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A Critical and Comparative Analysis on the Effect of Business Rescue on Creditors' Rights against Sureties

LLM

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Word Count: 25 555

Research paper presented for the approval of Senate in fulfilment of part of the requirements for the LLM in approved courses and a minor dissertation. The other part of the requirement for this qualification was the completion of a programme of courses.

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Business rescue proceedings have been introduced into South African company law under chapter 6 of the Companies Act 71 of 2008. The United States Chapter 11 bankruptcy model was closely consulted by the legislature when drafting chapter 6. Further to this and although business rescue has been generally well received, there have been legal issues which have arisen in the interpretation of chapter 6. In particular, the issue of creditors' rights against third party sureties of financially distressed companies continues to fall under the spotlight which, in turn, has caused a ripple of commercial uncertainty to filter through to creditors. This issue will be investigated with comparative reference to the position in the United States. In doing so, a critical analysis will be undertaken of the procedures and processes in both of these jurisdictions, whereafter a comparative analysis will be presented. It will be advocated that although the essential difference between the two jurisdictions is the United States' legislative regulation on this issue, South African courts have correctly decided on creditors' rights against third party sureties. Unlike in the United States where conflicting decisions have been delivered, commercial certainty on this issue does in fact exist in South Africa notwithstanding the lack of statutory regulation under the Companies Act. It will be further advocated that although there is potential for this issue to be development under the South African common law when having regard to the decisions in the United States, caution is to be exercised as such development may generate commercial uncertainty.

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1. CHAPTER 1: INTRODUCTION

The notion of business rescue was introduced into our law as part of Chapter 6 of the new Companies Act¹ which came into force on 1 May 2011. For purposes of enhancing the prospects of the revival and continued business operations of financially distressed companies for the general benefit of stakeholders and the economy, business rescue was introduced in place of the unsuccessful procedure of judicial management.² Although the introduction of business rescue into our law has for the most part been warmly received,³ the practical implementation of business rescue has not been without its challenges, this being the result in no small part due to certain *lacunae* in the Companies Act.

Focus of this Research Paper

This research paper will focus on the current legal position in South Africa as to whether a creditor loses its claim against a surety if a duly adopted and implemented business rescue plan provides for such creditor's claim against a principal debtor to be compromised in full and final settlement. In doing so, this research paper will comparatively explore how this issue has been administered under the Chapter 11 reorganisation procedure regulated in the United States Bankruptcy Codes.⁴

Structure and Overview of Chapters in this Research Paper

In chapter 2 of this research paper, the nature of business rescue will briefly be examined and discussed. In chapter 3 and given its significance to this research paper, the nature and purpose of suretyships will be discussed and relevant cases will be cited. In chapter 4, the most recent and material decisions of South African courts will be examined to determine the current legal position on creditors' rights against sureties pre and post the adoption of a business rescue plan. This will include a research of cases dealing with the statutory moratorium specified in s 133(1) as well

¹ Act 71 of 2008 (hereinafter referred to as the '**Companies Act**'). Any reference in this research paper, whether in the main body or footnotes to a section, shall be a reference to a section in the Companies Act, unless the context provides otherwise.

² *Tuning Fork (Pty) Ltd t/a Balanced Audio v Greeff and Another* 2014 (3) SA 500 (WCC) paras 20 and 26.

³ Richard Bradstreet 'The Leak in the Chapter 6 Lifeboat: Inadequate Regulation of Business Rescue Practitioners may Adversely Affect Lenders' Willingness and the Growth of the Economy' (2010) 22 SA *MERC LJ* 195-213 at 197. See also H Stoop and A Hutchison 'Post-Commencement Finance-Domiciled Resident or Uneasy Foreign Transplant?' (2017) 20 *PER/PELJ* at 2.

⁴ Title 11, United States Code (hereinafter referred to as the '**Bankruptcy Codes**').

as a consideration of s 155, which details the compromise of debts between a debtor and its creditors. In particular, s 155(9), which details creditors' rights against sureties in circumstances of compromise, will also be discussed. Chapter 5, similarly to chapter 2, will set the foundation for what follows in chapter 6 by examining the framework of reorganisation proceedings under the Bankruptcy Codes. Chapter 6 will elaborate on the legal position of creditors' rights against non-debtors of entities which have filed for bankruptcy reorganisation proceedings in the United States of America. In doing so, a review will be undertaken on how courts have applied the interplay between s 524(e) and s 105(a) of the Bankruptcy Codes in determining whether to release non-debtors under a non-consensual reorganisation plan. Thereafter and in chapter 7, a comparative analysis will be presented on the respective legal positions adopted by the South African and American courts to determine the similarities and differences relating to the issue of enforceability of suretyships by creditors during business rescue and post the adoption and subsequent implementation of a business rescue plan, if any.

Contention of this Research Paper

It is the contention of this research paper that South African courts have correctly determined the legal position on creditors being able to enforce their rights against sureties subsequent to the adoption of a business rescue plan. This will be advocated when compared against the Bankruptcy Codes which, unlike the South African Companies Act, embed creditors' rights against sureties in statute and regulate creditors' rights against non-debtors following a discharge of debt between a principal debtor and its creditors under chapter 11 of the Bankruptcy Codes. Furthermore, this research paper advocates the importance of legal certainty for purposes of ensuring, for the most part, commercial certainty and the importance thereof to society during the business rescue process. To this end, this paper will advocate that whilst there is potential to develop South African company law having reference to the Bankruptcy Codes, caution is to be exercised when doing so.

2. CHAPTER 2: THE NATURE OF BUSINESS RESCUE PROCEEDINGS

2.1. INTRODUCTION

The purpose of this chapter 2, as well chapter 3, are to provide a high-level legal analysis on the two central components discussed during this research paper, namely business rescue and suretyships. This chapter will briefly focus on the nature of business rescue proceedings. This chapter will also explore the shift in focus from a ‘creditor-friendly’ to a ‘debtor-friendly’ process by means of the introduction of business rescue proceedings in the Companies Act. The commencement and termination of business rescue proceedings, the operation of the legal moratorium during such time and, significantly, the consequences of the adoption, or rejection, of a business rescue plan will also be discussed.

2.2. NATURE OF BUSINESS RESCUE PROCEEDINGS

The procedure for regulating the business rescue of financially distressed companies⁵ is set out in chapter 6 of the Companies Act. The term ‘business rescue’ is considered more apt than its counterpart term used in the United States of America, ‘corporate rescue,’ given that the emphasis is on the survival of the business enterprise conducted by the financially distressed company, as opposed to the survival of the actual entity itself.⁶ s 128(b) describes business rescue as, among other things, facilitating the rehabilitation of a financially distressed company. Although the term ‘rehabilitation’ is not defined in the Companies Act, it suggests that the purpose of business rescue is to enable a company to continue its business enterprise on a solvent basis.⁷

During business rescue a company’s management is taken out of the control of its directors and placed in the hands of a business rescue practitioner for purposes of supervision. During this time, and as further discussed in 2.5, a legal moratorium operates for the protection of the company by limiting the rights which creditors may

⁵ In terms of s 128(f), ‘financially distressed,’ in reference to a particular company at any particular time, means that-

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

⁶ Bradstreet op cit note 3 at 195.

