs if the company is eventually liquidated because the liquidation process does not provide super preferential claims towards the Business Rescue Practitioners' costs instead it becomes a concurrent creditor as mentioned in *Diener* case..⁸⁵

⁸³ Ibid 51,52

⁸⁴ Section 141(2)(a)(ii) of the Companies Act.

⁸⁵ *Van Jaarveld NO v Q-Civils (Pty) Ltd and Another (FB)* (case no 675/2017,30-3-2017). *Razzmatazz Trading Investments 19 (Pty) Ltd v Q-Civils (Pty) Ltd and Another (FB)* (case no 6115/2017, 7-12-2017).

4. PRACTICAL EXAMPLES OF RANKING OF CLAIMS

No one in business wants to suffer a loss; therefore, it is imperative that every business critically and continuously evaluates a client or potential client's ability to honour their financial obligations before extending credit. The following precautions can assist creditors to reduce their exposure to risk and the impact of a moratorium in business rescue procedures, which are cumbersome to creditors.

According to the Levenstein, creditors should pay attention to a company's deteriorating financial conduct such as late payments. He further identified the following top ten risks that expose creditors to the risk of being part of business rescue proceedings:⁸⁶

- '1. Failure to recognise when their customers are entering a period of financial distress, which can lead to significant financial loss.

2. Failure to participate in the first meeting of creditors can result in such creditor being prejudiced in the business rescue process.

3. Failure by creditors to understand the impact of the moratorium created by the business rescue process can result in wasted costs in the fruitless pursuit of claims.

4. Secured creditors must ensure that their secured property is protected and is not prejudiced by the business rescue process.

5. Creditors must appreciate that they are entitled to remove errant business rescue practitioners who are delaying the business rescue process.

6. Creditors should be aware that the business rescue practitioner is obliged to investigate malfeasance/unlawful conduct on the part of the management of the company prior to commencement of business rescue.

⁸⁶ 'Top ten risks for creditors of companies going into business rescue in 2017' available at <https://www.golegal.co.za/top-ten-risks-for-creditors-of-companies-going-into-business-in-2017/>, accessed on 15/9/2017.

7. Creditors need to understand the manner in which they are entitled to vote on the business rescue plan as failure to do so could result in diminished returns.

8. Creditors need to appreciate that once a plan has been approved, all claims against the company are discharged.

9. Creditors should appreciate that the claims of parties that provide post-commencement finance to the company in business rescue might be given priority in business rescue.

10. Creditors should realise that business rescue provides a “better” outcome than liquidation and should thus seriously consider supporting this process.’

Should creditors not be aware of such precautions, their chances of recovering debts in time may be jeopardized, threatening the survival of their businesses. Pre-secured creditors need to be aware that their ranking priority may be forfeited to post commencement secured creditors. In most cases, it will be beneficial for creditors to participate fully in the business rescue processes, which enhance not only the company’s chances of survival, but the chances of creditors receiving their payment.

The Stuttafords saga is an instructive example.

Retail group Stuttafords experienced financial distress and the board of directors adopted a resolution for voluntary business rescue rather than liquidation. Management was optimistic about the company’s prospects of survival. However, almost 30% of the company’s creditors refused to vote in favour of business rescue proceedings because their businesses stood to lose 77% of outstanding debts. Furthermore, they felt that the plan was not in accordance with the law, which stipulates that the interests and rights of creditors must be considered in determining a balanced business rescue plan.⁸⁷

⁸⁷Section 7(i) of the Companies Act.

The revised business rescue plan was submitted for consideration by creditors a few days later, but it failed to gain the support of 75% of the creditors, which is the minimum threshold required for approval as stipulated by s 152(2).⁸⁸

The proposed plan did not allow creditors to attach security on Stuttafords' assets as collateral in order to secure their credit status. Section 134 (3) of the Act stipulates 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 get a written consent of that person unless the proceeds of sale will fully discharge the indebtedness protected by that person.⁸⁹

The above example reflects the practicality of the rights of creditors and their power to exercise their voting rights in the business rescue plan. It is clear from this scenario that if there is no agreement on the business rescue plan, even a big company may find itself liquidated.

The Basil Read saga is another example of creditors' power with regard to a business rescue plan if the interests of parties are considered fairly.

Basil Read was a leading construction company until it hit a financial crunch in 2008 when the business started to suffer because of decreased government spending on construction. Management adopted a resolution for business rescue proceedings and the business rescue plan was overwhelmingly approved by almost all creditors (99%).⁹⁰ This reflects Kgomo J's observation that, if the plan balances the interests and rights of all stakeholders, including creditors, it is likely to be approved without delay.⁹¹

The company managed to secure PCF of R238 million because the business rescue plan aimed to rescue the business while securing the financiers of the business rescue proceedings.

