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**BUSINESS RESCUE FOR ZAMBIA: SUGGESTIONS FOR LEGISLATIVE  
REFORM**

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Research dissertation presented for the approval of Senate in fulfillment of part of the requirements for the degree of Master of Laws in Commercial Law in approved courses and minor dissertation. The other part of the requirements for this qualification was the completion of a programme of courses.

I hereby declare that I have read and understood the regulations governing the submission of Master of Laws in Commercial Law dissertations, including those relating to length and plagiarism, as contained in the rules of the University, and that this dissertation conforms to those regulations.

Signature: \_\_\_\_\_

Date: \_\_\_\_\_

## **ABSTRACT**

A Company is an integral part of the community in which it does business as it impacts on that community and the economy of the country as a whole. Consequently, the failure of that company not only affects that community but also the shareholders, suppliers, employees and customers. The company law of a country therefore needs to provide a means to preserve commercial enterprises that are capable of making a useful contribution to the economic life of a country.

In recent years, several developed and developing countries have enacted business rescue legislation to supplement existing insolvency rescue procedures such as receivership and the scheme of arrangements.

This dissertation discusses the need for Zambia to enact adequate business rescue legislation considering the current inadequacies in the existing 'business rescue' procedures of scheme of arrangements and receivership provided for in the Companies Act. The dissertation argues that that the scheme of arrangements is an expensive and difficult procedure for most companies whilst receivership is centered at realising a return for the floating charge holder even at the expense of the continued existence of the company.

This dissertation comparatively analyses the business rescue procedures in Australia, South Africa and the United Kingdom and highlights the best practices of these jurisdictions. The dissertation, informed by these best practices, suggests some of the major components that the business rescue law in Zambia should contain. The dissertation however cautions against the wholesome transplant of another country's business rescue law but recommends that the law should be tailored to suit the types of companies subsisting in Zambia.

## **DEDICATION**

To my parents Moyse Joseph Kaulungombe and Bernadette Kaulungombe

University of Cape Town

## **ACKNOWLEDGMENTS**

I give all glory to the Almighty God, Jehovah, for granting me the opportunity to study this programme and the strength to overcome all the challenges that I experienced during the program.

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I thank my family for standing by me and supporting me throughout the programme.

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**LIST OF ABBREVIATIONS**

GDP	Gross Domestic Product
LAZ	Law Association of Zambia
PACRA	Patents and Companies Registration Agency
UK	United Kingdom
USA	United States of America
UNZA	The University of Zambia

University of Cape Town

## Table of contents

<b>ABSTRACT .....</b>	<b>I</b>
<b>DEDICATION.....</b>	<b>II</b>
<b>ACKNOWLEDGMENTS .....</b>	<b>III</b>
<b>LIST OF ABBREVIATIONS.....</b>	<b>IV</b>
<b>CHAPTER ONE –INTRODUCTORY BACKGROUND .....</b>	<b>1</b>
1.1    DEFINING BUSINESS RESCUE .....	3
1.2    IMPORTANCE OF BUSINESS RESCUE .....	6
1.3    THE RESEARCH QUESTION AND SCOPE .....	7
1.4    SIGNIFICANCE OF THE DISSERTATION.....	9
1.5    OVERVIEW OF CHAPTERS.....	9
<b>CHAPTER TWO -THE ZAMBIAN ‘BUSINESS RESCUE’ REGULATORY FRAMEWORK .....</b>	<b>11</b>
2.1    SCHEME OF ARRANGEMENTS.....	11
2.1.1    Provisions of the Companies Act.....	12
2.1.2    Shortcomings of the Scheme of Arrangements as an effective Business Rescue Procedure.....	13
2.2    RECEIVERSHIP .....	15
2.2.1    Provisions of the Companies Act.....	16
2.2.2    Shortcomings of Receivership as an effective Business Rescue Procedure.....	18
<b>CHAPTER THREE – AN OVERVIEW OF THE BUSINESS RESCUE PROCESS IN AUSTRALIA, UNITED KINGDOM AND SOUTH AFRICA.....</b>	<b>21</b>
3.1    COMMENCEMENT.....	22
3.2    INVESTIGATION AND DEVELOPMENT OF PLAN.....	25
3.3    THE PLAN.....	28
3.4    DECISION MAKING.....	28
3.5    THE MORATORIUM.....	33
<b>CHAPTER FOUR-POTENTIAL PROBLEM AREAS DURING THE BUSINESS RESCUE PROCESS .....</b>	<b>37</b>
4.1    INADEQUATE CREDITOR PARTICIPATION AND PROTECTION .....	37
4.2    INADEQUATE REGULATION AND INAPPROPRIATE QUALIFICATION OF THE RESCUE PRACTITIONER .....	43
4.2.1    Qualifications.....	44
4.2.2    Regulation of the Practitioner.....	45
4.2.2.1    Supervision by the Court.....	46
4.2.2.2    Liability imposed on the Rescue Practitioner.....	47
4.2.2.3    Regulation by other Institutions.....	49
4.2.2.4    The role of creditors .....	49
4.2.2.5    Other measures.....	50
4.3    UNREGULATED USE OF POST COMMENCEMENT FINANCE.....	50
<b>CHAPTER FIVE- THE PROPOSED BUSINESS RESCUE LAW FOR ZAMBIA.....</b>	<b>55</b>
5.1    MAIN COMPONENTS OF THE ZAMBIAN BUSINESS RESCUE LAW.....	58
5.1.1    The Companies to be protected .....	58
5.1.2    Who should invoke the moratorium and commence business rescue.....	59

5.1.3	<i>Who should show that the company is capable of being rescued?</i> .....	61
5.1.4	<i>To which creditors and to what extent the moratorium must apply</i> .....	62
5.1.5	<i>How and by whom should the business be administered during the moratorium period.</i>	64
5.1.6	<i>The role of the business rescue plan</i> .....	65
5.2	OTHER SUGGESTED AMENDMENTS TO THE COMPANIES ACT TO ENHANCE BUSINESS RESCUE.....	65
5.2.1	<i>A provision to prohibit insolvent trading</i> .....	65
5.2.2	<i>A provision preventing the formation of phoenix companies</i> .....	66
5.2.3	<i>Miscellaneous Provisions</i> .....	67
5.3	POSSIBLE CHALLENGES IN ENACTING AND IMPLEMENTING THE BUSINESS RESCUE LEGISLATION....	67
5.3.1	<i>Changing the mindset of the creditors</i> .....	68
5.3.2	<i>Judiciary's ability to handle business rescue cases</i> .....	68
5.3.3	<i>Legal practitioners' ability to handle business rescue cases</i> .....	69
5.3.4	<i>Availability of business rescue practitioners</i> .....	69
5.3.5	<i>Availability of post commencement finance</i> .....	70
<b>CHAPTER SIX- CONCLUSION</b> .....		<b>71</b>
<b>BIBLIOGRAPHY</b> .....		<b>75</b>

## CHAPTER ONE –INTRODUCTORY BACKGROUND

Business rescue is a growing company rescue procedure in modern day company law. Numerous industrial nations have in the last twenty years, created business rescue regimes by statute, to protect insolvent debtor companies in their nations.<sup>1</sup>

Harry Rajak et al<sup>2</sup> write that,

the modern wave of business rescue regimes (in the last twenty years) started with Chapter 11 of the United States of America's Bankruptcy Act of 1978, with most of the European countries following this lead in the 1980's and 1990's. Australia followed suit in 1993 [and South Africa in 2008].

Rajak<sup>3</sup> further adds that,

business rescue regimes are generally invoked where the debtor's insolvency is believed to be temporal and the debtor is believed capable, with assistance, of returning to commercial life as an active and successful entrepreneur.

Many countries have embarked on establishing business rescue regimes in order to rescue companies on the verge of collapse.<sup>4</sup> The rescue of such companies restores 'production capacity, employment and [promotes] the continued rewarding of capital and investments.'<sup>5</sup>

Despite the significance of an adequate business rescue regime in many countries<sup>6</sup> that have registered and operational small, medium and large enterprises, Zambia has remained without comprehensive legislation on business rescue. The Companies Act<sup>7</sup>, provides for the insolvency procedures of receivership and the

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<sup>1</sup> Harry Rajak et al 'Business rescue for South Africa' (1999) 116 *South African Law Journal* 262 at 262.

<sup>2</sup>Ibid.

<sup>3</sup>Ibid.

<sup>4</sup>Andrew Keay 'A Comparative Analysis of Administration Regimes in Australia and the United Kingdom' in Paul J.Omar *International Insolvency Law- Themes and Perspectives* (2008) at 105.

<sup>5</sup>Ibid.

<sup>6</sup> Countries that have enacted business rescue regimes include Australia, France, Germany, South Africa, the USA and the UK.

<sup>7</sup>Chapter 388, Laws of Zambia, 1994.

schemes of arrangements, which can be utilized as indirect procedures for the rescue of insolvent or near insolvent companies. These procedures are however inadequate and lack the essential elements of the modern day business rescue regimes.

The scheme of arrangement is an expensive and time consuming procedure which few companies have utilized.<sup>8</sup> It requires a three quarters majority vote of creditors in order for a resolution to be passed or for an arrangement to be agreed upon.<sup>9</sup> This may be particularly difficult to achieve in a case where a company has numerous creditors with divergent views and interests. Challenges may also be faced where a company has fewer creditors if those creditors are unwilling to compromise.

Arguably, receivership is also not a reliable business rescue mechanism. This is because the receiver's primary duty is to realize the money owed to the appointing creditor or the charge holder under a debenture.<sup>10</sup> One would argue that a receiver in Zambia is under no obligation to rescue the company, as the Companies Act has not placed a statutory duty on a receiver, to manage the company in an effort to rescue the company or to formulate a rescue strategy for the survival of the company. As a result of this, receivership cannot be relied on as an effective business rescue procedure.<sup>11</sup>

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<sup>8</sup> The Companies register maintained by PACRA shows that no record of any company having utilized the scheme of arrangements as a business rescue mechanism existed as at 12<sup>th</sup> August 2011.

<sup>9</sup> See S235 of the Companies Act (note 7).

<sup>10</sup> Raymond Walton (Ed) *Kerr on the law and practice as to receivers* 16ed (1983) at 161.

<sup>11</sup> This conclusion is based on the records obtained from PACRA in July 2011 which shows that 242 companies have undergone receiverships in Zambia since 1991 and that 159 companies have been liquidated in Zambia. The records show that only 3 companies that went into receivership were resuscitated and continued to operate as profitable entities. Although accurate records of the exact number of companies that went into liquidation after receivership were not readily available, these statistics show that at least half of the companies that went into receivership were eventually liquidated. This high rate of liquidation is most likely because of the sale of the companies assets during receivership which left these companies as assetless shells which could not continue to operate.

This position justifies the need to enact a comprehensive business rescue law in Zambia, which may assist future insolvent or near insolvent companies and prevent their liquidation.

This dissertation analyses the ‘business rescue’ procedures<sup>12</sup> in Zambia. The dissertation will conclude that the ‘business rescue’ procedures in Zambia are inadequate. It will recommend the amendment of the Companies Act<sup>13</sup> to provide for a comprehensive business rescue law. A comparative analysis of the business rescue procedure in Australia, South Africa and the United Kingdom will inform the recommendations.

## **1.1 Defining Business Rescue**

Business rescue in simple terms is ‘the procedure by which a company is restored to a profitable entity in order to avoid liquidation’.<sup>14</sup> Keay<sup>15</sup> defines business rescue as ‘a major intervention necessary to avert the eventual failure of the company’.

Australia, South Africa and the United Kingdom use different terminologies to refer to the business rescue process although the scope of companies to which the business rescue process applies is almost the same.

In Australia, the business rescue procedure is known as Voluntary Administration (Voluntary Administration).<sup>16</sup> The procedure is applicable to a company that is insolvent or likely to be insolvent at some time in the future<sup>17</sup> and the company must be capable of being rescued.<sup>18</sup>

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<sup>12</sup> The ‘business rescue’ procedures in Zambia are receivership and scheme of arrangements discussed in detail in chapter two.

<sup>13</sup> The Companies Act.(note 7).

<sup>14</sup> Farouk HI Cassim et al *Contemporary Company Law* (2010) at 782.

<sup>15</sup>Keay (note 4) at 105.

<sup>16</sup> See S 436A of the Corporations Act, 2001.

<sup>17</sup> See S 436A (1) of the Corporations Act (note 16).

<sup>18</sup> See S 436A of the Corporations Act (note 16).

The business rescue procedure in the United Kingdom is referred to as Administration (Administration) and is applicable to an insolvent company or to one that is likely to be insolvent.<sup>19</sup>

A company, according to the Australian Corporations Act<sup>20</sup> and the English Insolvency Act<sup>21</sup>, is insolvent if it is unable to pay all its debts as and when they fall due.

In South Africa, the business rescue procedure is referred to as Business Rescue and is applicable to a financially distressed company, which is capable of recovery.<sup>22</sup>

A financially distressed company is defined as a company, that appears to be reasonably unlikely to pay all its debts as they become due and payable within the immediately ensuing six months or a company that appears to be reasonably likely to become insolvent within the immediately ensuing six months.<sup>23</sup>

The process of business rescue in the three jurisdictions generally involves three main stages, which are commencement, investigation and development of plans and decision-making.<sup>24</sup> Once a company is in business rescue, a practitioner is appointed who takes over the management of the company. Although the directors of the company remain in office, they are subject to the directions and control of the practitioner.

The practitioner therefore investigates and assesses the viability of rescuing the company and prepares a report and proposals on how to go about company rescue.

The proposals may be that the obligations to the creditors are reduced or that the repayment period of creditors is lengthened to

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<sup>19</sup>Keay (note 4) at 105.

<sup>20</sup> See S95A.

<sup>21</sup> See S123.

<sup>22</sup> See S 128 of the Companies Act, 2008.

<sup>23</sup> See S 128(1)(f) of the Companies Act, (note 22).

<sup>24</sup> Colin Anderson 'Viewing the proposed South African Business Rescue Provisions from an Australian Perspective' (2008) 1 Potchefstroom Elektroniese Regsblad 1 at 1

grant the company breathing space. Where the creditors decide on the proposals and approve of the proposals, they are thereafter implemented to facilitate the company rescue.

During the process, a general moratorium on all legal proceedings and enforcements against the company subsists in order to safeguard the interests of the creditors. Where the creditors do not approve of the proposals, business rescue does not take place and a company may thereafter enter into receivership or be liquidated.

It is important at this stage to mention that Voluntary Administration in Australia and Administration in the United Kingdom are not rescue procedures as such but are preliminary procedures that facilitate the possible rescue of a company.<sup>25</sup> A company in need of rescue must therefore first go into Voluntary Administration or Administration.

In Australia, company rescue takes place after the company signs a deed of company arrangement (the deed) with the creditors, which sets out the administrator's plan to rescue the company<sup>26</sup> while in the United Kingdom, a company would have to sign an agreement with the creditors under a scheme of arrangements or creditor voluntary arrangement to facilitate company rescue.<sup>27</sup>

The business rescue process in South Africa however is a rescue procedure in itself because a rescue practitioner is primarily appointed to rescue the company. This makes the Business Rescue procedure in South Africa attractive and more direct than Administration and Voluntary Administration.

Although a business rescue mechanism may not always result in the full recovery of the company to the extent of regaining its solvency, the rescue process achieves 'a better return for the creditors

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<sup>25</sup>Keay (note 4) at 106.

<sup>26</sup> Anderson (note 24) at 1.

<sup>27</sup> Gerard McCormack *Corporate Rescue Law-An Anglo American Perspective* (2008) at 66.

and shareholders than would be achieved in a case where a company is immediately liquidated.<sup>28</sup>

## **1.2 Importance of Business Rescue**

The importance of a business rescue procedure in a country's company or insolvency law cannot be over-emphasized. A business rescue procedure serves numerous purposes, not only in the survival and continued existence of a company but also in the economy of a country at large.