⁷ Hans Klopper and Richard S Bradstreet ‘Averting Liquidations with Business Rescue: Does a section 155 Compromise Place the Bar too High?’ *STELL LR* (2014) 549-565 at 550.

have in instituting legal proceedings against the company for the duration of the business rescue process. The primary goal of business rescue⁸ is the survival of the business enterprise of a company which is facilitated by means of a business rescue plan which is populated and, if accepted,⁹ implemented to restructure the company's affairs, together with its business, property, debt, other liabilities and equity, such that the company can continue its business enterprise on a solvent basis. To the extent that the primary goal cannot be achieved, the secondary goal¹⁰ is to generate a return for shareholders and creditors of a company greater than that which they would have received had the company been placed into liquidation.¹¹

2.3. DEBTOR FRIENDLY PROCESS

Unlike its predecessor,¹² the Companies Act focuses on the financially distressed company in question and primarily seeks to rehabilitate such entity whilst balancing the interests of all other relevant stakeholders.¹³ This is supported by s 7(k) which provides that the purpose of the Companies Act is to, among other things, effect business rescue 'in a manner that balances the rights and interests of all relevant stakeholders.'

Although the movement away from a 'creditor friendly' approach under the Old Companies Act to a 'debtor friendly' one is undoubtedly favourable to the debtor, caution is to be exercised on placing too much emphasis on the protection of debtors' rights as this could potentially create a disincentive for creditors to finance the business operations of such debtors.¹⁴ This is of particular significance in the context of creditors' rights to enforce third party suretyships where companies have been placed in business rescue. Financially distressed companies are already afforded a 'second chance' under business rescue. To deprive creditors of their rights to enforce third party suretyships during such proceedings in addition to this would unquestionably increase creditors' risk associated with the advancement of finance to debtors. Creditors play a key role in the development and continued sustainability of

⁸ Ibid at 550.

⁹ s 150(1).

¹⁰ Klopper and Bradstreet op cit note 7 at 550.

¹¹ s 128(b)(iii).

¹² The Companies Act 61 of 73 (hereinafter referred to as the 'Old Companies Act').

¹³ Bradstreet op cit note 3 at 197-98.

¹⁴ Ibid at 198.

economic growth and caution is to be exercised in adopting an approach which significantly and detrimentally affects their rights.¹⁵

2.4. COMMENCEMENT AND TERMINATION

Commencement

Business rescue proceedings can either be commenced by the board of directors of a financially distressed company¹⁶ or on application by an affected person¹⁷ to the relevant high court having jurisdiction.¹⁸ In either instance, there must be reasonable grounds to believe that the company is financially distressed. This entails, on the one hand, a cash-flow insolvency test on the basis of determining whether the company will be unable to pay its debts as they fall due. Alternatively and on the other hand, a balance-sheet test enquiry can be conducted to determine whether, at any particular time, the value of a company's assets do not exceed the value of its liabilities.¹⁹ That said and on application by an affected person to court, the grounds for commencing business rescue is not limited to a cash flow or balance sheet insolvency enquiry, instead the requirements which are to be satisfied to commence proceedings are more complex.²⁰

Under s 129 business rescue proceedings commence upon the filing of a board resolution with the Companies and Intellectual Property Commission ('CIPC'). Where an application to commence such proceedings has been launched by an affected person under s 131, such proceedings commence upon the court placing a company under supervision and ordering the commencement of business rescue.²¹ Having said this, there are certain restrictions against the institution of such

¹⁵ Ibid at 199.

¹⁶ s 129. In terms of this section, a resolution can only be passed by the board of directors where the board has reasonable grounds to believe that (i) the company is financially distressed and (ii) there appears to be a reasonable prospect of rescuing the company.

¹⁷ s 131. An 'affected person' is defined in s 128(a) as meaning –

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

¹⁸ Unlike in terms of s 129, under s 131(4) it is left to the courts' discretion to determine whether (i) the company is financially distressed and there is a reasonable prospect for rescue or (ii) whether it is otherwise just and equitable to order the commencement of business rescue proceedings in the circumstances.

¹⁹ Jonathan Rushworth 'A critical analysis of the business rescue regime in the Companies Act 71 of 2008' (2010) *Acta Juridica* 375-408 at 377.

²⁰ Ibid at 381.

²¹ s 131(4)(a).

proceedings.²² For example, the board of directors cannot resolve to place a company under business rescue where liquidation proceedings have already been initiated by or against the company,²³ nor are such proceedings commenced until the board resolution resolving to place the company in business rescue has been filed at CIPC. In addition to the foregoing, the court may during business rescue proceedings, but before the adoption of a business rescue plan in accordance with s 152, set aside such proceedings if, having regard to all evidence, the court considers that it is otherwise just and equitable to do so.²⁴

Having regard to business rescue proceedings initiated by an affected person, such an application cannot be made where a resolution has been passed first in time by the board of directors in terms of s 129.²⁵ Where liquidation proceedings have already been instituted by or against a company before an application by an affected person for its business rescue, such liquidation proceedings are suspended pending determination by the court of the application.²⁶ Once placed under business rescue by the court, a company may not pass a resolution resolving to place itself in liquidation until such time as business rescue proceedings have been terminated.²⁷

Termination

Business rescue proceedings terminate where a court has set aside a board resolution commencing business rescue proceedings²⁸ or converted such proceedings into liquidation proceedings.²⁹ In addition to this, where a business rescue plan has been adopted and implemented, such proceedings terminate upon the filing of a notice of substantial implementation of the plan by the business rescue practitioner with CIPC. Where a business rescue plan has been rejected, and a revised plan is not published,³⁰ or the business rescue practitioner has not applied to court to set aside the result of the vote against the adoption of the plan,³¹ or any affected person has not made a binding offer to purchase the voting interests of one or more persons who

²² Rushworth op cit note 19 at 378.

²³ s 129(2)(a).

²⁴ s 130(5)(a)(ii).

²⁵ s 131(1).

²⁶ s 131(6).

²⁷ s 131(8).

²⁸ s 132(2)(a)(i).

²⁹ s 132(2)(a)(ii).

³⁰ s 153(1)(a)(i).

³¹ s 153(1)(a)(ii).

opposed adoption of the plan,³² then the business rescue proceedings are terminated and the practitioner must file the relevant notice of termination with CIPC.³³

2.5. LEGAL MORATORIUM

In terms of s 133, for the duration of the business rescue proceedings, a financially distressed company enjoys the protection of a legal moratorium. This entails that no legal proceeding, including enforcement action, may be commenced or proceeded with against a company, or its property or in respect of property lawfully in its possession, subject to the exceptions specified in s 133(1). The Companies Act³⁴ expressly specifies that, save for certain exceptions, during business rescue proceedings a guarantee or surety provided by the financially distressed company in favour of another person may not be enforced by that person. Having said this, the Companies Act is silent on creditors' rights to enforce third party suretyships provided for the obligations of a financially distressed company during such proceedings.