⁸⁸ Section 152(2) of the Companies Act.

⁸⁹ Section 134(3)

⁹⁰http://www.engineeringnews.co.za/article/basil-read-to-proceed-with-business-rescue-plan-2018-09-28/rep_id:4136. Accessed on 12/01/2019.

⁹¹*Redpath Mining South Africa (Pty) Ltd v Marsden N.O. & Others* [2013] ZAGPJHC 148 para 66.

Basil Reads' Business Rescue Practitioners proposed the following Ranking of Creditors:⁹²

- Business Rescue Practitioner's Costs.
- Pre-Commencement Secured Creditors will rank to the extent of their security in priority to all other claims except BRP's remuneration and expenses.
- Post Commencement Finance Employees for employment during business rescue.
- Secured PCF Creditors according to their security.
- Unsecured PCF Creditors, which will rank in the order in which such PCF has been incurred.
- Pre Commencement remuneration, reimbursement, expenses, or other money relating to employment that become due and payable prior to Business Rescue to employees.
- Pre-Commencement Concurrent Creditors.

Although the above ranking did not follow s 135 of the Act, but it is worthy to note that this ranking of creditors emphasised that pre-commencement secured creditors are ranked above post-commencement secured creditors. Scholars such as Levenstein can argue whether it is correct to rank pre-commencement secured creditors above post-commencement secured creditors as it may cause challenges for the business rescue practitioner to secure funding for the distress business.⁹³

Another argument can be that pre secured creditors must not lose their preferential order that they enjoyed prior business rescue proceedings because the position came at a cost. Although the above ranking may be attractive to pre-commencement creditors but on the opposite side it poses a challenge for the business rescue practitioner on how to attract post commencement funding as they are ranked below the pre commencement creditors therefore a need for a clear direction is necessary.

⁹²<https://matusonassociates.co.za/wp-content/uploads/2018/06/Basil-Read-Limited-Business-Rescue-Plan-26-September-2018>. Accessed on 07/02/2020.

⁹³ Levenstein E "An appraisal of the new South African business rescue procedure" (2015 Thesis SA) page 297.

5. CONCLUSION

It is clear that once a company commences business rescue, consequences follow, one of which is PCF. It is apparent that PCF plays a major role when a company has embarked on business rescue and that if such funds are forthcoming, the chances are high that the company will survive. It is thus submitted that PCF is an important factor in rescuing ailing companies. However, it becomes a problem when it comes to interpretation of the Act.

This study has shown that s 135 of the Act is ambiguous or not explicitly clear when it comes to ranking creditors. This has led to different interpretations by the courts as well as academics. Different views have been expressed on how the creditors' claims should rank under business rescue. These are important in understanding this issue. Further engagement could result in a solution that is acceptable to the courts as well as the academic fraternity.

It is further submitted that section 134(3) does give priority to secured creditors before business rescue proceedings. This is because section 134(3) 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 get a written consent of that person unless the proceeds of sale will fully discharge the indebtedness protected by that person. However, section 135 (3) does not mention the matter of pre secured claims which result in confusion because pre secured creditors feel they enjoy preferential claim whereas section 135 doesn't provide that in the ranking sequential order.

Another submission is with section 135 when it is linked with section 150, which deals with business rescue plan. The ambiguity of s 135 compromises s 150 because it is difficult for the business rescue plan to be implemented if there is a bit of confusion that may lead for the matter to be decided by courts whether ranking of creditors is fairly aligned. This confusion has an ability to put financial burden to a distressed business.

Section 7 emphasises on balancing the rights and obligations of all stakeholders' interest with the company. For a successful business rescue process to be reached, the

ranking of creditors must be done in a balance manner so that the business rescue plan can be adopted easily without further delays.

In conclusion, it clear that gaps exist in the Act's ranking of creditors. It is therefore important that the Act be aligned properly in order to provide clarity and alignment with industry norms and to avoid uncertainty, with the aim of enhancing business rescue proceedings. The courts and law scholars need to engage in developing and improving South Africa's laws in order to reduce confusion and ensure that the country's practices align with international standards and expectations.

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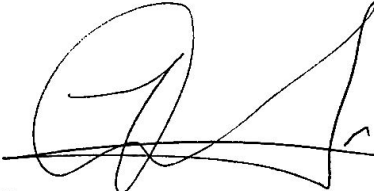
DECLARATION

I hereby declare that this thesis, presented to the UKZN, is my own original work and that, to the best of my knowledge, it contains no material previously published by another person or material which has been accepted for the award of any other degree at this or any other University, except where due acknowledgement has been made in the text.

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