Business rescue helps to reduce the number of businesses and companies that are liquidated in a country.<sup>29</sup> This enables the rescued companies to continue paying taxes to the government of the country and ultimately increase a country's revenue base.

Business rescue also serves the interests of society by granting the debtor company another opportunity to trade profitably.<sup>30</sup> This encourages the growth of the private sector and the entrepreneurial class in the economy of a country.<sup>31</sup>

Business rescue is also significant as it indirectly promotes competition between the various enterprises. When financially distressed enterprises are rescued and restored to profitable entities, they are able to compete favourably with other enterprises and consequently avail customers, the luxury of choice on goods and services that the various entrepreneurs may provide.

At the company level, business rescue preserves employment<sup>32</sup> and maximizes returns to creditors.<sup>33</sup> It also ensures that suppliers continue to have a ready market for their products and services.

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<sup>28</sup>Cassim (note 14) at 784.

<sup>29</sup> McCormack (note 27) at 19.

<sup>30</sup> Ibid.

<sup>31</sup> Ibid.

<sup>32</sup> The liquidation of Zambia Airways (The only national airline in Zambia) in 1995 after entry into receivership resulted in over 200 employees losing their jobs. Liquidation may have been avoided if a favourable business rescue regime existed at that time. According to an article entitled 'Zambia Airways had K46BN worth of

It has also been suggested that a country with a business rescue regime attracts foreign investment.<sup>34</sup>This may be because an adequate business rescue law assures investors of an avenue of redress should the investor's company become insolvent.

Additionally, business rescue may provide security to lending institutions as it prevents liquidation and avails the lender an opportunity to recover debts owed by the debtor company.

### **1.3 The research question and scope**

The research question addressed by this dissertation is two fold. The first part of the question focuses on the nature and adequacy of the 'business rescue' procedures in Zambia and the second part focuses on the major components that the ideal business rescue law in Zambia should contain.

This dissertation takes a broad outlook of the issues. It is important to note that an indepth and narrow analysis of business rescue in Zambia is not possible given that Zambia does not have a proper business rescue procedure. Receivership and the scheme of arrangements as will be discussed in chapter two, do not fit the profile of a proper business procedure.

The intention of the dissertation is not to recommend a wholesome transplant of a business rescue procedure of one of the three jurisdictions under discussion, but to highlight the best practices of the three jurisdictions and suggest a business rescue law that best suits the Zambian business environment.

Nevertheless, the approach taken appropriately addresses the issues to give a logical understanding of the problem.

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assets at liquidation', Zambia Airways had assets worth 46 billion kwacha (US \$ 8,966,861.60) at the time of liquidation. *Available at [www.allafrica.com/stories/200511160468.html](http://www.allafrica.com/stories/200511160468.html)* [Accessed on 20th January 2012].

<sup>33</sup>McCormack (note 27) at 20.

<sup>34</sup>Anneli Loubser 'Some comparative aspects of Business Rescue in South African Company Law' University of South Africa PhD research Thesis (2010) at 3.

The three jurisdictions have been earmarked for the comparative study for reasons discussed in the subsequent paragraphs.

A comparison is drawn from the United Kingdom because Zambia is a former British colony and inherited the English legal system. The Zambian company law amongst others, has since independence, been significantly influenced by that of the United Kingdom.

A comparison is drawn with Australia because it shares a similar history of English influence with Zambia. Despite this influence, Australia has enacted a business rescue law that is different from that of the United Kingdom and one that has worked well for small, medium and large enterprises in Australia.

A comparison is drawn with South Africa because South Africa has English law as part of its legal system.<sup>35</sup> Most importantly however, South Africa has adopted a hybrid business rescue regime. It has imported provisions from Chapter 11 of the Bankruptcy Act of the United States of America<sup>36</sup>, the Australian Voluntary Administration Regime<sup>37</sup> and the United Kingdom Administration Regime.

Although the South African economy is much larger than that of Zambia, it could be concluded that South Africa being an African country, may, during the enactment of the business rescue procedure, have taken into consideration, the challenges that companies operating in Africa would encounter.

From Zambia, the dissertation looks at the 'business rescue' provisions in the Companies Act<sup>38</sup>. The dissertation briefly assesses

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<sup>35</sup> South Africa has a mixed legal system that comprises of Roman-Dutch law and English law.

<sup>36</sup> Cassim (note 14) at 783.

<sup>37</sup> Ibid.

<sup>38</sup> See S 235 of the Companies Act (note 7).

the adequacy of the provisions and outlines the shortcomings of the existing 'business rescue' regime.

From Australia, the dissertation focuses on the Corporations Act<sup>39</sup> while from the United Kingdom, the dissertation focuses on the Insolvency Act of 1986, the Insolvency Act of 2000 and the Enterprises Act of 2002. From South Africa, the dissertation will focus on the Companies Act of 2008.

#### **1.4 Significance of the dissertation**

This dissertation highlights the inadequacies in the existing 'business rescue' law in Zambia and recommends the amendment of the Companies Act of 1994 in order to provide for the inclusion of a comprehensive business rescue law. The recommendation is based on lessons drawn from a comparative analysis of the business rescue regimes in Australia, the United Kingdom and South Africa.

The dissertation also proposes some of the main elements that the business rescue law in Zambia should contain, in order to make it more effective and useful to companies in Zambia.

#### **1.5 Overview of chapters**

Chapter one has outlined the scope of the dissertation. It has defined and discussed the concept of business rescue and its importance to companies. The chapter has also discussed the research question, outlined the limitations of the dissertation and justified the comparative study taken in the dissertation.

Chapter two discusses the Zambian 'business rescue' regulatory framework. The chapter briefly discusses the legal provisions relating to receivership and schemes of arrangements and outlines the weaknesses of the two mechanisms. It concludes that Zambia does not have a proper business rescue law.

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<sup>39</sup>S 436A of the Corporations Act ( note 16).

Chapter three gives an overview of the business rescue process in Australia, South Africa and the United Kingdom. The chapter also draws out the similarities, differences and shortcomings of the three regimes.

Chapter Four discusses three potential problem areas in business rescue in the three jurisdictions. The chapter also discusses the measures that the three jurisdictions have put in place to remedy these possible challenges.

Chapter five discusses the business rescue law that Zambia should enact. The chapter is divided into three parts. The first part discusses the main components that the law should contain while the second part of the chapter discusses the other provisions that may need to be included in the Companies Act to promote business rescue. The third part of this chapter discusses the possible challenges that the country may encounter in implementing the business rescue law.

Chapter six concludes the dissertation.

## **CHAPTER TWO -THE ZAMBIAN ‘BUSINESS RESCUE’ REGULATORY FRAMEWORK**

This chapter briefly discusses the Zambian ‘business rescue’ regulatory framework. It discusses the adequacy of Receivership and Schemes of Arrangement as procedures for facilitating business rescue in Zambia and outlines the weaknesses of the two procedures.

The Companies Act<sup>40</sup> regulates the formation, management, administration and winding up of companies registered in Zambia.<sup>41</sup> The Companies Act also regulates the management, administration and winding up of insolvent companies as Zambia does not have an independent piece of legislation regulating insolvent companies.<sup>42</sup>

Although the Companies Act regulates the management and administration of insolvent companies, as mentioned in the previous chapter, the Companies Act does not provide for a comprehensive business rescue procedure to rescue insolvent or near insolvent companies that are capable of being rescued.

In spite of this, the Companies Act provides for Receivership<sup>43</sup> and Schemes of Arrangements.<sup>44</sup> These procedures can be indirectly used as mechanisms to rescue or rehabilitate an insolvent or near insolvent company, which is capable of being rescued.

### **2.1 Scheme of Arrangements**

The scheme of arrangements is a useful procedure for a company where the company desires to compromise with creditors and members on any matter permitted by the Companies Act.

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<sup>40</sup> See the Companies Act (note 7).

<sup>41</sup> See long title of the Companies Act (note 7).

<sup>42</sup> Ibid.

<sup>43</sup> Part 5.3 of the Companies Act, (note 7).

<sup>44</sup> See SS 234 and 235 of the Companies Act (note 7).

### 2.1.1 Provisions of the Companies Act

A company can enter into a compromise or arrangement with

- a) the company's creditors or any class of the company's creditors; or
- b) the company's members or any class of the company's members.<sup>45</sup>

To initiate the process of compromise or agreement, the company itself, a creditor, a member of the company or a liquidator must apply to court for an order, that a meeting of the company and the relevant category of stakeholders be held to consider the compromise or arrangement.<sup>46</sup>

In a compromise or agreement between the company and the company's creditors, a creditor will vote in proportion to the amount of money owed to that creditor by the company, unless the court orders otherwise.<sup>47</sup>

The compromise or agreement must be agreed to by an extraordinary resolution<sup>48</sup> which resolution then binds all creditors, members or the relevant class of creditors or members.<sup>49</sup>

The compromise or agreement must additionally be approved by an order of the court and a copy of the order must be lodged with the Registrar of companies.<sup>50</sup>

During the court hearing to approve a compromise, an affected member or creditor may object to the compromise and the court may grant the company a conditional compromise.<sup>51</sup> One of the possible conditions that the court would attach to an order approving a

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<sup>45</sup> See S234 (2) of the Companies Act (note 7).

<sup>46</sup> See S234 (2) of the Companies Act (note 7).

<sup>47</sup> See S 234 (5) of the Companies Act (note 7).

<sup>48</sup> An extraordinary resolution is passed by not less than 75% of the votes cast by persons entitled to vote either in person or by a proxy at a meeting.

<sup>49</sup> See S234 (6) of the Companies Act (note 7).

<sup>50</sup> See S234 (7) of the Companies Act (note 7).

<sup>51</sup> See S234 (9) of the Companies Act (note 7).

compromise or arrangement would be for the company to allow the affected member of the company, to exercise his appraisal right<sup>52</sup>. Such an order would compel the company to purchase that member's shares at a price fixed or determined by the court.

### **2.1.2 Shortcomings of the Scheme of Arrangements as an effective Business Rescue Procedure**

Although the Scheme of arrangements is a useful tool in facilitating various compromises and agreements between the company and its shareholders or creditors, the scheme of arrangements is an inadequate mechanism for business rescue.

The first shortcoming is the requirement that the resolution supporting the compromise must be supported by seventy five percent of the votes cast by the creditors of the company who were entitled to vote. Since the creditors vote in proportion to the money owed to them by the company, a single creditor who is owed just over twenty five percent of the company's total debts is capable of frustrating the whole process by voting against it. This would inevitably prevent the company from concluding the relevant compromise to enable it begin the rescue procedure.

While the seventy five percent majority threshold may be sufficient protection for the other complex transactions that the company may enter into, this threshold does not support a compromise with creditors in order to rescue a company.

Secondly, the court's power to order a company to purchase a dissenting shareholder's equity as a condition to the grant of the order permitting the compromise, poses a serious challenge to the company. While the provision is necessary and important where the company is compromising with its shareholders in other types of

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<sup>52</sup>Cassim (note 14) at 719 defines an appraisal right as a right of a dissenting shareholder who does not approve of certain trigger events to have their shares bought out by the company in cash, at a price reflecting the fair value of the shares and which value may in certain cases be judicially determined.

agreements, this provision imposes an unnecessary expense on the company. Further, the provision does not expressly impose limits on or exceptions to the dissenting shareholder's exercise of an appraisal right. It would have been helpful if a proviso had been included in the Act that the court could only order a company to buy back any shares if it would not further compromise the company's solvency or liquidity.

One would assume that when a company contemplates a compromise with creditors in order to rescue the company, that company would already be insolvent or at the verge of becoming insolvent. The company would most likely be experiencing serious cash flow problems and would have very little or no cash at its disposal. Consequently, an order by the court to buy out a dissenting shareholder's equity would most likely worsen the company's liquidity problems.

Further, allowing a shareholder to exercise an appraisal right technically means that the shareholder's interests takes precedence over those of the creditors of a company, which ordinarily should not be the position.

Another shortcoming of the provision is the right of a shareholder to object to the compromise. An objection by a shareholder may delay the process of concluding the compromise.

The numerous court applications throughout the process make the whole procedure expensive and one which would ordinarily only be used by larger companies.<sup>53</sup> Most of the registered enterprises in Zambia are small and medium enterprises<sup>54</sup> which may not afford to

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<sup>53</sup>McCormack (note 27) at 66 writes that the scheme of arrangements when carried out on its own even in countries like the UK is described as 'complex and difficult to organize as it demands expensive legal resources and is generally the preserve of larger companies. When the scheme of arrangements is carried out through administration however, some difficulty and complexity is removed because of the statutory moratorium.

<sup>54</sup> The Companies Register maintained by PACRA shows that as at August 12<sup>th</sup> 2011, 40,324 small enterprises with a nominal capital of 5,000,000 to

utilize the scheme of arrangements as a rescue mechanism. This may be the reason the Companies Register<sup>55</sup> does not contain any record of the scheme of arrangements being utilized as a business rescue procedure in Zambia.

Another reason one may assert that the scheme of arrangements is an inadequate procedure for business rescue, is that it does not offer a moratorium on legal proceedings and executions against the company during the period of concluding the compromise and of implementing the agreement. As a result, a company desirous of entering into a compromise with its creditors must agree on the terms of a moratorium with the creditors as part of the compromise. This may not be an easy exercise considering the divergent interests that the various creditors of the company may have.

A moratorium provided by statute would be a standard provision, which would apply automatically as is the case in Australia, South Africa and the United Kingdom. It would also protect the interests of the company and the creditors from other impatient creditors whose greater interest would be to realize what is owed to them, than to save the company and keep it as a going concern.

## **2.2 Receivership**

Raymond Walton writes that

the general duty of a receiver is to take possession of...the subject matter in dispute in the action...and under the sanction of the court...make the property productive or collect

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20,000,000 kwacha (US \$ 1,000 – 4,000), 874 Medium enterprises with a nominal capital of 20,000,000 to 50,000,000 kwacha (US \$4,000- 10,000) and 1,229 large enterprises with a nominal capital of 50,000,000 kwacha (US \$10,000 and above) were registered under the Companies Act. The statistics also show that 1,489 foreign companies have been registered under the Companies Act.

<sup>55</sup> This register contains records of all registered companies in Zambia and all court orders relating to those companies, which are required to be filed with the registrar of companies.

and realize it as the owner himself could do if he were in possession.<sup>56</sup>

### **2.2.1 Provisions of the Companies Act**

A receiver is appointed either by the court or out of court by an individual or company through a debenture and referred to as the chargee.<sup>57</sup> A person may either be appointed as a receiver or as a receiver and manager.<sup>58</sup> A receiver is normally required to only receive rents and profits and to get in outstanding property while a receiver and manager additionally carries on or oversees a trade, business or undertaking.<sup>59</sup> The receiver and manager has the power to deal with that property and appropriate the proceeds in a proper manner.<sup>60</sup>

The Companies Act does not set out the functions of a receiver, but a receiver appointed by the court is an officer of the court and is expected to act in accordance with the directions and instructions of the court.<sup>61</sup>

Where a receiver is appointed by the chargee or the creditor, the receiver is an agent of the company and not of the persons who appoint that receiver or on whose behalf the receiver is appointed.<sup>62</sup> The receiver is expected to act in accordance with the instrument of appointment and any directions that the court may make.<sup>63</sup>

A receiver appointed under the Companies Act is personally liable for any contract that the receiver enters into unless the contract provides otherwise.<sup>64</sup> The receiver is however entitled to

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<sup>56</sup> Walton (note 10) at 161.

<sup>57</sup> See S 108 of the Companies Act (note 7).

<sup>58</sup> See S 108 (2) of the Companies Act (note 7).

<sup>59</sup> Walton (note 10) at 212.

<sup>60</sup> Ibid.