The legal moratorium is at the heart of this research paper's analysis on whether a creditor loses their right to pursue their claim against a surety pre and post the adoption and implementation of business rescue plan which provides for such creditor's claim to be compromised in full and final settlement. The legal moratorium is of significance given that the enquiry is twofold as to whether creditors of companies, which have been placed under business rescue, can enforce third party suretyships. First, an enquiry must be had as to whether creditors are prohibited from proceeding against a third party surety as a result of the legal moratorium which endures for the business rescue process. If not and secondly, an enquiry must be had as to whether creditors can proceed against a surety notwithstanding a compromise of their claim in full and final settlement with the principal debtor in the business rescue plan.

2.6. THE BUSINESS RESCUE PLAN

Subsequent to the commencement of business rescue proceedings, the business rescue practitioner, who has been appointed to supervise the affairs and

³² s 153(1)(b)(ii).

³³ s 153(5).

³⁴ s 133(2).

administration of a financially distressed company, must prepare a business rescue plan. The business rescue plan is populated and presented to affected persons for consideration.³⁵ The principal purpose of the business rescue plan is to assist creditors in making a determination whether or not to accept or reject the plan.³⁶

The business rescue plan is divided into three parts. The first part of the plan must set out its background including, among other things, a material asset list of the company,³⁷ a complete list of creditors of the company when the business rescue proceedings began³⁸ and the return that creditors would receive if the company were to otherwise be placed into liquidation.³⁹ The second part of the plan which sets forth proposals, and which is of significance for purposes of this research paper, must specify, among other things, the nature and duration of any moratorium for which the plan makes provision⁴⁰ and the extent to which the company is to be released from any debts.⁴¹ This is of significance given that, for all intents and purposes, it is in this part of the plan that proposals of compromise with creditors will be proposed and voted on. Given the accessory nature of suretyships, further discussed in 3.4 below, it is this section of the business rescue plan, pursuant to its adoption, that has been at the heart of much of the debate surrounding creditors' rights of enforcement against third party sureties. The third and final part of the plan must provide for assumptions and conditions. This entails that any conditions to which the plan is subject must be specified⁴² and the assumed effect, if any, that it will have on employees,⁴³ the circumstances in which the plan will terminate,⁴⁴ a projected balance sheet for the company, together with a projected statement of income and expenses for the ensuing three years.⁴⁵

The business rescue plan is subsequently presented by the business rescue practitioner to creditors for consideration.⁴⁶ The plan is adopted provided that it is

³⁵ s 150(1).

³⁶ s 150(2).

³⁷ s 150(2)(a)(i).

³⁸ s 150(2)(a)(ii).

³⁹ s 150(2)(a)(iii).

⁴⁰ s 150(2)(b)(i).

⁴¹ s 150(2)(b)(ii).

⁴² s 150(2)(c)(i).

⁴³ s 150(2)(c)(ii).

⁴⁴ s 150(2)(c)(iii).

⁴⁵ s 150(2)(c)(iv).

⁴⁶ s 151.

supported by more than 75 per cent of creditors' voting interests that were voted⁴⁷ and that votes in support of the proposed plan included at least 50 per cent of independent creditors' voting interests.⁴⁸ The consequence of a plan which has satisfied the voting percentages aforesaid are that it binds the company, each creditor and every holder of securities in the company.⁴⁹ This is of significance in the context of this research paper given that should a creditor have agreed to the release of a company for its debt it would effectively be agreeing to a compromise and, in turn, releasing a third party surety from its obligations to the creditor given the accessory nature of suretyships. This finds support in s 154 which provides that:

‘(1) A business rescue plan may provide that, if it is implemented in accordance with its terms and conditions, a creditor who has acceded to the discharge of the whole or part of a debt owing to that creditor will lose the right to enforce the relevant debt or part of it.

(2) If a business rescue plan has been approved and implemented in accordance with this Chapter, a creditor is not entitled to enforce any debt owed by the company immediately before the beginning of the business rescue process, except to the extent provided for in the business rescue plan.’

⁴⁷ s 152(2)(a).

⁴⁸ s 152(2)(b).

⁴⁹ s 150(4).

3. CHAPTER 3: THE NATURE OF SURETYSHIPS

3.1. INTRODUCTION

This chapter 3 will focus, in brief, on the legal nature of suretyships in South Africa. This chapter will explore the nature and purpose of a suretyship, particularly within the commercial environment, the law under which suretyships are regulated and the importance of such security to creditors. This chapter will not explore suretyships in the context of business rescue as that aspect will be central to discussion in chapter 4 below.

3.2. UNDERSTANDING THE NATURE OF SURETYSHIPS

Regard was had to the text contained in Caney's *Law of Suretyship*⁵⁰ in the case of *Nedbank v Van Zyl*,⁵¹ where consideration was had to defining a suretyship as follows:

'Suretyship is an accessory contract by which a person (the surety) undertakes to the creditor of another (the principal debtor), primarily that the principal debtor, who remains bound, will perform his obligation to the creditor and, secondarily that if and so far as the principal debtor fails to do so, he, the surety, will perform it or, failing that, indemnify the creditor.'⁵²

Suretyships are a personal form of security and are accessory contracts in nature,⁵³ meaning that their existence and enforcement is conditional upon a principal debt, whether this be a debt or other form of obligation, being in existence, or coming into existence,⁵⁴ between a principal debtor and a creditor.⁵⁵ A practical example of a suretyship is where a third party agrees to assume the obligations of a debtor to a creditor in terms of a loan agreement in the event of there being a breach of such loan agreement by the debtor. Should the debtor fail to discharge its obligations to the creditor in accordance with the terms of the loan agreement, the creditor has the right to proceed against the third party surety, such that the surety discharge the obligations

⁵⁰ The most recent version of this publication is CF Forsyth and JT Pretorius *Caney's the Law of Suretyship* 6 ed (2010). The third edition of this book published in 1982 was cited in the case of *Van Zyl*. Reference is to be had to page 27 of this third publication.

⁵¹ 1990 2 SA 469 (A).

⁵² *Ibid* at 59.

⁵³ CF Forsyth and JT Pretorius *Caney's the Law of Suretyship* 6 ed (2010) 28.

⁵⁴ See the case of *Trust Bank of Africa Ltd v Frysch* 1977 (3) SA 562 (A) at 584G-H where it was held that a suretyship will be enforceable even where reference is had in such a suretyship to a principal obligation which will only come into existence in the future.

⁵⁵ Robert dos Santos: 'The lazy man's suretyship: Are unlimited debts of limited application?' available at <http://www.saflii.org/za/journals/DEREBUS/2015/156.pdf>, accessed on 27 December 2017.

of the debtor to the creditor. In circumstances where a creditor has recovered money from the surety, the surety can then, in turn, have recourse against the principal debtor as a consequence of having discharged the latter's financial debt to its creditor.

3.3. STATUTORY REGULATION OF SURETYSHIPS

Before the introduction of the General Law of Amendment Act,⁵⁶ the common law was responsible for the administration of suretyships and such security documents could even be entered into orally.⁵⁷ Similarly to the Alienation of Land Act,⁵⁸ which requires that agreements in respect of the sale of immovable property be reduced to writing, the GLAA sought to avoid unnecessary litigation between creditors and sureties and specified in s 6 of that Act that '[n]o contract of suretyship entered into after the commencement of this Act, shall be valid, unless the terms thereof are embodied in a written document signed by or on behalf of the surety...'

The meaning of the word 'terms' in s 6 of the GLAA is not defined, and this was addressed by the court in *Fourlamel (Pty) Ltd v Maddison*,⁵⁹ where it was held that the identification of the principal debt and the debtor are essential to a creditor imposing liability on a surety. The terms of the suretyship must therefore set out the obligations and scope of a surety's rights.⁶⁰ In determining what constitutes the essential terms of a suretyship, it was held by the court in *Sapirstein and Others v Anglo African Shipping Co (SA) Ltd*⁶¹ that these include:

'the identity of the creditor, of the surety and of the principal debtor, and the nature and amount of the principal debt, must be capable of ascertainment by reference to the provisions of the written document, supplemented, if necessary, by extrinsic evidence of identification other than evidence by the parties (namely the creditor and surety) as to their negotiations and consensus.'⁶²

⁵⁶ Act 50 of 1956 (hereinafter referred to as the 'GLAA').

⁵⁷ Forsyth and Pretorius op cit note 53 at 67.

⁵⁸ Act 68 of 1981.

⁵⁹ 1977 (1) SA 333 (A).

⁶⁰ Ibid at 345.

⁶¹ 1978 (4) SA 1 (A).

⁶² Ibid at 7. See also the case of *Nedbank Ltd v Wizard Holdings (Pty) Ltd* 2010 (5) SA 523 (GSJ) where the dictum in *Sapirstein* was upheld and the court stated that '[t]he essential terms of the contract of suretyship are the identity of the creditor, the identity of the surety, and the nature and amount of the principal debt. Failure to complete the essential terms of the suretyship agreement means that the contract is invalid for failure to comply with the statutory formalities.'

3.4. ACCESSORY NATURE OF SURETYSHIPS

The accessory nature of suretyships is referenced in several of the cases to be discussed in chapter 4. In understanding the meaning of the word ‘accessory,’ the court in *Corrans v Transvaal Government and Coull’s Trustee*⁶³ held that the liability of a surety to a creditor is dependent upon the existence of a principal debt.⁶⁴ In other words, should the principal debt not exist then a creditor will not, in turn, have any claim against a surety. This notion is explored in depth by Rogers AJ, as he was then, in *Investec Bank Ltd v Bruyns*,⁶⁵ where the notion of the defences *in rem* and *in personam* were measured against the statutory moratorium contained in s 133.

It was held in the case of *Standard Bank of SA Ltd v SA Fire Equipment (Pty) Ltd & Another*⁶⁶ that the defence of *in rem* can be relied upon where the defence attaches to the claim itself, thereby entailing that if the claim itself by a creditor against the principal debtor is extinguished or discharged, so too is the claim against the surety similarly extinguished. Therefore, and for all intents and purposes, should the underlying cause giving rise to the principal debt or obligation be illegal, for example a person entering into a contract without the requisite legal capacity, the subsequent result is that the cause giving rise to a creditor’s claim against the debtor is extinguished and therefore as a consequence the creditor will have no claim against either of the debtor or the surety.⁶⁷

3.5. SIGNIFICANCE OF SURETYSHIPS TO CREDITORS

Suretyships are of particular significance in the commercial sphere where creditors have concluded transactions with juristic persons. In such cases and for example, as a suspensive condition to a loan agreement to be concluded between a company, as borrower, and a creditor, as lender, the company’s directors may be required to stand as surety and co-principal debtors with the company for its obligations to the creditor. On a commercial basis, the inclusion of the requirement to conclude a suretyship is understood where, for example, the company is a newly incorporated entity and has no assets against which the creditor would be able to execute in order to realise a return on its claims against the debtor.

⁶³ 1909 TS 605.

⁶⁴ *Ibid* at 612.

⁶⁵ 2012 (5) SA 430 WC.

⁶⁶ 1984 (2) SA 693 (C).

⁶⁷ Forsyth and Pretorius *op cit* note 53 at 38–9.

4. CHAPTER 4: BUSINESS RESCUE: SOUTH AFRICA

4.1. INTRODUCTION

This chapter 4 will focus on business rescue proceedings and the effect which such proceedings have on creditors' rights against third party sureties of financially distressed companies. Given the lack of statutory regulation on this legal issue in South Africa, an analysis of case law takes centre stage in this chapter.

4.2. CREDITORS' RIGHTS BEFORE BUSINESS RESCUE PLAN

The cases discussed under this 4.2 focus on creditors' rights against third party sureties during business rescue proceedings but before the adoption and implementation of a business rescue plan. This 4.2 specifically focuses on the legal implications of the legal moratorium embedded in s 133(1).

Bruyns

The case of *Bruyns*⁶⁸ was one of the first cases before our courts to provide insight on defences raised by third party sureties during business rescue proceedings and the effect of the legal moratorium carried into effect by s 133(1) of the Companies Act. In this case, summary judgment proceedings had been launched against the defendant whereby the plaintiff sought to claim, among other things, payment from the defendant flowing from two suretyships which the defendant had executed for two principal debtor companies that had been placed in liquidation,⁶⁹ which companies however it was alleged, had commenced with business rescue in terms of s 131(6).⁷⁰ In its opposing affidavit, the defendant sought to challenge summary judgment having regard to the provisions of s 133(1).⁷¹ This section, in

⁶⁸ Supra note 65.

⁶⁹ Ibid para 1.

⁷⁰ Ibid para 10.

⁷¹ s 133(1) states that:

During business rescue proceedings, no legal proceeding, including enforcement action, against the company, or in relation to any property belonging to the company, or lawfully in its possession, may be commenced or proceeded with in any forum, except

(a) with the written consent of the practitioner;

(b) with the leave of the court and in accordance with any terms the court considers suitable;

(c) as a set-off against any claim made by the company in any legal proceedings, irrespective of whether those proceedings commenced before or after the business rescue proceedings began; [Para. (c) substituted by s. 84 of Act 3/2011];

(d) criminal proceedings against the company or any of its directors or officers; [Para. (d) substituted by s. 84 of Act 3/2011];

summary, prohibits the commencement of, or proceeding with, legal proceedings,⁷² including enforcement action,⁷³ against the company, or in relation to any property belonging to a company, or lawfully in its possession.⁷⁴ As a consequence of the legal moratorium embedded in s 133(1), the defendant placed reliance on s 133(2),⁷⁵ and argued that the legal moratorium enjoyed by the financially distressed company also extended to the benefit of a surety or guarantor.⁷⁶

Rogers AJ first turned to consider the defence raised in respect of s 133(2). The court held that the provisions of the section are clear in that they are only to be enjoyed by a financially distressed company, not its third party sureties or guarantors.⁷⁷ The court then turned to explore 133(1) having regard to the defences of *in rem* and *in personam*. Placing reliance on the decision in *Worthington v Wilson*,⁷⁸ the court acknowledged that a defence *in personam* is one which is strictly available only for reliance upon by a principal debtor, not a third party surety or guarantor.⁷⁹ The court held that the legal moratorium embedded in s 133(1) is a defence *in personam* and no reliance thereon could be raised by a third party surety or guarantor⁸⁰ and as a result of this the court subsequently granted the application for summary judgment.