<sup>61</sup> See S 112 of the Companies Act (note 7).

<sup>62</sup> See S 113 of the Companies Act (note 7).

<sup>63</sup> See S 113 of the Companies Act (note 7).

<sup>64</sup> See S 114(1) of the Companies Act (note 7).

indemnity<sup>65</sup> where that receiver enters into a contract in the proper performance of the receiver's duties.<sup>66</sup>

A receiver has several duties under the Companies Act. A receiver, who is appointed over the whole or substantially the whole of the undertaking of any company, has the responsibility to submit a preliminary report<sup>67</sup> of the statement of affairs of the company, to the court. The receiver also has a duty to lodge his accounts of receipts and payments to the registrar and the official receiver.<sup>68</sup>

Other duties of the receiver are to lodge an abstract of receipts and payments to the registrar<sup>69</sup> and to make a report to the registrar where the receiver, in the course of performing his duties, discovers a contravention of the Act or a failure to comply with the Act.<sup>70</sup>

Amendments effected to the Companies Act in July 2011 also revised the provisions relating to receivership and liquidation amongst several other objectives.<sup>71</sup> The amendments related to qualifications and remuneration of receivers, the receiver's duty to prepare a statement of a company's affairs and accounts of receivers.

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<sup>65</sup> This indemnity will arise from the property on which the receiver has been appointed to act on as receiver.

<sup>66</sup> See S 114(2) of the Companies Act (note 7).

<sup>67</sup> The preliminary report should disclose the amount of capital issued, subscribed and paid up and the estimated amount of assets and liabilities; the cause of the failure of the company, if it has failed; and whether in his opinion inquiry is desirable as to the matter relating to the promotion, formation or failure of the company or the conduct of its business.

<sup>68</sup> See S 338 of the Companies Act (note 7). This must be done within a month after the end of the period of six months from the date of his appointment; the end of every subsequent period of six months; or after ceasing to act as a receiver or obtaining an order of release.

<sup>69</sup> See S 117 of the Companies Act (note 7). This is where a receiver is appointed for a part but not the whole or substantially the whole of the undertaking of a company.

<sup>70</sup> Section 118 of the Companies Act (note 7). The report must be made where the receiver believes that the directors of the company will not deal with it if it is brought to their attention.

<sup>71</sup> See the Companies (Amendment) Act no 24 of 2011.

### 2.2.2 Shortcomings of Receivership as an effective Business Rescue Procedure

The major short coming of receivership as an effective business rescue mechanism is the absence of an express provision requiring a receiver to draw up a rescue plan as the receiver manages the charged assets on behalf of the chargee.

The High Court of Zambia in the case of *Magnum (Zambia) Limited v Basit Quadri (Receivers /Managers) & Grindlays Bank International Zambia Limited*<sup>72</sup> held that a receiver who was an agent of the company under receivership was there to secure the interests of the debenture holder. As a result of this decision and the conspicuous absence of an express provision in the law stating otherwise, the primary duty of a receiver appointed outside the court has been to realize the assets of the debenture holder.

The Supreme Court in *Avalon Motors Limited (in receivership) v Leigh Gadsen Motor City Limited*<sup>73</sup> later held that a receiver occupies a fiduciary relationship with the company as that of a director and is liable for any wrong doing to the company.<sup>74</sup>

Cassim et al<sup>75</sup> defines a fiduciary as a person who acts on behalf of or in the interests of another person.<sup>76</sup> A fiduciary controls the assets of another or exercises the power to act on behalf of another.<sup>77</sup> A fiduciary is required to exercise his duty in good faith, honesty and loyalty.<sup>78</sup>

A receiver, by this authority, is expected to exercise his powers in the best interests of the company and in good faith, honesty and loyalty.

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<sup>72</sup> 1981 Zambia Law Reports 141(H C).

<sup>73</sup> 1998 Selected Judgments 26 (S C).

<sup>74</sup> See (note 73).

<sup>75</sup> Cassim (note 14) at 461.

<sup>76</sup> Ibid.

<sup>77</sup> Ibid.

<sup>78</sup> Ibid.

Although case law considers a receiver to be a fiduciary and requires the receiver to exercise his power in accordance with his fiduciary position, this still does not place an express duty on the receiver to draw up or propose a rescue strategy for the company.

One can argue that the duty to act in the best interests of the company does not extend to the receiver drawing up a rescue strategy for the company, but simply to ensure that that receiver, in recovering what is owed to the chargee or creditor, manages the assets in a manner that is not prejudicial to the company.

A receiver who is appointed by the court is an officer of the court and is expected to conduct his duties according to the direction of the court. Where a receiver is so appointed, the court has the duty to make orders on how the receiver must manage the assets of the company. The Companies Act does not expressly require the court to order a receiver appointed by the court to propose a rescue strategy for the company.

The receiver's bias towards realisation of the creditor's interest at the expense of all other stakeholders of the company, has led to the reform in the insolvency law of several jurisdictions. The New Zealand Receiverships Act of 1993<sup>79</sup> imposes an obligation on the receiver to act with reasonable regard to the interests of unsecured creditors, guarantors and others claiming an interest in the property through the debtor. The Australian Corporate Law Reform Act<sup>80</sup> imposes a duty on the receiver to exercise the degree of care and diligence that a reasonable person in a like position would exercise.

Even with the inclusion of these provisions in New Zealand and Australia, the two jurisdictions have enacted comprehensive business rescue legislation because of the apparent inadequacies in their corporate and insolvency laws.

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<sup>79</sup> See S 18.

<sup>80</sup> See S 232(4).

Although recent amendments were made to some provisions relating to receivership in Zambia, these amendments did not impose a duty on the receiver to consider a rescue strategy for a company in receivership so as to remedy the current problem.

An inclusion of an express provision in the Companies Act requiring a receiver to consider a rescue strategy for the company while managing the assets of the company would be progressive. It would also compel receivers to manage the assets of the company responsibly.

Objections to such a provision would most likely be expressed by the chargees. The likely argument to be advanced would be that the chargees would have to incur a higher fee for the appointment of receivers because the receivers would have to provide this extra service. Further, the consideration or proposal of a rescue strategy for the company would not always be in the chargee's interest.

Another difficulty with receivership as a rescue procedure is that it is limited only to a company with secured creditors who hold a floating charge over the assets of the company. Receivership is not available as a business rescue procedure in a case where an insolvent or nearly insolvent company only has unsecured creditors, as unsecured creditors cannot invoke receivership. The only options available to such a company would be to enter a scheme of arrangements with its creditors or to opt for liquidation.

These shortcomings highlighted justify the need for the enactment of a comprehensive business rescue law in Zambia. The form that the business rescue law should take will be discussed in detail in chapter five.

### **CHAPTER THREE – AN OVERVIEW OF THE BUSINESS RESCUE PROCESS IN AUSTRALIA, UNITED KINGDOM AND SOUTH AFRICA**

This chapter gives an overview of the business rescue procedure in Australia, South Africa and the United Kingdom. From the outset it is cardinal to mention that the procedure of business rescue in each of these jurisdictions is extremely wide and can not be comprehensively dealt with within the scope of this dissertation. Consequently, the chapter will only outline the major stages in the business rescue process in the three jurisdictions, and will in so doing draw out their similarities and differences.

The comparative analysis taken in this chapter will inform the basis for the recommendations made in chapter five. The chapter takes a comparative approach in discussing each major stage of the business rescue process in the three regimes.

The actual rescue of a company under Voluntary Administration may be carried out through the adoption and implementation of a deed<sup>81</sup>. In Administration, company rescue may be carried out through the adoption and implementation of proposals made by the administrator. The proposals may suggest that the company enters into a company voluntary arrangement or a scheme of arrangements with the company's creditors.<sup>82</sup> These, strictly speaking are the rescue procedures that are brought into operation through the shelter regimes.<sup>83</sup>The proposals and the deed may

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<sup>81</sup> Richard Fisher et al Voluntary Administration in Australian Corporations Law- Principles and Practice Vol 2(1991) at 53,463 writes that proposals constitute an instrument prepared by the administrator which sets out the property available to pay the creditors' claims, the extent to which the company will be released from its debts and the order in which the proceeds realized from the property will be distributed to satisfy the creditors' claims.

<sup>82</sup> David Milman 'Schemes of arrangements and other restructuring regimes under UK Company Law in context (2011) 301 Company Law Newsletter 1-4 at 1 writes that a scheme of arrangements and a company voluntary agreement are restructuring tools under the United Kingdom's company law.

<sup>83</sup> See chapter one for an explanation of Administration and Voluntary Administration as shelter regimes.

sometimes not recommend the rescue of a company but that the business is sold in order to realise a better return for the creditors.

In South Africa, the actual rescue of a company is effected through the adoption and implementation of the business rescue plan.

Although these rescue mechanisms are different, they have similar steps in the rescue process as alluded to in chapter one. Anderson<sup>84</sup> explains that '[a]ll corporate rescue regimes have three distinct steps which are commencement, investigation and development of plans and decision making'. This chapter will be discussed in the context of these three steps.

### **3.1 Commencement**

The Voluntary Administration process in Australia commences when an administrator is appointed. Although the appointment of the administrator is simple in that it is by an out of court process, it limits the categories of persons qualified to appoint an administrator to the board of the company<sup>85</sup>, the liquidator, the provisional liquidator<sup>86</sup> and a secured creditor who holds a charge over the whole or substantially the whole of the company's property (fully secured creditor)<sup>87</sup>. The board of directors and the liquidator are required to show that the company is insolvent or likely to be insolvent while the fully secured creditor is only required to show an entitlement to enforce the charge.

A wider category of persons can commence the Administration process in the United Kingdom by appointing an administrator either by a petition to the court or through an out of court procedure.<sup>88</sup>The

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<sup>84</sup>Anderson (note 24) at 1.

<sup>85</sup> See S436 (A)(1) of the Corporations Act (note 16).

<sup>86</sup> See S 436 (B)(1) of the Corporations Act (note 16).

<sup>87</sup> See S 436 (C)(1) of the Corporations Act (note 16).

<sup>88</sup> Richard Nevins 'Bankruptcy Law client strategies in Europe-leading Lawyers on analysing the European bankruptcy process, developing creative strategies for clients and understanding the latest trends-A thorough analysis of the UK's

juristic and natural persons qualified to petition the court to appoint an administrator include the company, the company's directors, a creditor, the supervisor and the liquidator of the company.<sup>89</sup>In such cases the court only makes an administration order where satisfied that 'the company is or is likely to become unable to pay its debts and that the administration order is reasonably likely to achieve the purpose of administration'<sup>90</sup>.

Additionally, the directors of the company or a fully secured creditor can appoint an administrator out of court.<sup>91</sup>The directors are still required to file appropriate documentation in the court after which the appointment of the administrator is effected.<sup>92</sup>A fully secured creditor who appoints an administrator through an out of court appointment is only required to show that the floating charge is a qualifying floating charge and that the charge has become enforceable.

Similarly, Business Rescue in South Africa can also be commenced through an out of court procedure or an application to the court. An out of court procedure can only be commenced by the board of the company after passing a board resolution to commence business rescue proceedings on the grounds that the company is financially distressed and that there are reasonable prospects of rescuing the company.<sup>93</sup> Business Rescue however commences only after the board has filed that resolution at the Companies Commission.<sup>94</sup>

Business Rescue also commences when the court makes a commencement order after considering an application filed in court.

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restructuring process' 2010 *Aspatore* at 16. Available at <http://international.westlaw.com/result/documenttext.aspx?cnt=Doc&cfid=1&eq=we> l [Accessed on 4<sup>th</sup> November 2011].

<sup>89</sup> See Schedule B1 Para 2 (a) of the Insolvency Act, 1986.

<sup>90</sup> See S 123 of the Insolvency Act (note 89).

<sup>91</sup> See Schedule B1 Para 2 (b) and (c) of the Insolvency Act (note 89).

<sup>92</sup> See Schedule B1 Para 33 of the Insolvency Act (note 89).

<sup>93</sup> See S129 (1) (a) and (b) of the Companies Act (note 22).

<sup>94</sup> See S 129(2)(b) of the Companies Act (note 22).

An application for Business Rescue can be filed to the court by any affected person.<sup>95</sup> An affected person includes a creditor, shareholder, registered trade union representing employees of the company and any individual employee.<sup>96</sup> The business rescue practitioner is appointed either by the board<sup>97</sup> or by the court<sup>98</sup>. The court's appointment of the rescue practitioner is based on the proposal and recommendations made by the affected person in the application and supported by the majority of affected persons.<sup>99</sup>

Voluntary Administration has been criticized for deliberately excluding the court in the commencement of the process, consequently limiting the court's supervisory role at the commencement of the process. Anderson<sup>100</sup> justifies this limitation of court participation as done in an effort to reduce costs, which would possibly arise due to delays in the court processes and subsequent litigation. Anderson<sup>101</sup> adds that this exclusion of the court helps to avoid the depletion of the company's remaining funds and assets in litigation and related court procedures.

One would also argue that the court's exclusion from the commencement proceedings is compensated by the general supervisory jurisdiction that the court enjoys under the Corporations Act<sup>102</sup> and which can be invoked by an interested person including the company, a creditor or the Australian Securities Investments Commission.<sup>103</sup> In *Cawthorn v Kiera Construction Pty Ltd*<sup>104</sup> the court interpreted section 447A as conferring the court with extremely wide

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<sup>95</sup> See S 131(1) of the Companies Act (note 22).

<sup>96</sup> See S128 (1) (a) of the Companies Act (note 22).

<sup>97</sup> See S129 (3)(b) of the Companies Act (note 22).

<sup>98</sup> See S 131(5) of the Companies Act (note 22). This is where business rescue is commenced by an application made by an affected person to the court.

<sup>99</sup> See S 131(5) of the Companies Act (note 22).

<sup>100</sup> Anderson (note 24) at 1.

<sup>101</sup> Ibid.

<sup>102</sup> See the Corporations Act (note 15).

<sup>103</sup> See S 447 A (4) of the Corporations Act (note 16).

<sup>104</sup> 1994 33 NSWLR 607.

jurisdiction to make any order appropriate for the operation of the regime.

The commencement procedure of Administration has also been criticised for being complicated and expensive. Keay<sup>105</sup> in comparing Voluntary Administration to Administration argues that the ‘out of court’ process of commencement in Administration is more complicated than that of Voluntary Administration owing to the court’s requirement that particular documents be filed.

Keay<sup>106</sup> suggests that the likely reason for the requirement that prescribed documents are filed even in an ‘out of court’ application is so that the administrators appointed out of court may be recognized as officers of the court and be consequently covered by the European Union Regulations on Insolvency Proceedings.<sup>107</sup>

Business Rescue is also considered to be somewhat complicated and expensive because both the commencement procedure and the appointment of a practitioner require numerous notices to be filed to affected persons throughout the process. Nevertheless the numerous filing requirements may be desirable in order to notify all affected persons of the commencement of the business rescue proceedings and to ensure that the interests of all stake holders in the company are taken into account.

### **3.2 Investigation and development of Plan**

The Corporations Act<sup>108</sup> sets out the purpose of Voluntary Administration which is ‘to provide for the business, property and affairs of the insolvent company to be administered in a way that maximizes the chances of the company or as much as possible of its business, continuing in existence or, if this is not possible, results in

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<sup>105</sup>Keay (note 4)115

<sup>106</sup>Ibid.

<sup>107</sup> Council Regulation 1346/2000 cited in Keay (note 4) at 115. This regulation seeks to incorporate the European Union Regulations designed to harmonise insolvency proceedings across the European Community.

<sup>108</sup> See S435 A of the Corporations Act (note 16).

a better return than would be the case if there was an immediate winding up of the company.’

Once a company enters into Voluntary Administration, the administrator is obliged to investigate the company’s affairs and to form an opinion on whether it would be in the best interests of the creditors for the company to execute a deed to facilitate company rescue, for the administration to end or for the company to be wound up.<sup>109</sup>The administrator is thereafter required to report the findings to the company’s creditors in order for the creditors to decide on the company’s future.<sup>110</sup>The administrator in investigating the company’s affairs and coming up with this opinion is to be assisted by the directors of the company.<sup>111</sup>

The Insolvency Act<sup>112</sup> provides that Administration seeks to achieve one purpose, set out in a hierarchy of three objectives.<sup>113</sup> The objectives are set out in order of priority. The first is to rescue the company as a going concern while the second, is to achieve a better result for the company’s creditors as a whole than would be likely if the company was wound up. Where the first two objectives are unachievable, the administrator is required to realise property in order to make a distribution to one or more secured or preferential creditors.<sup>114</sup>

To achieve this objective, the administrator is, as soon as is reasonably practicable, required to investigate the prospects of the company achieving the objectives and prepare a statement of proposals. The Insolvency Act requires a current or former director or any other officer of the company to provide the statement of affairs for

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<sup>109</sup> See S 438A (4) of the Corporations Act (note 16).

<sup>110</sup> See S 439 A (4) of the Corporations Act (note 16).

<sup>111</sup> See SS 438B, 438C and 442A of the Corporations Act (note 16).

<sup>112</sup> See the Insolvency Act (note 89).

<sup>113</sup> See Schedule B1 Para 3(1) of the Insolvency Act (note 89).

<sup>114</sup> See Schedule B1 Para 3(1) of the Insolvency Act (note 89).

the administrator's use in formulating proposals.<sup>115</sup>The proposals must be formulated within eight weeks of the appointment and the initial creditors meeting to discuss the proposals for the future of the company held during this time.<sup>116</sup>

The South African Companies Act provides that Business Rescue seeks to facilitate the rehabilitation of a financially distressed company.<sup>117</sup>This rehabilitation process is to be undertaken through the temporal supervision and management of the company's affairs, business and property<sup>118</sup> and the development and implementation of a rescue plan to restructure the company's affairs, business, property, debts and other liabilities in order for the company to remain solvent and continue to exist. Where this is not possible, the restructuring is hoped to result in a better return for the company's creditors and shareholders than would be the case if the company was immediately liquidated.<sup>119</sup>

The primary duties of the practitioner are to develop a business rescue plan to be considered by the affected persons and to implement the plan adopted by the affected persons.<sup>120</sup> To fulfill these duties the practitioner is, as soon as is reasonably practicable, required to investigate the affairs of the company and consider whether company rescue is possible.<sup>121</sup> The directors and the other officers are obliged to assist the practitioner during the investigation by availing the practitioner with all requested information.<sup>122</sup>

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<sup>115</sup> See Schedule B1 Para 47(1) of the Insolvency Act (note 89).

<sup>116</sup> See section 8 and Schedule B1 Para 51(1) of the Insolvency Act (note 89).

<sup>117</sup> See S128 (1)(b) of the Companies Act (note 22).

<sup>118</sup> See S128 (1)(b)(i) of the Companies Act (note 22).

<sup>119</sup> See S128 (1)(b)(iii) of the Companies Act (note 22).

<sup>120</sup> See S 140 (1)(d)(i) and (ii) of the Companies Act (note 22).

<sup>121</sup> See S 141(1) of the Companies Act (note 22).

<sup>122</sup> See S142 of the Companies Act (note 22).

### 3.3 The Plan

The proposed rescue plan prepared by the administrator or practitioner is termed differently in the three regimes but essentially contains the same information.

The implementation of the deed in Voluntary Administration, like the statement of proposals in Administration, can facilitate the rescue and restoration of a company to a position of financial health. The deed can also provide for a controlled sale of the assets of the company over a period of time and for the eventual winding up or dissolution of the company.<sup>123</sup>

The deed, apart from the prescribed formal requirements<sup>124</sup>, identifies the property of the company available to pay the creditors' claims and the extent to which the company is to be released from its debts.<sup>125</sup> The deed additionally explains how the company will be managed and financed and also sets out the order in which the creditors' claims are to be satisfied after the company property has been sold<sup>126</sup>

The proposals in Administration and the rescue plan under Business Rescue essentially provide the same information.<sup>127</sup>

### 3.4 Decision Making

In Voluntary Administration, the administrator is required to convene and conduct two meetings during the process of Voluntary Administration.<sup>128</sup> The creditors participate in the process and determine the direction that the company under administration will take through these meetings. The first meeting is to be held within eight business days of the commencement of

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<sup>123</sup>Fisher(note 81) at 53,463.

<sup>124</sup> The formal requirements relate to the company, the administrator and creditors.

<sup>125</sup> See S 443A (3) of the Corporations Act (note 16).

<sup>126</sup> See S 443A (3) of the Corporations Act (note 16).

<sup>127</sup> See the Insolvency Rules 1986/1925 Sch 4 Form 2.17 B(Rule 2.33(2)(m) and (o)). See also S 150(2)(a)(b) and (c) of the Companies Act (note 22).

<sup>128</sup> See the Corporations Act (note 16).

administration.<sup>129</sup> During this meeting, the creditors decide on the appointment of a committee of creditors and its membership. The committee consults with the administrator on matters relating to administration and also receives and consider reports from the administrator.<sup>130</sup> The committee can not however give directions to the administrator.<sup>131</sup>

The creditors decide the future of the company at the second meeting of creditors which is required to be held within five business days before or after the convening period<sup>132</sup> but may be extended by the court.<sup>133</sup>

At this meeting, the creditors decide on three possible courses of action. The first is for the company to execute the deed as prepared by the administrator. The second is for the administration proceedings to end while the third is for the company to be wound up.<sup>134</sup>

Where the creditors resolve to execute the deed, the company is also required to execute that deed<sup>135</sup>. The moratorium continues to apply until the deed is executed.

Where the creditors resolve that the company should be wound up, the administrator continues to conduct the affairs of the company but as the company's liquidator.<sup>136</sup>

Voluntary Administration terminates where the company and the creditors execute the deed or where the creditors resolve that the administration ends.<sup>137</sup> Voluntary Administration will also terminate

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<sup>129</sup> See S 436 E (2) of the Corporations Act (note 16).

<sup>130</sup> See S 436 F (1) of the Corporations Act (note 16).

<sup>131</sup> See S 436 F (2) of the Corporations Act (note 16).

<sup>132</sup> The convening period is ordinarily 21 days from the day when administration commences.

<sup>133</sup> See S 439 A (6) of the Corporations Act (note 16).

<sup>134</sup> See S 439 C of the Corporations Act (note 16).

<sup>135</sup> See S 439 C (a) of the Corporations Act (note 16).

<sup>136</sup> See S 446 A of the Corporations Act (note 16).

<sup>137</sup> See SS 435 C (2)(b) and 439 C(b) of the Corporations Act (note 16).

when the creditors resolve that the company should be wound up<sup>138</sup> or when the court makes an appropriate order terminating administration.

When Voluntary Administration terminates, the powers of management revert to the directors of the company. Secondly all prohibitions on the rights and powers of creditors and other persons in respect of the company or its property cease.<sup>139</sup>

An administrator in the United Kingdom is not obliged by law to hold an initial creditors' meeting, as is the case in Voluntary Administration. The administrator is not required to hold the initial creditors' meeting where the company either has enough property to pay every creditor in full or has insufficient property to enable a distribution to the unsecured creditors.<sup>140</sup> The Insolvency Act<sup>141</sup> also permits the administrator to correspond with the creditors on any matters that would ordinarily have been discussed in a creditors meeting.

Where an initial creditors' meeting is held and the administrator's proposals presented to the creditors and approved, the administrator must manage the affairs of the company, the business of the company and the property of the company in accordance with those approved proposals.<sup>142</sup>

The decision making process in Business Rescue is somewhat different from that of Administration and Voluntary Administration. This difference is that the Companies Act<sup>143</sup> requires the practitioner to not only take into account the interests of the creditors but those

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<sup>138</sup> See Ss 435 C (2)(b) and 439 C(c) of the Corporations Act (note 16).

<sup>139</sup> Fisher (note 81) at 53,294.

<sup>140</sup> See S 8 and Schedule B1 Paragraph 51 (1) (a) and (b) of the Insolvency Act (note 89).

<sup>141</sup> See S8 and Schedule B1 Paragraph 58(1) of the Insolvency Act (note 89). See also Lord Mackay(Ed) Halsbury's Laws of England 4<sup>ed</sup> (2004 reissue) Vol 7 (3) at 249 para 247.

<sup>142</sup> See Schedule B1 Paragraph 53(2) of the Insolvency Act (note 89).

<sup>143</sup> See the Companies Act (note 22).

of employees and where applicable, the interests of shareholders as well. This is fulfilled by allowing these employees and shareholders to participate in the discussions during the Business Rescue proceedings and to vote at meetings and on the business rescue plan.<sup>144</sup>

The practitioner is required to convene at least two meetings of the creditors through out the business rescue process in accordance with the Companies Act.<sup>145</sup>

The creditors and other holders of company security may, during this second meeting approve the rescue plan, reject the rescue plan and require the practitioner to amend it or outrightly reject the plan.<sup>146</sup>

The plan when adopted binds the company and each creditor and holder of a company security regardless of their absence at the second creditors meeting.<sup>147</sup> The practitioner is obliged to implement the plan.<sup>148</sup>

Where the plan is rejected the practitioner or an affected person may apply to the court to disregard that decision and allow the practitioner to resubmit a business rescue plan.<sup>149</sup> Where such an application is unsuccessful and the plan is rejected, the business rescue proceedings come to an end.<sup>150</sup> Business Rescue will also end where the practitioner applies to the court for the termination of the procedure,<sup>151</sup> or where the practitioner substantially implements the business rescue plan and notifies the court.<sup>152</sup>

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<sup>144</sup> See SS 144, 154 and 146 of the Companies Act (note 22).

<sup>145</sup> See SS 147(1), 147(1)(a), 145(3), 149(1)(a), 150(5) and 151(1) of the Companies Act (note 22).

<sup>146</sup> See S152 of the Companies Act (note 22).

<sup>147</sup> See S 152 (4)(a) of the Companies Act (note 22).

<sup>148</sup> See S 84(5) of the Companies Act (note 22).

<sup>149</sup> See S 153(1) of the Companies Act (note 22).

<sup>150</sup> See S 153(5) of the Companies Act (note 22).

<sup>151</sup> See S 153(5) of the Companies Act (note 22).

<sup>152</sup> See S 152(8) of the Companies Act (note 22).

In furthering the interests of the employees, the practitioner is also required to hold a first meeting of the employees.<sup>153</sup> This meeting must, like that of the creditors, be held within ten business days of the practitioner's appointment. The practitioner is required to give the same opinion as that given at the first creditors' meeting, on the prospects of rescuing the company.<sup>154</sup> The employees may also appoint an employees' committee during this meeting which, like that of the creditors, would consult with the practitioner on any matter relating to the business rescue proceedings although the employees committee would not be entitled to direct or instruct the practitioner.<sup>155</sup>

The employees are entitled to be present at the creditors meeting to consider the business rescue plan. Although the employees cannot vote<sup>156</sup> during this meeting, they are availed an opportunity to address the meeting and to comment on the business rescue plan.<sup>157</sup>

The interests of the shareholders are also taken into account where the business rescue plan alters the rights of any class of shareholders.<sup>158</sup> The affected shareholders vote and approve the business rescue plan although their vote is cast after that of the creditors. The vote of the creditors on such a business rescue plan is considered as a preliminary approval<sup>159</sup> while the vote of the shareholders determines whether the plan will be adopted. Where the shareholders do not vote in favour of the plan, the plan must be rejected although this decision is appealable.<sup>160</sup>

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<sup>153</sup> See S 148 of the Companies Act (note 22).

<sup>154</sup> See S 148 (1)(a) of the Companies Act (note 22).

<sup>155</sup> See S 149 (1)(a) of the Companies Act (note 22).

<sup>156</sup> An employee can only vote on the adoption of a business rescue plan if that employee is also a creditor of the company.

<sup>157</sup> See S 152 (1)(c) of the Companies Act (note 22).

<sup>158</sup> See S 146(d) of the Companies Act (note 22).

<sup>159</sup> See S 152(3)(c)(i) and (ii) of the Companies Act (note 22).

<sup>160</sup> This appeal would be made in terms of Section 153 of the Companies Act (note 22).

### 3.5 The Moratorium

The moratorium is described as the ‘heart of the administration process’. This is because it stays all legal proceedings and executions against the company, its property or assets and the exercise of the creditors’ rights against the company.<sup>161</sup> It provides the company with an opportunity to consider a rescue<sup>162</sup> and also grants the administrator and the creditors an opportunity to work out a course of action that is in the best interests of both the creditors and the company.<sup>163</sup>

In Voluntary Administration, the general effect of the moratorium is that court proceedings against the company are automatically stayed except with the consent of the administrator or the court.<sup>164</sup> Another effect is that all execution processes that had been commenced against the company are stopped<sup>165</sup> and attempts to enforce judgments also barred.<sup>166</sup>

This prohibition affects both secured and unsecured creditors save in excepted cases.<sup>167</sup> The moratorium also extends to third parties that own property or have claims against the company.

The moratorium applies only during the period of Voluntary Administration and terminates once the deed is signed by the creditors and the company. Once the deed is operational, only the unsecured creditors remain bound under that deed. The fully secured

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<sup>161</sup>Cassim (note 14) at 793.

<sup>162</sup> Anderson (note 24) at 1.

<sup>163</sup>John Kong Shan Ho, Rohan Price ‘bringing corporate rescue laws to Hong Kong: A reform too big to fail?’ (2011) *Business Law International* 12 at 12.

<sup>164</sup> See S 440 D of the Corporations Act (note 16).

<sup>165</sup> See S 440 G of the Corporations Act (note 16).

<sup>166</sup> See S 440 F of the Corporations Act (note 16).

<sup>167</sup> SS 440B and 441 provide the following exceptions- with the administrator’s written consent; with the court’s leave; where the creditor holds a charge or charges over the whole or substantially the whole of the company’s property and either has already commenced or during decision period commences, to enforce the charge in relation to all of the charged property; where enforcement proceedings were commenced prior to the beginning of the moratorium period; or where the charged property is perishable.

creditors and the owners of the property in the company's possession are free to enforce their security or recover their property in accordance with the rights they held before the commencement of the Voluntary Administration. Fully secured creditors can only be bound by the deed if they agreed to be bound by it.<sup>168</sup>The Court can also order that the fully secured creditors and owners of property are bound by the deed in the interests of the company and other creditors.<sup>169</sup>

A company in Administration is not only protected by a general moratorium as that under Voluntary Administration but additionally by an interim moratorium. An appointment of an administrator made by a petition to the court, triggers an interim moratorium for the period between the time that application is made to the court and the time when the court makes the administration order.<sup>170</sup>

An interim moratorium also applies where a company appoints an administrator by resolution but files the prescribed documents into court before the administration order can be made.<sup>171</sup>Edward Bailey and Hugo Groves<sup>172</sup>explain that

the interim moratorium aims to protect the company from attack whilst the appointment of an administrator is in progress but the company is not yet in administration. Where the interim moratorium applies, the same general restrictions apply as in the general moratorium that comes into effect once the company is in administration.

Once a company is in Administration, the moratorium imposed generally restricts the liquidation of the company except in limited circumstances<sup>173</sup> and also prohibits the enforcement of security over the company's property unless the administrator permits.<sup>174</sup> The

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<sup>168</sup> See SS 444D and 444F of the Corporations Act (note 16).

<sup>169</sup> See SS 444D and 444F of the Corporations Act (note 16).

<sup>170</sup> See Schedule B1 Paragraph 42,43 and 44(5) of the Insolvency Act (note 89).

<sup>171</sup>See Schedule B1 Paragraph 44(1), (2) and (4) of the Insolvency Act (note 89).