Although it was only mentioned in *obiter* by Rogers AJ,⁸¹ the court held that the defendant surety could not complain of the outcome given that even the terms of suretyships executed by the defendant provided that the creditors' rights were not compromised in the event of liquidation or judicial management.⁸² Having said this,

(e) proceedings concerning any property or right over which the company exercises the powers of a trustee; or [Para. (e) substituted by s. 84 of Act 3/2011];

(f) proceedings by a regulatory authority in the execution of its duties after written notification to the business rescue practitioner.

⁷² See the case of *Murray N.O. and Another v Firstrand Bank Ltd t/a Wesbank* 2015 (3) SA 438 (SCA) para 31, where it was held that 'legal proceedings' are a lawsuit or hofsak.

⁷³ See the case of *Murray* supra note 72 para 32, where it was held that 'enforcement action' is a species of legal proceedings.

⁷⁴ Supra note 65 para 11.

⁷⁵ s 133(2) states that:

'During business rescue proceedings, a guarantee or surety by a company in favour of any other person may not be enforced by any person against the company except with leave of the court and in accordance with any terms the court considers just and equitable in the circumstances.'

⁷⁶ Supra note 65 para 11.

⁷⁷ Ibid paras 15-6.

⁷⁸ 1918 TPD 104.

⁷⁹ Supra note 65 para 17.

⁸⁰ Ibid at para 18.

⁸¹ Ibid para 25.

⁸² The suretyships in *Bruyns* did not expressly make reference to business rescue proceedings as they had been executed prior to the introduction of the Companies Act.

regard must be had to the impact of this decision in the timeline of business proceedings. The issues in this case were ones arising after business rescue proceedings had commenced, however, before the adoption of a business rescue plan. The court was clear that third party sureties and guarantors could be sued during business rescue proceedings for the obligations of a principal debtor to its creditor notwithstanding the legal moratorium enjoyed by a financially distressed company.

Tsakiroglou

In *Business Partners Limited v Tsakiroglou and Others*,⁸³ the legal moratorium survived constitutional scrutiny. In this case, the plaintiff carried on the business of a registered credit provider and financier and the first defendant had executed a deed of suretyship in favour of the plaintiff for the obligations of a close corporation of which the defendant was the sole member.⁸⁴ The defendant surety had, by way of resolution in terms of s 129, placed the financially distressed entity under business rescue. The business rescue plan which was pitched to the plaintiff, the holder of 100% voting interest,⁸⁵ failed to address the defendant's liability and therefore the business rescue plan was rejected at both meetings of creditors.⁸⁶

Similarly to the issue raised in *Bruyns*,⁸⁷ the defendant surety raised the defence that he, in conjunction with the financially distressed entity, was entitled to rely on the legal moratorium embedded in s 133.⁸⁸ Interestingly in this matter, and unlike in *Bruyns*,⁸⁹ the defence on the same issue was dressed in a constitutional grab.⁹⁰ The constitutional argument raised was that whilst s 133 specifically precluded legal proceedings from being instituted against a financially distressed company,⁹¹ it did not preclude such proceedings from being commenced against a guarantor or surety of that financially distressed entity.⁹² The defence centred on the notion that s

⁸³ (17827/2014) 2015 ZAWCHC 61.

⁸⁴ *Ibid* at 1-2.

⁸⁵ *Ibid* at 3.

⁸⁶ *Ibid*. The plaintiff had repeatedly demanded that the business rescue practitioner address the defendant surety's liability under the business rescue plan, however, this was ignored.

⁸⁷ *Supra* note 65.

⁸⁸ *Supra* note 83 at 5.

⁸⁹ *Supra* note 65.

⁹⁰ *Supra* note 83 at 6.

⁹¹ The defence voiced clearly accepted the reasoning of Rogers AJ in *Bruyns*, acknowledging that the legal moratorium does not extend to a guarantor or surety, however and as an alternative defence, sought to escape this by raising a constitutional issue.

⁹² *Supra* note 83 at 8.

133 ‘...differentiates between people or categories of people, and such differentiation bears no rational connection to a legitimate government purpose.’⁹³

Le Grange J acknowledged that indeed there was a differentiation imposed by s 133 between natural and juristic persons,⁹⁴ however, regard was had to *Cloete Murray and Another NNO v Firstrand Bank Limited t/a Wesbank*⁹⁵ where it was held that:

‘[i]t is generally accepted that a moratorium on legal proceedings against a company under business rescue is of cardinal importance since it provides the crucial breathing space or a period of respite to enable a company to restructure its affairs. This allows the practitioner in conjunction with creditors and other affected parties to formulate a business rescue plan designed to achieve the purpose of the process.’⁹⁶

The court therefore acknowledged that s 133 served a particular purpose and had not been included arbitrarily. This was substantiated by the court where it linked the enjoyment of legal moratorium solely to juristic persons⁹⁷ and therefore something which in any event could never have been relied upon by natural persons, and in doing so causing any alleged differentiation to be justified.⁹⁸ The decision in this case makes good sense because the very nature of business rescue proceedings is such that they are to be relied upon by financially distressed companies, the purpose of which is to rescue the business of an entity and to afford that entity temporary protection of its business.

Pioneer Foods

A full bench of appeal⁹⁹ in the case of *Tuna v Pioneer Foods (Pty) Limited*¹⁰⁰ was tasked with determining whether the legal moratorium in s 133 extended protection to the surety concerned. A deed of suretyship had been executed in favour of the respondent for the obligations of a financially distressed close corporation

⁹³ Ibid at 9.

⁹⁴ The court took into consideration the decision of *Prinsloo v Van der Linde and Another* 1997 (3) SA 1012 (CC) para 25, where differentiation between persons could not be accepted where such differentiation was regulated in an arbitrary manner or for which there was no legitimate purpose giving rise to the regulation of the differentiation. Where such differentiation is not arbitrary or for which there is a legitimate purpose, then the differentiation cannot be said to be unconstitutional.

⁹⁵ 2015 (3) SA 438 (SCA).

⁹⁶ Ibid para 14.

⁹⁷ Supra note 83 at 12. This reliance flowed from the decision in *Bruyns* where it was held that a third party surety cannot enjoy the defence of s 133 as this was a defence *in personam* and one which was not capable of being enjoyed by a third party surety.

⁹⁸ Ibid at 12.

⁹⁹ Judges presiding were Van Oosten J, Wepner J and Mphahlele J.