<sup>172</sup> Edward Bailey and Hugo Groves *Corporate Insolvency-Law and Practice* 3ed (2007) at 383.

<sup>173</sup>See Schedule B1 Paragraph 42(2) of the Insolvency Act (note 89).

<sup>174</sup> See Schedule B1 Paragraph 43(2) of the Insolvency Act (note 89).

moratorium also restricts any legal process against the company<sup>175</sup> and the landlord's right to re-entry<sup>176</sup>.

In spite of this moratorium, the court can permit the lifting of the moratorium on consideration of the principles set out in the landmark decision of *Re Atlantic Computer Systems Plc*<sup>177</sup>

The moratorium continues to apply throughout the process of Administration until it comes to an end to ensure that the property of the company remains protected until all the creditors concerned agree on the way forward and are bound by it.

The moratorium in Business Rescue also applies to all company creditors and suspends legal proceedings against the company unless the practitioner consents or with leave of the court.<sup>178</sup> The moratorium also prohibits the disposal of property unless the property is disposed of in the ordinary course of the company's business<sup>179</sup> or as part of the approved business rescue plan.<sup>180</sup>

The moratorium during Business Rescue is however, peculiar as it remains in effect throughout the business rescue process until the business rescue plan is substantially implemented. The moratorium ends when the business rescue plan is rejected and the business rescue proceedings terminated.

Despite the continued existence of the moratorium through out the Business Rescue process and its application to both secured and

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<sup>175</sup>See SS 10 (1)(c) and 11(3) of the Insolvency Act (note 89).

<sup>176</sup>See Schedule B1 Paragraph 43(3) of the Insolvency Act (note 89).

<sup>177</sup> (1992)CH 505,542 ff- this case sets out the principles that should be considered in an application for permission to lift a moratorium. The court in giving permission should not prefer the interests of one secured creditor over another and where appointment of a receiver would be more likely to produce a better return for creditors than an administrator, the court will permit the appointment of the former.

<sup>178</sup> See S133 (1)(a) and (b) of the Companies Act (note 22).

<sup>179</sup> See S 134 (1) (a) (i) and (ii) of the Companies Act (note 22).

<sup>180</sup> See S 134 (1) (a) (iii) of the Companies Act (note 22).

unsecured creditors, Anneli Loubser<sup>181</sup> writes that it is inadequate because it lacks an interim moratorium. Loubser writes that when an application for business rescue is brought before the court in terms of section 131(1), the applicant is required to notify each affected person of the application while the court considers the application and the lack of an interim moratorium before the official commencement order of business rescue by the court exposes the company. Loubser<sup>182</sup> elaborates that

this exposures relates to a run on the assets of the company by creditors in the period between the compulsory notification of the intended application and the moment of commencement of the rescue proceedings that would result in the automatic moratorium .

Loubser<sup>183</sup> suggests that the Companies Act<sup>184</sup> would better protect the assets of the company and the interests of the creditors, employees and other affected persons if a provision providing for an interim moratorium during that period was included in the Companies Act.<sup>185</sup>

Having discussed the three major stages of business rescue in Australia, South Africa and the United Kingdom, chapter four will discuss the potential problems that can arise in business rescue.

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<sup>181</sup>Anneli Loubser 'The Business Rescue Proceedings in the Companies Act of 2008: Concerns and Questions (part 2)' *Journal of South African Law (TSAR)* (2010) 689 at 689.

<sup>182</sup>Loubser (note 181) at 689.

<sup>183</sup>*Ibid.*

<sup>184</sup> See the Companies Act (note 22).

<sup>185</sup> See also Richard Bradstreet 'The New Business Rescue: Will Creditors Sink or Swim' 2011 *South African Law Journal* 352 at 374.

## **CHAPTER FOUR-POTENTIAL PROBLEM AREAS DURING THE BUSINESS RESCUE PROCESS**

This chapter discusses three of the potential problem areas in the business rescue process in the three jurisdictions. These areas relate to inadequate creditor protection and participation, inadequate qualification and regulation of the rescue practitioner and the unregulated use of post commencement finance. It is important to state from the onset that these are not the only potential problem areas in the business rescue process. The chapter discusses each potential problem consecutively and thereafter discusses the measures that the three jurisdictions have in place to remedy these potential problems.

### **4.1 Inadequate Creditor participation and protection**

Adequate creditor protection is cardinal in ensuring the success of a business rescue as creditors feel that their interests are protected and would then allow the company to undergo a business rescue. A good rescue regime must therefore provide for this. Creditor protection and participation is evidently an important aspect in all three rescue regimes although the level of protection afforded to secured and unsecured creditors evidently differs.

Voluntary Administration and Administration are perceived to provide stronger protection for the fully secured creditors at the expense of other secured creditors and unsecured creditors.<sup>186</sup> Business Rescue on the other hand strives to strike a balance in protecting the interests of both secured and unsecured creditors.<sup>187</sup>

There are two main types of creditors. The first is a secured creditor who holds an asset of the company as security for the amount that the debtor company owes that creditor. The second is a

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<sup>186</sup>Keay (note 4) at 115.

<sup>187</sup>This is evident from the uniform application of the moratorium on both secured and unsecured creditors. It is further evidenced by the fact that all creditors are bound by the business rescue plan regardless of whether they attended the meeting at which the plan was voted on or whether they voted in favour of the plan.

creditor who is owed money by the debtor company but does not hold any asset of the company as security for the debt. In certain jurisdictions<sup>188</sup>, there is a third type of creditor who is considered to be a fully secured creditor because that creditor holds a floating charge over all or substantially all the assets of the company.

The credit and security system in Australia and the United Kingdom provides for a floating charge.<sup>189</sup> In effect Australia and the United Kingdom have three types of creditors namely the fully secured creditor, the secured creditor and the unsecured creditor. South Africa only recognises two types of creditors namely secured and unsecured creditors.

The debate on the balance in the protection of secured creditors and unsecured creditors is an age-old debate and one that often arises in general company law. Gerard McCormack discusses the arguments that have been advanced over the priority of secured debt in company law. McCormack advances several reasons for which creditors take the debtor's security and for which reasons the secured creditors should enjoy a priority over unsecured creditors. One reason is that the secured creditor seeks to maximize the debtor's insolvency and take control of the assets in order to oblige the debtor to pay.<sup>190</sup> Another reason is that the secured creditor will be able to

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<sup>188</sup>Australia and the UK.

<sup>189</sup>Rajak (note 1) at 279 – 280 defines the floating charge as a means by which companies are able to obtain loans without being able to offer the security of fixed assets (either because they did not own any or because the assets were already fully mortgaged to other lenders). It usually confers security over all the debtor's moveable assets in favour of the creditor. The charge does not inhibit the debtor from using these assets in the normal course of business but when the debtor becomes insolvent, the floating charge crystallizes and becomes fixed over all the moveable assets that the debtor owns at the moment of crystallisation. When the debtor becomes insolvent, the creditor can either appoint a receiver to run the business and realize what is owed to the creditor or to sell the assets and recover the outstanding loan out of the proceeds of the sale.

<sup>190</sup> Gerard McCormack 'The Priority of secured Credit: An Anglo American Perspective' (2003) *Journal of Business Law* 389-419 at 391.

sell off or take possession of the debtor's assets without having to seek judicial or other official intervention.<sup>191</sup>

McCormack<sup>192</sup> goes on to say that the law permits the taking of security for several reasons. The first of these is that parties have a freedom to contract and security is considered a fair exchange for the loan.<sup>193</sup> The secured creditor is considered to have bargained for the right of a proprietary nature over the debtor's property whereas the unsecured creditors have not.<sup>194</sup> The second reason is that the debtor has the freedom of alienation and is free to sell or alienate his property.<sup>195</sup> A counter argument raised against the freedom to alienate property is that the priority of secured claims is actually inconsistent with an important principle of commercial law against non consensual subordination. According to this principle, a borrower may not subordinate one creditor's claim to that of another without the consent of the subordinated creditor.<sup>196</sup>

McCormack concludes that

although the freedom of contract theory provides some justification for the recognition of the security interests, this argument is inconclusive largely because of the existence of third parties who may be harmed by legislative or judicial acceptance of the security interest. The third parties are either involuntary creditors such as tort claimants or other creditors who are not in a position effectively to alter the terms on which they advance credit to take into account the existence of secured debt in the debtor's capital structure.<sup>197</sup>

Although the debate on priority protection of secured creditors is inconclusive as argued by McCormack, Voluntary Administration and Administration somewhat embrace the approach of the proponents of the priority of secured credit theory. This is because the level of protection that the two rescue regimes accord to fully

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<sup>191</sup> McCormack (note 190) at 391.

<sup>192</sup> Ibid.

<sup>193</sup> Ibid.

<sup>194</sup> Ibid at 394.

<sup>195</sup> Ibid.

<sup>196</sup> Ibid at 395.

<sup>197</sup> Ibid.

secured creditors is different from that accorded to the other secured creditors and the unsecured creditors. The floating charge by its very nature can have unfair effects especially when an unsecured creditor was not aware of its existence. Rajak<sup>198</sup> supports this view and explains that the security offered by a floating charge has been criticised by many quarters including the chancery bench for being unfair to unsecured creditors.<sup>199</sup>

A shifting of the balance of protection accorded to fully secured creditors as compared to other secured creditors and unsecured creditors in Australia and the United Kingdom may perhaps only be achieved by a reform on the types of security offered to creditors but an in-depth discussion of this is beyond the scope of this thesis.

Although Voluntary Administration and Administration accord priority protection to fully secured creditors over and above other secured creditors and unsecured creditors, the two regimes try to ensure that the secured and unsecured creditors also enjoy a considerable level of protection in several ways discussed later in the chapter.

In the case of Business Rescue, the question of creditor protection does not seem to have really come up as a point of discussion perhaps because Business Rescue is a new phenomenon and creditor protection issues have not been encountered thus far. It is however seems that the courts will protect the interests of all creditors even above those of the company. This inference is drawn from the Gauteng High Court's decision in the recent case of *Swart v Beagles Run Investments 25 and others*<sup>200</sup>. The Judge in this case refused to grant a business rescue application brought by the sole director and shareholder of the company because the company was

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<sup>198</sup> Harry Rajak 'The Enterprise Act and Insolvency Law Reform' (2003) vol 24(1) *Company Lawyer* 1 at 2.

<sup>199</sup>Ibid.

<sup>200</sup> 2011 (5) SA 422 (GNP).

hopelessly insolvent and that business rescue proceedings would not in any way increase the prospects of the creditors receiving more money.<sup>201</sup>

Creditor participation in all three jurisdictions generally begins with the ability to commence the business rescue proceedings. Voluntary Administration however restricts this participation to fully secured creditors who are the only creditors entitled to appoint an administrator and to commence the proceedings.<sup>202</sup> Administration and Business Rescue promote the participation of both secured and unsecured creditors in the commencement of the proceedings and the appointment of the administrator.<sup>203</sup>

The moratorium provides creditor protection in that it preserves the assets of the company during the rescue process although the duration of the moratorium and the categories of creditors to which the moratorium applies however differ.

The moratorium under the Business Rescue lasts the longest as it continues throughout the process until there is a substantial implementation of the plan or the business rescue plan is rejected.<sup>204</sup> The moratorium in Voluntary Administration and Administration ends when the deed is signed by the creditors and the company or when the proposals are approved by the creditors. Although the creditors in the two regimes can vote for the continuation of the moratorium throughout the implementation of the deed or the proposals.

The consequence of the ending of a moratorium immediately after the deed is signed in Voluntary Administration or a company voluntary arrangement in Administration, is that the fully secured creditors and third parties are free to enforce their security against

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<sup>201</sup>See (note 200).

<sup>202</sup> See S 436C of the Corporations Act (note 16).

<sup>203</sup> See SS 131(1) of the Companies Act (note 22); See Schedule B1 Paragraphs 12 and 14 of the Insolvency Act (note 89).

<sup>204</sup> See S152 (8) and 153 of the Companies Act (note 22).

the company unless they were bound by these agreements. This compromises the protection of other secured and unsecured creditors.<sup>205</sup>

The solution to this problem may perhaps be to provide that fully secured creditors, like other secured and unsecured creditors should be bound by the decision of all creditors in order for the moratorium to be effective and achieve the intended purpose. What complicates the Australian situation however is that the fully secured creditors do not actually participate in the voting except to the extent where the security is insufficient. In that case, it would seem illogical to suggest that a fully secured creditor who did not vote, ought to be bound by the deed. This remains an unsettled area that every jurisdiction ought to deal with in accordance with what best suits that jurisdiction.

Creditors are further protected by their participation in the decision making process of the rescue procedure through the creditors meetings.<sup>206</sup>

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<sup>205</sup> Michael Joseph Balzic in 'In search of a corporate Rescue Culture: A Review of the Australian Part 5.3 A Legislation' a student paper presented at the Sydney Business School HDR Student Conference in 2010 at 5 criticizes the Voluntary Administration procedure for exempting fully secured creditors from being bound by a deed unless they agree to be so bound. He writes that although the court can limit the rights of secured creditors, the same restrictions cannot be implemented on a fully secured creditor. He argues that because of this, a company in distress that enters into administration may not have any protection from banks, which may desire to enter into receivership instead of administration. He concludes that this right is subject to abuse and can potentially derail a rescue or restructuring process.

Previously, Andrew Keay in 'The new era for administrations: pointers from down under' (2005) *Insolvency Intelligence* 1 at 2 Available at <http://international.westlaw.com/result/documenttext.aspx?cnt=doc&cfid=1&eq=w> had suggested that although the fully secured creditors were not bound by the moratorium during Voluntary Administration, they did not disrupt the Voluntary Administration process by appointing a receiver but went along with Voluntary Administration because they were relatively happy with the process. Although Keay's statement may be reassuring, Balzic's criticism of the Voluntary Administration system is logical because a fully secured creditor can in fact derail the rescue process by liquidating the assets of the company. This situation leaves the company to only hope for the good will of the fully secured creditor in order to complete the rescue process, which should not be the case.

The class of creditors entitled to vote in each of the three jurisdictions, differs. In Voluntary Administration and Administration, the unsecured creditors are entitled to vote in proportion of all that is owed to them by the debtor company<sup>207</sup> while the secured creditors only vote in proportion to what remains outstanding after the valuation of the security that those creditors hold.<sup>208</sup> In the case of Business Rescue, the secured creditors vote for the whole amount that is owed to them and not only for the outstanding money that is owed to them after the security they hold is valued.<sup>209</sup> Although the reasoning for this is not clear, one would suggest that the distinction is because of the nature of the security that the secured creditors hold.<sup>210</sup>

## **4.2 Inadequate regulation and inappropriate qualification of the Rescue Practitioner**

Richard Bradstreet<sup>211</sup> quotes the Insolvency Law Review Committee<sup>212</sup> as acknowledging that ‘the success of an insolvency regime was heavily dependent on those who administered it’.<sup>213</sup> The qualifications and experience of the business rescue practitioner are cardinal in ensuring that a successful rescue is effected.<sup>214</sup>

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<sup>206</sup> See SS 436 E (2) and 439A (1) of the Corporations Act (note 16).

<sup>207</sup> See Lord Mackay (Ed) (note 141) at 238 Paragraph 280.

<sup>208</sup> Ibid at 239 Paragraph 282.

<sup>209</sup> Jonathan Rush worth ‘A Critical Analysis of the Business Rescue Regime in the Companies Act no 71 of 2008’ in Tshepo H. Mongalo’s *Modern Company Law for a Competitive South African Economy* (2010) at 401.

<sup>210</sup> The security that the secured creditors hold can further be utilised in the business rescue process, whether to earn cash for the process or in the ordinary course of doing business but the secured creditors are still protected in that when that security is disposed of, the creditors will still enjoy the priority of payment. Interestingly however *Brash Holdings Ltd v Shafir* (1994) 14 ACSR 192 and *Re T and D Industries Plc* (2000) BCC 956 show that the administrator in Voluntary Administration and Administration can also sell the creditors’ security to realise funds for the process but must provide adequate security for the secured creditors.

<sup>211</sup> Richard Bradstreet ‘The Leak in the Chapter 6 Life Boat: Inadequate regulation of Business Rescue Practitioner may adversely affect Lenders willingness and the growth of the Economy’ (2010) *Mercantile Law Journal* 195-213 at 201.

<sup>212</sup> Excerpt from the report of the Insolvency Review Committee on Insolvency Law and Practice cmnd 8558(1982) cited in Bradstreet (note 211) at 201.

<sup>213</sup> Bradstreet (note 211) at 201.

<sup>214</sup> Ibid.

Additionally, adequate mechanisms should be put in place to monitor and regulate the conduct of the practitioner as the practitioner's decisions directly influence the success of the business rescue proceedings and impact on the financial interests and livelihoods of those involved in the business rescue proceedings.<sup>215</sup>

Inadequate regulation of the administrator or practitioner can potentially derail a business rescue process and negatively affect the interests of the creditors and the company as a whole. Additionally, inappropriate qualifications of the administrator or practitioner not only cause discomfort for the creditors but may also affect the quality of the management of the business rescue process and in extreme cases, result in a failure to achieve the ultimate goal of the rescue process.

The provisions that regulate the qualifications and conduct of the administrator in Voluntary Administration, Administration and the practitioner in Business Rescue indicate the cardinal role the administrator plays in the rescue process.

#### **4.2.1 Qualifications**

In order to ensure that the practitioner or administrator is sufficiently qualified, Voluntary Administration requires an administrator to be a qualified liquidator who has consented to the appointment<sup>216</sup> while Administration requires an administrator to be qualified to act as an insolvency practitioner.<sup>217</sup> In Business Rescue the business rescue practitioner must be a member in good standing of a legal, accounting or business management profession accredited by the Commission.<sup>218</sup>

The qualifications of the administrator in Voluntary Administration have often been criticised for being inappropriate

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<sup>215</sup> Ibid.

<sup>216</sup> See SS 448 A, 448B and 448 C of the Corporations Act (note 16).

<sup>217</sup> See S 8 and Schedule 1 B1 Paragraph 6 of the Insolvency Act (note 89).

<sup>218</sup> See S138 (1) (a) of the Companies Act (note 22).

because liquidators generally have more expertise in dissolving a company than in resuscitating it and are considered to not be the best persons to carry out an Administration.

Bradstreet<sup>219</sup> in commenting on the proposals made in the Companies Bill<sup>220</sup> to include liquidators as persons qualified for appointment as business rescue practitioners, compared the appointment of a liquidator as a business rescue practitioner to ‘appointing an executioner to act as a nurse or a paramedic’.<sup>221</sup> Bradstreet suggested that ‘qualifications of a practitioner should not only relate to academic qualifications but also to impartiality, skill and ability to perform the functions and duties of the practitioner properly’.<sup>222</sup>

While this may be a perfectly logical argument, the decision by the Australian Legislature to require an administrator to be a registered liquidator may have stemmed from the Australian Government’s desire to keep Voluntary Administration simple and straightforward. It may also have been impractical to require the emergence of a new profession of business rescue experts at the time the legislation was passed. In spite of the criticism on the qualifications of the administrators, Voluntary Administration has emerged as the principle corporate rehabilitation procedure in Australia since its introduction in 1993.<sup>223</sup>

#### **4.2.2 Regulation of the Practitioner**

Several mechanisms have been put in place in the three regimes to regulate the conduct of the administrator and practitioner.

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<sup>219</sup> Bradstreet (note 211) at 207.

<sup>220</sup> This was the Bill that was, after amendments, passed by parliament as the Companies Act no 71 of 2008.

<sup>221</sup> Bradstreet (note 211) at 207.

<sup>222</sup> Ibid at 201.

<sup>223</sup> See the report of the Corporations and Markets Advisory Committee in Australia (CAMAC) submitted to the Australian Parliament’s Joint Committee on Corporations and Financial services in October 2004 *Available at* <http://www.camac.gov.au/camac/camac.nsf/0/3DD84175EFBAD69CCA256B6C007FD4E8?opendocument> [accessed on 5<sup>th</sup> December 2011].

#### 4.2.2.1 Supervision by the Court

An administrator in Voluntary Administration is subject to the court's supervision and the court has the power to make an appropriate order where the administrator does an act or omits to act as the administrator ordinarily should.<sup>224</sup>

Similarly, the conduct of an Administrator in Administration is liable to regulation by the court through hearing an application made by a creditor, in which the conduct of the administrator is challenged.<sup>225</sup> The administrator's conduct can be challenged on the grounds that the administrator is acting or proposes to act unfairly to harm the interests of the applicant or those of other creditors. A challenge can also be premised on the ground that the administrator is not performing his functions as quickly or as efficiently as is reasonably practicable.<sup>226</sup>

A creditor can also bring misfeasance proceedings against an administrator.<sup>227</sup> Jeremy Goldring et al write that<sup>228</sup>

where the unsecured creditor shows that the administrator breached a fiduciary or other duty in relation to the company or that the administrator has been guilty of misfeasance, the administrator may be required to compensate the estate.

Additionally, an administrator is an officer of the court and is accordingly regulated by the court.<sup>229</sup> The court also regulates the conduct of the administrator by exercising its express powers to examine the conduct of the administrator.<sup>230</sup>

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<sup>224</sup> See SS 477E and 477 E(1) of the Corporations Act (note 16) ; See also *Cawthorn v Kiera Construction PTY Ltd* (note 104).

<sup>225</sup> In *Kyrris v Oldham* (2004) BCC 111, the court set out the common law and equitable duties owed by the administrator to all creditors. The court also confirmed that the administrator's conduct can be challenged.

<sup>226</sup> See Schedule B1 Paragraph 74(1),(2) and(3) of the Insolvency Act (note 89).

<sup>227</sup> See Schedule B1 Paragraph 74 of the Insolvency Act (note 89).

<sup>228</sup> Jeremy Goldring et al 'Rescue and reconstruction' (2002) *Insolvency Intelligence* 75 at 78.

<sup>229</sup> In *Ex Parte James* (1874) LR 9ch APP 609 the court stated that an administrator is an officer of the court who is subject to the control of the court and also to the ethical requirements imposed in this case.

<sup>230</sup> See Schedule B1 Paragraph 95 of the Insolvency Act (note 89).

Under Business Rescue, the practitioner is also considered to be an officer of the court and subject to the direction and control of the court.<sup>231</sup> The practitioner is expected to follow the direction of the court on any matter relating to Business Rescue.

#### **4.2.2.2 Liability imposed on the Rescue Practitioner.**

The liability imposed on the administrator and practitioner serves to regulate the conduct of these persons. Section 433 A of the Corporations Act<sup>232</sup> imposes a personal liability on the administrator for all the debts that the administrator incurs in the course of the administration of the company for services rendered, goods bought or property which is hired, leased, used or occupied. Although the Administrator may be liable in the instances, set out in section 443A, that liability is in most instances mitigated by the provisions of section 443D, which allow an administrator to be indemnified.

Michael Balzic<sup>233</sup> criticises the imposition of liability on the administrator. He argues that although the threat of liability is important to ensure that the administrator carries out his duties properly and diligently, it is also clear that the administrator serves a broad spectrum of interests of creditors which can in some instances be a daunting task. Balzic adds that this may negatively influence administrators to behave 'in an unnecessary risk averse manner' which would inevitably prevent the successful rescue of a company.

Although the concerns expressed by Balzic on the imposition of liability, ought to be taken into account, it must be appreciated that the imposition of liability is essential to ensure that the administrator conducts all duties and functions according to the statutory prescription. Additionally, the imposition of liability compels the administrator to fulfil his obligations with responsibility and in observance of the duty of care to the creditors and the company as a

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<sup>231</sup> See S140 (3)(a) of the Companies Act (note 22).

<sup>232</sup> See the Corporations Act (note 16).

<sup>233</sup> Balzic (note 205) at 8.

whole. The removal of liability could encourage a mediocre attitude among administrators and would possibly plunge companies capable of rescue, into liquidation.

A practitioner in Business Rescue is subject to the responsibilities and liabilities of a director as set out in sections 75 to 77 of the Companies Act.<sup>234</sup> The practitioner is however exempted from liability which may arise from another law, if that act or omission complained of was done in the course of the practitioner's duty and it was done in good faith. The practitioner will however be liable if that act or omission amounts to gross negligence.

Bradstreet<sup>235</sup>, while supporting the imposition of liability on a practitioner, argues here that the standard of gross negligence is too high and may accord the practitioner an avenue of escape for an act or omission that the practitioner should ordinarily have been liable for. Bradstreet<sup>236</sup> suggests that the threshold should be lowered so that the practitioner is subject to the same restrictions placed on directors.<sup>237</sup> In his view, the benchmark should be the ordinary skilled insolvency practitioner.<sup>238</sup>

Bradstreet's<sup>239</sup> argument on the need to lower the threshold of negligence, to that applied to directors because the office of an administrator bestows enormous powers on an administrator, which ought to be regulated, is logical. This is because the practitioner practically determines the future of the company and of all affected persons. The responsibility is a serious one and requires a high standard of accountability and care.

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<sup>234</sup> See S140 (3) (b) of the Companies Act (note 22).

<sup>235</sup> Bradstreet (note 211) at 209.

<sup>236</sup> *Ibid.*

<sup>237</sup> *Ibid.*

<sup>238</sup> *Ibid.*

<sup>239</sup> *Ibid.*

#### **4.2.2.3 Regulation by other Institutions**

An administrator in Voluntary Administration is also subject to the regulation of the Australian Securities Investments Commission to which the administrator must be registered as a liquidator. This Commission supervises the administrator but not to the same extent as the court would. An administrator appointed in Administration is regulated by the European Union Regulation on Insolvency proceedings of 2000 and by the professional body to which the administrator is registered as an insolvency practitioner.<sup>240</sup>A business rescue practitioner is also regulated by the professional body to which that practitioner is registered.

The various professional bodies to which administrators and practitioners are registered play a major role in ensuring that administrators and practitioners are not only qualified and independent but also perform their duties with reasonable care, due diligence and integrity. The regulation provided by these professional bodies is cardinal because they have rules of ethics and conduct to which the members must adhere. A serious breach of these rules will in most cases result in suspension from the professional body or a complete revocation of that member's practicing license. The revocation of a practicing license would, for any member, be an indirect deprivation of a steady source of income, which any member of such a professional body would by all means try to avoid.

#### **4.2.2.4 The role of creditors**

As earlier discussed, the creditors of the company not only regulate the conduct of the administrator and practitioner but also promote accountability.<sup>241</sup>

In Voluntary Administration and in Business Rescue, the creditors' power to appoint or reject an administrator or practitioner

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<sup>240</sup> See the Insolvency Act (note 89).

<sup>241</sup> McCormack (note 27) at 62.

nominated by the company ensures that the administrator or practitioner is qualified and skilled to deliver.

#### **4.2.2.5 Other measures**

The practitioner, under the Business Rescue is also regulated by the requirement to provide security for an amount and on conditions made by the court. This order may be made to secure the interests of the company and any affected persons.<sup>242</sup> While this is an excellent provision to regulate the conduct of the practitioner, Loubser<sup>243</sup> suggests that the implementation of the requirement should not be by an order of the court but rather a precondition for the practitioner's appointment. This is because the practitioner not only holds wide powers but also a position of trust.

Loubser's reasoning is logical because the interests of the creditors and the company should be automatically protected and not reliant only on an order of the court.

### **4.3 Unregulated use of post commencement finance**

The use of post commencement finance is another potentially problematic area in a business rescue process where it is not properly regulated. Post commencement finance is one of the most important aspects of business rescue as new financing after a company commences business rescue proceedings is 'critical to the survival and turn around of the company's business'.<sup>244</sup> Unless new finance is available, the assets of the company may have to be sold on a piecemeal basis and the company forced into liquidation.<sup>245</sup>

New finance is required because in many cases where [rescue proceedings] are commenced, the existing lenders or creditors may terminate the debtors access to funds in order to limit their future

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<sup>242</sup> Section 130 (1) (c) of the Companies Act (note 22).

<sup>243</sup> Loubser (note 181) at 689.

<sup>244</sup> Cassim (note 14) at 793.

<sup>245</sup> Gerard McCormack 'Super priority new financing and corporate rescue' (2007) *Journal of Business Law* 1 at 1.

exposure.<sup>246</sup> The company in such a case needs funds to finance its operations until a satisfactory arrangement with creditors is negotiated and approved.<sup>247</sup> The post commencement finance additionally covers the costs of insolvency and legal professionals in those proceedings.<sup>248</sup>

The use of post commencement finance in a business rescue often results in super priority being given to post commencement financiers over unsecured creditors. The question of super priority does not arise in post commencement finance when a company has sufficient unencumbered assets that can provide sufficient security to the lenders.<sup>249</sup> When the question of super priority arises, questions of the fairness in allowing the claims of post commencement financiers to override those of pre commencement financiers are often raised.<sup>250</sup>

The United Kingdom and Australia<sup>251</sup> have not made provision for post commencement finance or super priority. The United Kingdom Government left post commencement finance matters to the markets to decide on which corporate debtor to lend to.<sup>252</sup> In spite of this provision, an administrator can however obtain post commencement finance and apply to the court that that loan be considered an administration expense, which can then enjoy super priority. The court allowed such an application in the case of *Bibby Trade Finance Ltd v McKay*.<sup>253</sup>

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<sup>246</sup> Ibid.

<sup>247</sup> Ibid.

<sup>248</sup> Janis Sarra 'Financing Insolvency restructurings in the wake of the financial crisis: stalking horses, rogue white knights and circling vultures' (2011) *Penn State International Law Review* 1 at 1.

<sup>249</sup> McCormack (note 245) at 2.

<sup>250</sup> Ibid.

<sup>251</sup> Balzic (note 205) at 6 criticizes Voluntary Administration for not providing for post commencement finance and super priority lending to promote the availability of finance for an ailing company. He adds that the lack of super priority ranking constrains banks from playing a facilitative role and encourages them to focus on negotiating strategies that protect them and their interests.

<sup>252</sup> McCormack (note 245) at 15.

<sup>253</sup> (2006) All Er 266.

Business Rescue however provides for post commencement finance, an idea which seems to be imported from the US Bankruptcy code which provides that ‘any credit extended to the debtor company during the reorganization process has priority over all unsecured claims.’<sup>254</sup>

Section 135 of the Companies Act tries to persuade possible financiers to provide finance to companies in distress in exchange for preferential repayment of that finance.<sup>255</sup> This finance may be secured to the lender by the use of the company’s unencumbered assets and will be paid after the practitioner’s remuneration, expenses and the employee post commencement financiers are paid.<sup>256</sup> Although the post commencement creditors rank above the unsecured creditors, they remain below the secured creditors.<sup>257</sup> The post commencement financiers enjoy preference in repayment in the order in which the finance was provided to the company.<sup>258</sup>

Andrew Hutchison<sup>259</sup> explains that the post commencement finance [as provided for in the Companies Act] shows signs of being favorable to secured creditors because the interests of the secured creditors are taken into consideration. This is evident from the balance that Section 135<sup>260</sup> strikes in favour of secured creditors.

Although the favourable treatment of secured creditors over unsecured creditors can be justified, the fact remains that the super priority accorded to post commencement financiers infringes on the

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<sup>254</sup> See S 364 of the United States Bankruptcy Code, which provides that where the extension of the credit is in the ordinary course of business, then priority is automatic whereas if done outside the ordinary course, then the priority must be authorized by the court prior to the granting of the credit. In section 364(d) the court can, in narrowly defined circumstances, permit a company to obtain post commencement finance and grant super priority over pre filing secured creditors.