¹⁰⁰ (A5001/2015) 2016 ZAGPJHC 298.

which had been placed under business rescue.¹⁰¹ Summary judgment was awarded against the appellant who sought, and was granted, leave to appeal to the full bench. In my view, it is surprising that the court granted leave to appeal given that it had been established in *Bruyns*¹⁰² that the legal moratorium does not extend to the benefit of a third party surety.

The court recited and placed reliance on the provisions of *African Bank Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd & Others*¹⁰³ and *Bruyns*¹⁰⁴ and held that s 133 is directed exclusively at protecting the financially distressed company's interests and did not affect a surety's indebtedness during business rescue proceedings. In addition to this, and among other things, reliance was placed on Voet¹⁰⁵ where it was recorded that '[n]evertheless [the] suretyship does not disappear if the goods of the debtor have been confiscated, or have been transferred to his creditors by the benefit of surrender, or of if a written order for a stay of payment has been obtained by the debtor.' The appeal in *Pioneer Foods*¹⁰⁶ was dismissed by way of unanimous decision. It is therefore clear that the only circumstances under which a surety will be released from its obligation is where there has been an absolute release between the principal debtor and its creditors. The notion of an 'absolute release' is further discussed in the case of *Tuning Fork*¹⁰⁷ in 4.3 below.

Zevoli

The recent case of *Nedbank Limited v Zevoli 208 (Pty) Ltd and Others*¹⁰⁸ also warrants brief discussion. In this case the plaintiff creditor had concluded a loan agreement with a company and sought to recover its debts against several defendant

¹⁰¹ Ibid para 2. It is unclear from the judgment whether a business rescue plan was approved, however, the court held that this was of little consequence.

¹⁰² Supra note 65.

¹⁰³ 2013 (6) SA 471 (GNP). In particular at para 68, it was stated that:

'There is no express provision contained in ch 6 of the Act which provides that the adoption of a business rescue plan will deprive creditors of the company in business rescue of their rights as against sureties for the debts of the company in business rescue. The effect of such a provision, in my view, would be drastic, as it would also deprive a creditor of its rights as against a third party (surety) simply by virtue of the adoption of a business rescue plan for the debtor. If the legislature intended that the adoption of a business rescue plan would have such far-reaching consequence, the legislature would have expressly provided for this consequence.'

¹⁰⁴ Supra note 65. Reliance was had on the distinction drawn between the defences *in personam* and *in rem* by Rogers AJ.

¹⁰⁵ Supra note 100 para 11. Voet 46.1.39-Gane's Translation.

¹⁰⁶ Supra note 100.

¹⁰⁷ Supra note 116.

¹⁰⁸ 2017 (6) SA 318 (KZP).

sureties who had each stood as surety and co-principal debtor for the company's obligations to the creditor.¹⁰⁹ The company had resolved in terms of s 129 to be placed under business rescue supervision and the creditor sought to exercise recourse against the sureties.¹¹⁰ Over several defences were advocated by the defendants, however for purposes of this research paper the focus will centre on the first defence voiced, namely that the creditor was precluded from proceeding against the sureties given the legal moratorium specified in s 133. Madondo DJP reiterated the comments of Ponna AJ in the case of *Dessert Star Trading 145 (Pty) v No 11 Flamboyant Edleen CC and Another*¹¹¹ that '[i]t is well settled that the general rule is that a surety may avail himself or herself of any defences that the principal debtor has, save for those defences that are purely personal to the principal debtor.'¹¹² Against this backdrop, the court took into consideration the decision in *New Port*¹¹³ and *Bruyns*¹¹⁴ and ruled that the liability of the sureties had not been affected given that they could not rely on the legal moratorium as such reliance was only available and personal to a financially distressed company, not its third party sureties.¹¹⁵

Conclusion

The aforementioned series of cases make it unquestionably clear that the legal moratorium in s 133(1) does not operate for the benefit of third party sureties and creditors are within their rights to proceed with legal proceedings against such sureties during business rescue.

4.3. CREDITORS' RIGHTS AFTER BUSINESS RESCUE PLAN

The cases discussed under this 4.3 focus on whether a creditor loses its claim against a surety if a duly adopted and implemented business rescue plan provides for the creditor's claim against the principal debtor to be compromised in full and final settlement of such claim.

Tuning Fork

¹⁰⁹ Ibid paras 7-8.

¹¹⁰ Ibid para 1.

¹¹¹ 2011 (2) SA 471 (SCA).

¹¹² Ibid para 11.

¹¹³ Supra note 172 paras 9, 10 and 12.

¹¹⁴ Supra note 65 paras 15-7.

¹¹⁵ Supra note 108 paras 28-9.

Issues concerning creditors' rights against sureties where a financially distressed company had been placed under business rescue were once again before Rogers J in the matter of *Tuning Fork (Pty) Ltd t/a Balanced Audio v Greeff and Another*.¹¹⁶ The central issue to be determined by the court in this case was whether the creditor concerned lost its claim against the surety subsequent to the adoption and implementation of a business rescue plan as consequence of the plan providing that the creditor's claim against the principal debtor was compromised. Significantly in this case, neither the business rescue plan nor the deed of suretyship preserved the plaintiff creditor's claim against the defendant sureties.¹¹⁷ Significantly and given my views adopted later on in this research paper advocating support for the reasoning by Roger J in this case, I point out that an extensive analysis of this case was undertaken as well as of the case law relied upon therein by Rogers J.

In this case, the defendants, in their capacities as directors of the financially distressed company, had signed unlimited suretyships for the company's debts, present and future, in favour of the plaintiff. The company was placed under business rescue and a business rescue plan was adopted.¹¹⁸ It was expressly provided for in the business rescue plan that '[s]hould the Creditors approve the Business Rescue Plan, the payment under the Business Rescue Plan to them [being the Creditors] will be in full and final settlement of their claims against the Company...'¹¹⁹

Interestingly and in making its decision, the court first turned to draw a comparison between business rescue proceedings and compromising of debts with creditors. It is important to highlight the distinction in procedure and legal consequence between business rescue proceedings, regulated between s 128 to s 154, and that of compromising debts with creditors which is regulated under s 155.¹²⁰ The court highlighted, among other things, several differences between compromise of debts under the new Companies Act and the Old Companies Act, however, particular consideration was afforded to s 155(9).¹²¹ This section of the Companies Act, unlike the sections regulating business rescue, expressly states that '[a]n arrangement or a

¹¹⁶ 2014 (3) SA 500 (WCC).

¹¹⁷ Ibid para 1.

¹¹⁸ Ibid para 5.

¹¹⁹ Ibid para 7.

¹²⁰ Among other things, business rescue proceedings only find application to companies which are financially distressed, whereas a compromise of debts with creditors can be initiated regardless of whether a company is financially distressed or not.

¹²¹ Supra note 116 paras 21-5.

compromise contemplated in this section¹²² does not affect the liability any person who is a surety of the company.’ One appreciates why the court made reference to s 155(9) in this instance given that in circumstances of compromise the legislature sought to expressly preserve creditors’ interests, however, failed to expressly afford the same protection in any of the sections between s 128 to s 154.