<sup>255</sup> Bradstreet (note 185) at 359.

<sup>256</sup> See S 135 (3) of the Companies Act (note 22).

<sup>257</sup> Ibid.

<sup>258</sup> Ibid.

<sup>259</sup> Andrew Hutchison ‘business rescue- How secure is the secured creditor?’ (2011) Unpublished Article 1 at 24.

<sup>260</sup> Section 135 of the Companies Act (note 21) provides that post commencement financiers will rank below the secured pre commencement creditors.

rights of the pre commencement unsecured creditors. While post commencement finance and super priority are necessary to ensure that adequate finance is availed to the ailing company in order to facilitate that company's recovery, little or nothing is done to protect the unsecured creditors.

Jonathan Rushworth<sup>261</sup> explains that the alternative to the super priority provision in the Companies Act is to rely on pre-commencement lenders to fund the proceedings. He however highlights the potential problem with this approach. This would be that the pre-commencement finance documents may prohibit the company from utilizing the security to obtain further finance without the consent of the existing lenders, which lenders can, or can not grant the permission required.<sup>262</sup> This, in his view, would ultimately leave the rescue of a company to the mercy of such lenders.<sup>263</sup>

The arguments in support of post commencement finance and those against are both logical and valid. The plight of the unsecured creditors is that they are pushed further down the repayment queue by the post commencement financiers and this is a genuine concern.

The question that one might however ask is whether the unsecured creditors in first place have a chance of getting what is owed to them without the company obtaining any post commencement finance during the rescue process. Where this question is answered in the affirmative, I too would argue that post commencement finance would then be unjustified and would unfairly prejudice the rights of the unsecured creditors. Where the question is answered in the negative, and which in most cases would be the case, I would support the need to obtain this finance to help the company along. In most cases, post commencement finance will be necessary

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<sup>261</sup>Rushworth (note 209) at 368.

<sup>262</sup> Ibid.

<sup>263</sup> Ibid.

to facilitate business rescue and should not be viewed with suspicion as being disadvantageous to the unsecured creditor. In some instances, it may be the only way that the unsecured creditors would be able to even receive a fraction of what is owed to them by the company in financial distress. In such instances, the intrusion on the unsecured creditors' rights may therefore be justified.

That said, post commencement finance is capable of being abused and misused. It is therefore important for the practitioner's use of post commencement finance to be regulated in order to ensure that this finance is obtained for the correct reasons and not to further the interests of a few creditors over those of the majority.

Chapter five will now consider the suitability of the business rescue regime in the three jurisdictions to the *Zambian* environment. The chapter focuses on essential business rescue components as adapted from these jurisdictions and proposes a modified application of these in order to achieve an effective business rescue regime.

## **CHAPTER FIVE- THE PROPOSED BUSINESS RESCUE LAW FOR ZAMBIA**

This chapter discusses the business rescue law that Zambia should enact.

The first part of the chapter discusses the main components of business rescue law that the policy makers and legislature will have to take into account when structuring the business rescue law for the country.

The second part of the chapter discusses further provisions that may need to be included in the Companies Act<sup>264</sup> in order to support the business rescue law whilst the last part of the chapter discusses the potential challenges that Zambia is likely to face in the implementation of the business rescue law.

One aspect that the three jurisdictions reviewed have in common is that they have bigger economies than Zambia, bigger companies and that these companies contribute more to the GDP of the economies of these countries than companies incorporated in Zambia do to the Zambian economy.<sup>265</sup>

Against that background, one would then ask why a country like Zambia would need a business rescue regime. Another question that one would ask is whether a business rescue regime in Zambia is workable and necessary.

Statistics obtained from PACRA show that as at August 12<sup>th</sup> 2011, 40,324 small enterprises with a nominal capital of 5,000,000 to 20,000,000 kwacha (US \$ 1,000 – 4,000), 874 medium enterprises with a nominal capital of 20,000,000 to 50,000,000 kwacha (US

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<sup>264</sup> See (note 7).

<sup>265</sup> According to the International Monetary Fund list of countries' gross domestic product in 2010, the United Kingdom ranks at number 6 with a GDP of 2,250,209 million dollars, Australia is at number 13 with 1,237,363 million dollar, South Africa is at number 29 with a GDP of 363,655 and Zambia is at 105 with a GDP of 16,192 million dollars. Available at [www.en.wikipedia.org/wiki/list\\_of\\_countries\\_by\\_GDP\\_\(nominal\)](http://www.en.wikipedia.org/wiki/list_of_countries_by_GDP_(nominal)) [Accessed on 28<sup>th</sup> November 2011].

\$4,000- 10,000) and 1,229 large enterprises with a nominal capital of 50,000,000 kwacha (US \$10,000 and above) were registered under the Companies Act. The statistics also show that 1,489 foreign companies have been registered under the Companies Act.<sup>266</sup>

Although the statistics show that majority of the enterprises in Zambia are small, a substantial number of medium and large enterprises also exist in Zambia, which may from time to time require business rescue. Additionally, the foreign companies also registered in Zambia would require the facility of business rescue.

As discussed in chapter one, business rescue is essential in that it not only ensures the survival and continued existence of a company but also ensures that the company continues to contribute to the growth of the economy through the payment of taxes, the provision of other services and the creation of employment opportunities.

While it is true that most enterprises in Zambia are small and may not afford the expenses associated with business rescue, that should not prevent the country from putting legislative mechanisms to facilitate business rescue. I would further argue that the medium enterprises, large enterprises and the foreign companies registered under the Companies Act may require this facility and this justifies the enactment of a business rescue law in Zambia.

Additionally, chapter two of this thesis attempted to bring out the numerous weaknesses with the existing mechanisms of receivership and scheme of arrangements in the Companies Act and exposed the need for reform.

Pieter Kloppers<sup>267</sup> writes that 'it is widely recognized today that small and medium companies play an important role in the economy

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<sup>266</sup> Statistics obtained from PACRA as at 12<sup>th</sup> August 2011.

<sup>267</sup> Pieter Kloppers 'Judicial management-A Corporate Rescue Mechanism in need of reform' (1999) *Stellenbosch Law Review* 417 at 425.

of any developing or developed economy and because of this, a small company is as worthy of a corporate rescue as a big company with many employees'.<sup>268</sup>

As can be seen from the overview of the business rescue regimes in Australia, South Africa and the United Kingdom, each business rescue regime is similar to the others but different in some aspects in order to suit the unique needs of the country. It would therefore be extremely unwise for Zambia to simply transplant one of these regimes and then implement it. The legislature and the policy makers must therefore come up with a rescue mechanism that meets the needs of the Zambian business environment, the size and type of registered companies and the planned national growth through the National development plan. Judging from the rare usage of the scheme of arrangements<sup>269</sup> under the Companies Act, the business rescue law to be enacted will also need to be cost effective so that a wide range of companies may be able to utilise the mechanism.

As pointed out in chapter two, attempts at enhancing accountability in receiverships have been made through legislative reform in the Companies Amendment Act<sup>270</sup>. The rationale of these amendments was to regulate receivership and the fees charged for the receivers services. In as much as the aim was good, it did not remedy the attendant inadequacy of receivership as a 'business rescue' mechanism.

In light of this, I suggest the amendment of the part regulating receivership to oblige a receiver and manager to consider the prospects of rescuing the business during receiverships.

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<sup>268</sup>Kloppers (note 267) at 425.

<sup>269</sup> One possible explanation for the rare usage of the scheme of arrangements under the Companies Act as discussed in chapter two of this dissertation would be the expenses involved in the whole process. The unavailability of records can also be due to non compliance in filing all court orders at PACRA.

<sup>270</sup> Act no 24 of 2011.

I further propose the introduction of a new comprehensive part on business rescue in the Companies Act. The subsequent discussion outlines the suggested components of this business rescue law.

## **5.1 Main components of the Zambian Business Rescue Law.**

Rajak<sup>271</sup> discusses six common components of a modern business rescue regime.<sup>272</sup> This part of the chapter discusses these components and where appropriate, make suggestions that the legislature and the policy makers may consider when enacting the business rescue law in Zambia.

### **5.1.1 The Companies to be protected**

The business rescue law must firstly prescribe the types of companies that it will apply to.

I would propose that business rescue in Zambia should only apply to companies registered under the Companies Act as is the case in Australia and South Africa. This is because the Bankruptcy Act<sup>273</sup> already regulates individuals who are bankrupt whilst the Banking and Financial Services Act<sup>274</sup>, the Insurance Act<sup>275</sup> and the Pensions Scheme Regulation Act<sup>276</sup> regulate insolvent banks, insurance companies and pension schemes respectively. A detailed discussion into the rescue provisions included in these pieces of legislation is however beyond the scope of this dissertation.

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<sup>271</sup> Rajak (note 1) at 270.

<sup>272</sup> These components relate to: (a) the type of entity or entities to be subjected to business rescue; (b) the mechanism by which eligible entities move from unprotected to protected status; (c) how heavy the burden of showing the likelihood of success should be; (d) what the nature of the protection should be; (e) how and by whom the business debtor should be administered during the protection period; (f) by what process it is to be determined that a rescue has been effected and that the debtor should emerge from the protective regime.

<sup>273</sup> See Chapter 82, Laws of Zambia.

<sup>274</sup> See Chapter 387, Laws of Zambia.

<sup>275</sup> Act no 27 of 1997.

<sup>276</sup> Act no 28 of 1996.

Additionally, the business rescue law must be simple and flexible enough to apply to a wide range of companies under the Companies Act.<sup>277</sup>

In designing a business rescue regime it is important to firstly design provisions that are appropriate for small enterprises and then add on provisions that are necessary for larger enterprises.<sup>278</sup>

Although what is termed as a small company in the United Kingdom may in certain instances be the size of a large company in Zambia<sup>279</sup>, the important point made by McCormack is that a business rescue regime should be simple enough to be utilised by both small and large companies.

### **5.1.2 Who should invoke the moratorium and commence business rescue**

Careful consideration must be taken in deciding on who should trigger the moratorium and the entire process of business rescue. Additionally, the procedures must adequately protect the rights and interests of the creditors.

In support of this, Rajak<sup>280</sup> points out that framing legislation which allows the suspension of a creditor's right to seek enforcement of a debt owed by the debtor is a sensitive matter as the creditor ordinarily has the right to demand the payment of what a debtor owes.<sup>281</sup> Protecting a debtor from the enforcement simply means that the rights of the creditor and the contractual principle of sanctity of contract are interfered with.<sup>282</sup>

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<sup>277</sup> See (note 7).

<sup>278</sup> Gerard McCormack 'Rescuing small businesses: designing an "efficient" legal regime'(2009) *Journal of Business Law* 1 at 9

<sup>279</sup> This conclusion is premised on the definition of a small company in England in this Article. It is one that satisfies two out of three conditions.(a)turn over is less than 6.5 million Pounds;(b)the balance sheet is less than 3.26 Million Pounds ;or (c) has fewer than 50 employees.

<sup>280</sup>Rajak (note 1) at 273.

<sup>281</sup>Ibid.

<sup>282</sup>Ibid.

Although court involvement in the commencement of the proceedings would seem necessary to protect the interests of the creditors, the expenses that a person would have to incur to initiate a moratorium and rescue proceeding where the commencement is court based should also be considered.

‘Out of court’ and ‘court based’ commencements should therefore be balanced and the number of people that commence the business rescue process needs to be regulated.

Zambia requires a cost effective rescue regime which is simple to commence but which will adequately protect the interests of the creditors. I would suggest that Zambia partially adopts the Voluntary Administration mode of commencing business rescue. This would entail that the directors of the company, a fully secured creditor or a liquidator be the persons to commence business rescue.

Additionally, I would also recommend that in a case where no fully secured creditor exists among the creditors of a company, creditors who are owed at least fifty percent of the company’s debts should be permitted to commence business rescue.

Further, the court should have overall supervisory powers to oversee the whole business rescue process and to hear applications arising out of the process. In this way, the commencement procedure will be less expensive, restricted only to the category of persons mentioned, and will prevent frivolous and vexatious proceedings.

I would also suggest that the interests of the employees and the shareholders are taken into account, as is the case in Business Rescue in South Africa. Where the employees and shareholders have reasonable belief that a company is insolvent or about to become insolvent, they should have the right to petition the board to consider commencing business rescue. Where the board does not respond favorably and continues to trade, shareholders and employees should be entitled to bring an action against the board for insolvent trading

which should be an offence included in the Companies Act. The Companies Act does not currently provide for this but an inclusion of such a provision would oblige the board to act appropriately in order to avoid the sanctions for the commission of this offence.

### **5.1.3 Who should show that the company is capable of being rescued?**

The requirement to show the likely success of business rescue will vary depending on which category of persons commence business rescue.

A common feature of the three business rescue regimes<sup>283</sup> discussed is that an entity is entitled to commence business rescue only if it is capable of being rescued.<sup>284</sup> This is the only way that it would make business sense to commence the business rescue procedure. Further, the aim in all three regimes is to rescue the company as a going concern and in the alternative, to ensure that the creditors get a better return than they would have, had that company been immediately liquidated.<sup>285</sup>

The board's decision to enter into business rescue should clearly show that this consideration was taken into account and that in their reasonable opinion, the company could be rescued. This requirement will serve to protect the interests of the creditors as it will prevent directors from avoiding the fulfillment of obligations to creditors on the pretext of entering into business rescue where it is evident that a company cannot be rescued.

The liquidator, when commencing business rescue proceeding must also be required to show that he addressed his mind to the existing company's assets and liabilities and concluded that there is a

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<sup>283</sup> Australian Voluntary Administration, the United Kingdom's Administration and South Africa's Business Rescue.

<sup>284</sup> See S 436 A of the Corporations Act (note 16) and S 128 of the Companies Act (note 22).

<sup>285</sup> See S 435A of the Corporations Act (note 16); Schedule B1 Paragraph 3(1) of the Insolvency Act (note 89) and S128 (1) (b) (iii) of the Companies Act (note 22).

likelihood that the company could be rescued or that a better return could be realized for the creditors. This evidence should then be given to the creditors to justify the moratorium and the suspension of the creditors' rights.

However, all creditors, whether fully secured, secured or unsecured must not be required to show that the company is capable of being rescued but only that they are entitled to commence the business rescue process. This is because it may not be easy for the creditors to obtain such information from the board as the board may not always cooperate with creditors.

#### **5.1.4 To which creditors and to what extent the moratorium must apply**

As discussed in chapter four, there are three main types of creditors namely the fully secured, secured and unsecured creditors. It is clear that the moratorium should bind the unsecured creditors and the secured creditors who do not hold a floating charge over all the assets of the company. The biggest question that remains to be answered is whether the moratorium should also cover a fully secured creditor.

Zambia, like Australia and the United Kingdom, has a credit and security system of the floating charge. As earlier discussed<sup>286</sup>, the floating charge has been criticised as affording the fully secured creditor more security and leverage to disrupt the rescue proceedings.

Considering the arguments that have been expressed in support of the moratorium binding the fully secured creditor and those against it, the legislators and the policy makers will have to make a choice between the two available options.

The first option will be to adopt the Voluntary Administration approach where the moratorium applies to the unsecured creditors

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<sup>286</sup>See item 4.1 in chapter four of this dissertation.

and all other secured creditors that are not fully secured. This will reserve the fully secured creditor's right to commence receivership proceedings before business rescue commences. It will also mean that the fully secured creditor would not be bound by any moratorium after the business rescue plan is approved and will be able to enforce the security covered by that charge. As earlier pointed out, the problem with this is that business rescue will wholly rely on the good will of the fully secured creditor.

The second option would be to follow the steps taken by the United Kingdom and abolish receivership except in exceptional cases. This will compel a fully secured creditor to see the rescue process through as that will be the only way that the fully secured creditor will be able to realise the value of the floating charge or the money owed to the fully secured creditor by the company. This approach may not be received well by fully secured creditors as they may feel that they are being forced into a business rescue procedure when an easier option would be to initiate receivership.

I would recommend the adoption of the first option especially if the part regulating receivership in the Companies Act is amended. This is because even when the floating charge holder invokes receivership, the receiver would be statutorily obliged to consider the prospects of rescuing the business.

I would also suggest that the moratorium should apply until the rescue practitioner determines whether a full or partial rescue of the company is possible. Where the rescue is possible, the moratorium should apply through out the implementation of the rescue plan. Where it is not possible, the moratorium should end and the company should then be liquidated and the proceeds paid to the creditors in order of preference.

### **5.1.5 How and by whom should the business be administered during the moratorium period.**

In Voluntary Administration and Administration, the company and the business as earlier said<sup>287</sup> is administered by an administrator who, in Voluntary Administration, is a liquidator and in Administration, an insolvency practitioner. In Business Rescue, the business rescue practitioner administers the company and the business during the whole rescue process. The practitioner is a person who is a member in good standing of a legal, accounting or business management profession and accredited by the Companies Commission.

I would suggest that the qualifications of the practitioner be as those set out in the South African Companies Act. The practitioner should either be a lawyer, an accountant or a business manager with experience in company rescue or related areas of law. In my view, liquidators may not be the best persons to rescue a company because they have more expertise in company dissolution than resuscitation.

I would further suggest that the rescue practitioner be considered an officer of the court and be regulated by the court. Additionally, the practitioner should be regulated by the professional body to which the practitioner is a member, in order to ensure that the practitioner performs all duties with integrity and observes the ethics of that profession.

The practitioner should be in charge of the management of the company but that the directors and other officers should remain in office to assist the practitioner. The practitioner should also perform the duties of a director and have the same liability as that imposed on directors of the company for acts or omissions done in the course

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<sup>287</sup>See chapter three of this dissertation.

of duty in order to ensure that the practitioner performs to the expected standard.<sup>288</sup>

### **5.1.6 The role of the business rescue plan**

I suggest that the rescue of a company in Zambia should likewise be conducted through a rescue plan that sets out how the rescue will be conducted and the procedures to be followed in detail. I would further suggest that the moratorium must continue to apply during the implementation of the rescue plan in order to protect the assets of the company throughout the process and to ensure that the assets are utilised to support the rescue.

This is consistent with the position in all three jurisdictions discussed

## **5.2 Other suggested amendments to the Companies Act to enhance Business Rescue.**

If the policy makers and the legislature decide to enact business rescue legislation, they may also need to amend the Companies Act to include further provisions that will promote a rescue culture particularly among the directors of the company as they are usually the first people to observe the early signs of company insolvency.

### **5.2.1 A provision to prohibit insolvent trading**

Kloppers<sup>289</sup> suggests that a corporate rescue regime should encourage directors to enter the corporate rescue procedure early enough to increase the chances of success. Making directors liable for debts incurred when they allow a company to trade in insolvent

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<sup>288</sup> Compare with the Statutory Instrument no 27 of 2011 which regulates the accreditation and registration of receivers and liquidators in Zambia.

<sup>289</sup>Kloppers (note 267) at 431.

circumstances would be an incentive for the directors to seek corporate rescue remedies sooner.<sup>290</sup>

I concur with Kloppers' view on the need for the prohibition of insolvent trading and the imposition of liability on directors who trade an insolvent company. I would suggest that a similar provision is included in the Companies Act to compel directors to be more diligent and to seek adequate assistance at the first sign of insolvency in the company.

### **5.2.2 A provision preventing the formation of phoenix companies**

A phoenix company is one formed by directors who have failed to properly operate one company and to escape honoring that first company's agreements and obligations to creditors', form the second company. The English Insolvency Act<sup>291</sup> contains a provision that curbs the setting up of phoenix companies. The provision prohibits a director of an insolvent company that has gone into liquidation from being a director or a shadow director of a second company using the same or similar name to the failed company for a period of five years.<sup>292</sup>

Although the Insolvency rules provide exceptions<sup>293</sup>, Kloppers suggests that the provision helps to curb the 'undesirable practice of unscrupulous businessmen reinventing themselves while leaving a mass of unpaid debts in their wake.'<sup>294</sup>The provision applies automatically, without the need to prove the director's guilt or blame

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<sup>290</sup>Ibid.

<sup>291</sup>See the Insolvency Act (note 89).

<sup>292</sup> See S216 of the Insolvency Act (note 89).

<sup>293</sup> The Insolvency Rules provide for three exceptions. The first is where the successor company buys the whole or substantially the whole of the business from the insolvency practitioner acting in respect of the first company in liquidation. The second is where a director seeks the leave of the court to act as the director of the second company. The third is where the second company was known by the relevant name for the whole of the twelve months prior to the liquidation of the first company and the former must not have been dormant for any portion of these twelve months.

<sup>294</sup>Kloppers (note 267) at 431.

worthy conduct. The penalty for the breach of this provision is that of a fine, imprisonment or both.<sup>295</sup>

I would suggest that such a provision is included in the Companies Act. It will encourage directors to be more responsible in handling the affairs of the company in order to avoid the prohibition of holding a position of director in a future company.

### **5.2.3 Miscellaneous Provisions**

The business rescue law should, as discussed in chapter four, also include provisions to ensure that the creditors are adequately protected and are availed an opportunity to participate in the rescue process. Additionally, the business rescue law must also include a provision to regulate the practitioner's use of the post commencement finance.

## **5.3 Possible challenges in enacting and implementing the Business Rescue Legislation**

The prospects of enacting business rescue legislation may to those who appreciate the inadequacies of receivership and the scheme of arrangements, offer a possible solution for the rescue of future insolvent or near insolvent companies in Zambia. The same cannot be said about those who perceive receivership and the scheme of arrangements to be adequate however.

In spite of these two possible divergent views, the benefits of business rescue have been highlighted throughout this dissertation. If Zambia embarks on the enactment of business rescue legislation, the legislature, policy makers and the implementers of the law may however encounter several challenges.

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<sup>295</sup> See S 216(4) of the Insolvency Act (note 89).

### **5.3.1 Changing the mindset of the creditors**

One of the major challenges that may be faced with the introduction of this law will be to change the mindset of the creditors and get them to appreciate the positive attributes of business rescue. A creditor's main concern is to get back what is owed by the debtor. Banks are often the major creditors of a business and have a lot of power in cases of insolvency. A bank, by virtue of being a major creditor with the overwhelming majority of votes, decides the future of a company by either choosing business rescue or liquidation even when other creditors are willing to be lenient to the debtor.<sup>296</sup>Banks can sometimes be merciless in their attempt to recover loans even in situations where there is no actual insolvency but only commercial insolvency.<sup>297</sup>The suggestions made earlier in the chapter to enhance receivership will address this problem and provide an enhanced receivership regime as an alternative to business rescue.

### **5.3.2 Judiciary's ability to handle business rescue cases**

It was previously indisputable that the judiciary comprised of learned lawyers with expertise in various fields of law. In the recent past however, the competence and capability of some of the judges has been questioned by the Law association of Zambia (LAZ).<sup>298</sup>This recent development coupled with the fact that business rescue will be a new concept which many judges may not be familiar with raises concern about the Judiciary's ability to adjudicate over business rescue matters. It may therefore be necessary to conduct some workshops so that the judiciary appreciates the intricacies of business rescue and its objectives.

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<sup>296</sup>Kloppers (note 267) at 427.

<sup>297</sup>Ibid

<sup>298</sup> See the Article 'Judiciary is facing a leadership challenge...LAZ wants inept Judges removed' in Post Newspaper, Vol 5568, 16 January 2012 at 1 where the LAZ President was quoted as saying that the performance of some of the judges left much to be desired. Available at [www.postzambia.com](http://www.postzambia.com)

It should be noted that a commercial list at the High Court for Zambia registry dealing specifically with adjudication of corporate disputes was introduced in 1990.<sup>299</sup> As such, there is still room for a more in depth knowledge in the adjudication of corporate aspects such as business rescue proceedings.

### **5.3.3 Legal practitioners' ability to handle business rescue cases**

The ability of the legal practitioners to adequately handle business rescue cases may be another challenge that may be faced in implementing the business rescue law. As previously discussed business rescue will be a new concept that many lawyers may not be embraced with. This challenge is further compounded by the fact that business rescue has not been taught in the past as part of the company law course at the local universities in Zambia.<sup>300</sup> As a short term measure, it may be necessary to conduct workshops for legal practitioners to understand the concept of business rescue to equip them to adequately handle their clients' court cases. Additionally, as a long term measure, local universities should be encouraged to incorporate insolvency law into their curricular and encourage specialization in insolvency law.

### **5.3.4 Availability of business rescue practitioners**

The availability of rescue practitioners will also be another challenge. Although I have recommended that the practitioners should be lawyers, accountants and business managers, these too need to have the relevant experience in the area of business rescue.

The few lawyers, accountants and business managers that may have the necessary expertise may charge exorbitant fees, which may then defeat the whole purpose of business rescue. The government

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<sup>299</sup> This was facilitated by Statutory Instrument no 29 of 1999, which amended the High Court Rules.

<sup>300</sup> A review of company law course outline at UNZA, the leading University in Zambia, has revealed that the teaching of business rescue begun only this year.

may have to step in to regulate the fees<sup>301</sup> that the practitioners will charge in order to ensure that the companies in need of assistance are not exploited. This is the practice in South Africa.

### **5.3.5 Availability of post commencement finance**

Another challenge that may be faced is the availability of post commencement finance for the companies that may require finance during the business rescue process. As discussed in chapter four, the provision of post commencement finance comes with several challenges.

The policy makers will have to decide on whether to make statutory provision for post commencement finance and priority of post commencement creditors or to leave the provision of the finance to the markets to decide as is the case in the United Kingdom and Australia.

The statutory regulation on the provisions of post commencement finance is however preferable.

Additionally, there may be a need to regulate the creditors, especially the banks in order to ensure that they do not charge exorbitant interest rates on post commencement finance and consequently defeat the whole purpose of business rescue.<sup>302</sup>

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<sup>301</sup> A possible guide to the fees to be charged by the business rescue practitioner could be based on stipulated fees that receivers are allowed to charge under the Companies Amendment regulations (note 288).

<sup>302</sup>This is because the current commercial lending rates in Zambia range between 16 and 19 percent as the base rate for an ordinary loan and it is likely that post commencement finance could attract an even higher interest charge because of the higher risks involved. See the Article entitled 'Zanaco-Indo Zambia lower interest rates' in which it was reported that 5 out of the 19 commercial banks in Zambia had reduced their lending rates from 19 percent to 16 percent. Available at <http://www.daily-mail.co.zm/index.php/business/1421-zanaco-indo-zambia-lower-interest-rates> [Accessed on the 5<sup>th</sup> of December 2011].

## **CHAPTER SIX- CONCLUSION**

The regulatory framework and legal environment within which companies operate is key to overall economic development. An effective regulatory framework must not only provide a conducive environment for corporate economic activity but also an effective mechanism to ensure the continued existence and where appropriate the resuscitation of insolvent companies capable of being rescued.

This dissertation proposes business rescue as an effective mechanism to achieve such a goal and focuses on several thematic areas as effective components of a business rescue regime for Zambia.

Zambia has a small economy and requires a cost effective rescue regime, which is simple to commence but can adequately protect the interests of creditors. The Australian model has been discussed as a good example of a simple business rescue procedure. The business rescue regime in Zambia should only apply to companies registered under the Companies Act. This has been done in Australia and South Africa from where Zambia can take a leaf.

Zambia must ensure that careful consideration is taken in deciding on who should trigger the moratorium and the entire process of business rescue. I have suggested that this category of persons should be limited to the directors of the company, a fully secured creditor or a liquidator. I have additionally recommended that where there is no fully secured creditor, creditors who are owed at least fifty percent of the company's debts should be permitted to commence business rescue.

I have also argued that the interests of the employees and the shareholders should be taken into account as regards commencement of business rescue. Employees and shareholders who have a reasonable belief that a company is insolvent or about to become insolvent should have the right to petition the board to

consider commencing business rescue. Where the board does not respond favorably and continues to trade, shareholders and employees should be entitled to bring an action against the board for insolvent trading which should be an offence included in the Companies Act. An amendment to the Companies Act will have to be made to include this provision.

It is noteworthy that the court should have overall supervisory powers to oversee the whole business rescue process and to hear applications arising out of the process. In this way, the commencement procedure will be less expensive, restricted only to the category of persons mentioned, and will prevent frivolous and vexatious proceedings.<sup>303</sup>

It is also cardinal for a company to show that it is capable of being rescued because this is the only way that it would make business sense to commence the business rescue procedure. Apart from this, this requirement will serve to protect the interests of the creditors, as it will prevent directors from avoiding the fulfillment of obligations to creditors on the pretext of entering into business rescue where a company cannot be rescued.

Further, the board's decision to enter into business rescue should clearly show that this consideration was taken into account and that in their reasonable opinion, the company could be rescued. The liquidator, when commencing business rescue proceeding must also be required to show that he has addressed his mind to the existing company's assets and liabilities and concluded that there is a likelihood that the company could be rescued or that a better return could be realized for the creditors. This evidence should then be given to the creditors to justify the moratorium and the suspension of the creditors' rights.

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<sup>303</sup> This recommendation is based on the Australian voluntary regime which I have discussed in chapter three of this dissertation.

A further recommendation is that the creditors, whether fully secured, secured or unsecured must not be required to show that the company is capable of being rescued but only that they are entitled to commence the business rescue process.

As is the case in Australia, the moratorium should apply to the unsecured creditors and all other secured creditors that are not fully secured. I have argued that although this will reserve the fully secured creditor's right to commence receivership proceedings before business rescue commences, a company will still be protected because the receiver will, if the amendments proposed in chapter five are implemented, be obliged to consider the prospects of company rescue during receivership. Additionally, the moratorium should apply until the rescue practitioner determines the viability of rescuing the company and where rescue is possible, through out the rescue process.

Additionally, Zambia must ensure that the qualifications of the practitioner are regulated. I have suggested that Zambia adopts the provisions of the South African Companies Act.

A further proposal that has been advanced is that the practitioner should be in charge of the management of the company, while the directors and other officers should remain in office to assist the practitioner with the duties and attendant liabilities of a director.

I have suggested that the rescue of a company in Zambia should be conducted through a rescue plan that is preceded by a moratorium, and by which the assets of the company can be protected throughout the business rescue process.

I have argued for statutory prohibition of insolvent trading and the imposition of liability on directors who trade an insolvent company so as to encourage greater diligence from directors in performing their director's duties.

A provision preventing the formation of phoenix companies should also be included in the Companies Act. This will encourage directors to be more responsible in handling the affairs of the company in order to avoid the prohibition of holding a position of director in a future company.

I have also argued for the inclusion of miscellaneous provisions in the Companies Act to ensure the adequate protection and participation of creditors during the rescue process. Additionally, a provision regulating the use of post commencement finance should be included.

That notwithstanding, I have highlighted several challenges that may be faced in enacting and implementing the proposed business rescue regime. These challenges may include changing the mindset of creditors, the judiciary's ability to handle business rescue cases, and the legal practitioners' ability to handle business rescue cases. Other challenges may include the availability of business rescue practitioners and post commencement finance for the companies that may require finance during the business rescue process.

The government will also need to regulate the creditors, especially the banks in order to ensure that they do not charge exorbitant interest rates on post commencement finance and consequently defeat the whole purpose of business rescue.

All in all, although there are many countries from which Zambia can draw examples on the form and procedure of the business rescue regime, it is important that the policy makers come up with a law that will suit the economic and commercial environment in Zambia. The implementation of the essential components of the business rescue regime proposed in this dissertation will help policy makers implement an effective business rescue regime that is tailor made for the *Zambian* environment.

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