The court stated that subsequent to the adoption of a business rescue plan in this case, the legal moratorium was superseded by the adoption of the plan as a consequence of the financially distressed company’s release against payment to creditors in full and final settlement of their claims.¹²³ It was acknowledged by the court that the Companies Act simply does not regulate creditors’ rights against third party sureties subsequent to the adoption of a business rescue plan¹²⁴ and, in the absence of such statutory regulation, the position therefore falls to be regulated by the common law.¹²⁵ The sections of the Companies Act regulating business rescue, unlike the section administering compromise of debts, do not expressly preserve creditors’ rights against sureties.¹²⁶ Rogers J took cognisance of the decision of Corbett AJ, as he was then, in *Rennie NO v Gordon and Another NNO*¹²⁷ where it was held in agreement by Rogers J that one cannot simply read words into statute to ascertain what is meant, the only basis upon which one could so being that without the reading in of such words the statute would be unworkable.¹²⁸

Applying the common law of suretyships, as well noting the glaring statutory absence in preservation of creditors’ rights against third party sureties, Rogers J held that where there has been a compromise of the debt between the principal debtor and its creditors in the adoption of a business rescue plan, third party sureties would, in turn, be released from their obligations.¹²⁹ That said, such release would be subject to the terms regulating the company’s release as specified in the business rescue plan

¹²² ‘section’ here being a reference to s 155.

¹²³ Supra note 116 para 35.

¹²⁴ Ibid paras 14(i) and 45.

¹²⁵ Ibid para 37.

¹²⁶ The absence of such mention in the Companies Act was held by Rogers J as ‘striking’ (Ibid para 38). Interestingly, other legislation which also regulates circumstances of compromise, such as the Insolvency Act 24 of 1936 (hereinafter referred to as the ‘**Insolvency Act**’), similarly preserve creditors’ rights against third party sureties where there has been a compromise of debts. In this regard s 120(3) of the Insolvency Act provides that ‘[a] composition shall not affect the liability of a surety for the insolvent.’ The creditors’ rights against third party sureties also do not appear to be compromised where a company is deregistered (Ibid para 71).

¹²⁷ 1988 (1) SA 1 (A) at 22E-H.

¹²⁸ Supra note 116 para 41. This view has previously been repeated by our court, for example see the case of *American Natural Soda Ash Corporation & Another v Competition Commission & Others* 2005 (6) SA 158 (SCA) para 27.

¹²⁹ Supra note 116 para 42.

and furthermore subject to the application of the common law principles of suretyship.¹³⁰ In my view, Rogers J's application of the common law principles of suretyships is a logical conclusion. This is so because the business rescue plan is ultimately a compromise between the principal debtor and its creditors and determining creditors' rights against sureties after the adoption of the plan would fall to be regulated by the law of suretyships.

In making a determination in this case, Rogers J's reasoning was substantiated following his consideration of the rationale adopted by Dove Wilson in *Wides v Butcher and Sons*¹³¹ where it was held that the extinction of the principal obligation extinguishes the obligation of a surety where the principal debt is discharged by settlement or is extinguished by prescription. Briefly, the facts of *Wides*¹³² entailed a principal debtor assigning her estate to her creditors in terms of the Natal Insolvency Act of 1887, however, a particular creditor introduced a proviso into the deed of assignment whereby it reserved its rights of recourse against third party sureties.¹³³ The case of *Wides*¹³⁴ is of significance given that it states what constitutes an absolute discharge and how this is linked to compromise of debts.

The court in *Wides*¹³⁵ explored whether the proviso in the deed of assignment, which sought to preserve the creditor's claim against the surety, constituted an absolute release, or whether it was simply an undertaking not to institute action against the principal debtor. Neatly put in this case, an absolute discharge was described as one whereby the creditor forfeits their right against both the principal debtor as well as the surety. Following this I therefore understand that a discharge is not absolute where a creditor agrees not to sue the principal debtor but reserves the right to claim against the surety given that in such circumstances the surety would preserve its right of recourse to lay claim against the principal debtor for any amount claimed against it by the creditor. This is crucial because the common law as per *Wides*¹³⁶ entails that where creditors have preserved their rights against a third party surety then the discharge is not an absolute release, but rather that the creditor's claim against the principal debtor is circumvented to the surety who can, in turn, claim

¹³⁰ Ibid para 14(ii).

¹³¹ 1905 (26) NLR 578.

¹³² Ibid.

¹³³ Supra note 116 para 50.

¹³⁴ Supra note 131.

¹³⁵ Ibid.

¹³⁶ Ibid.

recourse against the principal debtor. No such right of recourse exists where the discharge is absolute given that, on the one hand, the creditor cannot proceed against the principal debtor and, on the other hand and as consequence of this, the surety will not have a right of recourse as the creditor would not be able to proceed against the surety following its release. This is supported by Dove Wilson J where he stated that:

‘There is no doubt that a simple discharge of a debtor by a creditor discharges also the surety, upon the simple ground that if it were otherwise, it would be a fraud upon the debtor, to profess to discharge him of the debt due to the creditor, and at the same time to leave him open to recourse against him by the surety. *But a discharge of the debtor does not liberate the surety if the remedy against the surety is expressly reserved, because in that case the discharge is not an absolute release, but is merely a pactum de non petendo.* The reservation has the effect, because it rebuts the presumption which ordinarily exists that if you liberate the principal debtor, you mean to liberate also the surety, and it has the effect of preserving the right of recourse by the surety against the principal debtor. The test whether or not the discharge which has been given is absolute, or merely a covenant not to sue, is whether the debtor is, after the discharge, put in the position of being able to say to the creditor that “It is inconsistent with the discharge which has been given to him that there should be any right of recourse against him by the surety.” If the debtor is not in a position to say so, then the surety is not discharged.’¹³⁷

Rogers J also placed reliance on the case of *Moti and Co v Cassim’s Trustee*.¹³⁸ *Moti*¹³⁹ which was decided by a strong majority of the Appellate Division.¹⁴⁰ This case focused on the issue as to whether a release by the principal debtor, pursuant to a statutory assignment under the Insolvency Act,¹⁴¹ preserved a creditor’s claim against a surety.¹⁴² One can appreciate why Rogers J chose to rely on the decision in *Moti*¹⁴³ given that although the Old Insolvency Act, like the Companies Act¹⁴⁴ and the Insolvency Act, did preserve creditors’ rights against sureties in circumstances of compromise and rehabilitation, the Old Insolvency Act was silent on such rights where there had been a statutory assignment.¹⁴⁵ Wessels J in *Moti*¹⁴⁶ neatly summarised the position in his majority judgment by stating as follows:

‘Now if by the common law the debtor is discharged from a debt or from all his debts the surety is released. If in the case of assignment the creditors agree with the debtor

¹³⁷ Ibid at 584.

¹³⁸ 1924 AD 720.

¹³⁹ Ibid.

¹⁴⁰ Supra note 116 para 54. The majority judgments in *Moti* were handed down by Innes CJ, Kotzé JA and Wessels JA.

¹⁴¹ Act 32 of 1916 (hereinafter referred to as the ‘Old Insolvency Act’).

¹⁴² Supra note 116 para 54.

¹⁴³ Supra note 138.

¹⁴⁴ At s 155(9).

¹⁴⁵ Supra note 116 paras 54-6.

¹⁴⁶ Supra note 138.

that they will be satisfied with his assignment and will take these in full settlement then they discharge the debtor from all obligation to pay them the difference between the amount of the debts and the value of the assets.

Of this discharge the surety is by our law entitled to take advantage.

Now the fact that the Legislature has altered the common law in the case of rehabilitation and composition and clearly enacted that the sureties are to remain liable, and the fact that in the case of assignment under Chapter 6 the Legislature has been silent as regards sureties, leads me to infer that the Legislature did not think of the case where sureties had bound themselves and an assignment under the Act takes place, and if the Legislature did not think of it, it could not have intended in such a case to alter the common law as regards sureties...

It appears to me, therefore, that we have to deal here with a *casus omissus* and that the Act has not deprived the surety of his common-law rights.¹⁴⁷

In summary, it can be inferred from the decision in *Tuning Fork*¹⁴⁸ that where there has been no preservation of creditors' rights against third party sureties of financially distressed companies in either of the adopted business rescue plan, or in the deed of suretyship itself, there is then a compromise of the principal debt and the surety's release is absolute in such circumstances. The notion of absolute discharge was highlighted by Rogers J with reference to the decision in *Wides*.¹⁴⁹ Given the statutory silence on creditors preserving their rights against sureties, Rogers turned to the case of *Moti*¹⁵⁰ where, in similar circumstances to those of *Tuning Fork*,¹⁵¹ there had been a compromise of the principal debt regulated by statute, however, the statute failed to expressly state how this would affect the creditors' rights against sureties in certain circumstances. Given the similarities in statutory absence and circumstances, the common law was applied in *Moti*¹⁵² where it was, in my view, correctly held that in the absence of statutory regulation, creditors would lose their rights against sureties in circumstances of compromise.

Du Toit

In another decision handed down by the Western Cape Division, the court in *ABSA Bank Limited v Du Toit and Others*¹⁵³ was tasked with exploring the liability of defendants under suretyships which they had executed in favour of the plaintiff for obligations of a financially distressed arising from, among other things, a mortgage

¹⁴⁷ Supra note 138 at 745-46.

¹⁴⁸ Supra note 116

¹⁴⁹ Supra note 131.

¹⁵⁰ Supra note 138.

¹⁵¹ Supra note 116.

¹⁵² Supra note 138.

¹⁵³ (7311/13) [2013] ZAWCHC 194.

loan agreement and term loan agreement.¹⁵⁴ A business rescue plan had been adopted¹⁵⁵ and the defendants raised the defence that their liability had been extinguished as a consequence of the business rescue plan and reliance was placed on s 154(2).¹⁵⁶ It was alleged by the plaintiff that the business rescue plan made provision¹⁵⁷ that the implementation thereof would ‘...not affect any rights that any creditor (including plaintiff) may have against any surety for and on behalf of the principal debtors.’¹⁵⁸

Counsel for the defendant argued that liability under the suretyships was contingent on the existence of a principal debt and, in the absence of such debt through circumstances of compromise, the accessory obligation imposed on the defendant sureties would cease to exist.¹⁵⁹ It was further advocated that notwithstanding any preservation of creditors’ claims against sureties contained in the business rescue plan, such claims could not be enforced when having regard to the provisions of s 154(2). It was argued for the plaintiff that the terms of the suretyships¹⁶⁰ and business rescue plan preserved the plaintiff’s claim against the defendants and therefore the claim had not been extinguished.¹⁶¹

In making its determination, the court had regard to the decision in *African Bank Corporation*,¹⁶² where Kathree-Setiloane J held that it would be drastic had it been in the contemplation of the legislature to deprive creditors of their rights’ against third party sureties and, if it had been intended to be so, the legislature would have

¹⁵⁴ Ibid para 1.

¹⁵⁵ Ibid para 2.

¹⁵⁶ Ibid para 3(i). s 154(2) states that:

‘(1) A business rescue plan may provide that, if it is implemented in accordance with its terms and conditions, a creditor who has acceded to the discharge of the whole or part of a debt owing to that creditor will lose the right to enforce the relevant debt or part of it.

(2) If a business rescue plan has been approved and implemented in accordance with this Chapter, a creditor is not entitled to enforce any debt owed by the company immediately before the beginning of the business rescue process, except to the extent provided for in the business rescue plan.’

¹⁵⁷ Ibid para 6.

¹⁵⁸ The business rescue plan further made provision that ‘[s]uch settlement is not intended to affect any rights that any creditor may have against any third party who had bound itself as surety, or on any other basis in law, for and on behalf of either Views Restaurant or Views Development.’

¹⁵⁹ Supra note 153 para 11.

¹⁶⁰ Ibid para 14. The suretyships in this case specifically contemplated circumstances of compromise and judicial management and, notwithstanding any such event, creditors’ rights would not be prejudiced.

¹⁶¹ Supra note 153 paras 15-16.

¹⁶² Supra note 103.

otherwise expressly made provision for this.¹⁶³ Surprisingly in my view, Saldanha J disregarded the plaintiff's argument and favoured the defendants' argument on the basis that the facts in *Du Toit*¹⁶⁴ were distinguishable in so far as reliance was placed on s 154.¹⁶⁵ The court refused to grant summary judgment on the basis that a *bona fide* defence had been raised by the defendants.

In my view and taking into consideration the application of the common law principles to the law suretyships, as well as the commentary of Rogers J in *Tuning Fork*,¹⁶⁶ the court erred in its decision in ruling by ruling against the plaintiff. The defence raised against the enforcement of the suretyships was one of law and Saldanha J's decision entailed that regardless of the provisions of the business rescue plan, or those of suretyships, the adoption of the business rescue plan had the effect of releasing sureties from their obligations to creditors. Interestingly, this decision was blatantly ignored in *Tuning Fork*.¹⁶⁷ That said, it can be argued that the case of *Tuning Fork*¹⁶⁸ posed different facts on the basis that neither the business rescue plan nor the deed of suretyships sought to preserve creditors' rights against third part sureties in circumstances where there had been a compromise of the principal debt. Interestingly and correctly in my view, on materially similar facts to those of *Du Toit*¹⁶⁹ a different conclusion was arrived at by Bozalek J in *ABSA Bank Limited v Haremza*¹⁷⁰ which is further discussed in 4.5 below.

New Port

Almost a year later following the decision in *Tuning Fork*,¹⁷¹ a unanimous decision of the Supreme Court of Appeal was delivered by Wallis J in the case of *New Port Finance Company (Pty) & Another v Nedbank Limited*.¹⁷² In this case, deeds of suretyships had been executed by the defendants in favour of Nedbank, as the

¹⁶³ Supra note 162 para 68. The decision of the court in this case was overturned on appeal, see 2015 (3) All SA 10 (SCA), however, the comment of the Kathree-Setiloane J, relating to the effect of an adopted business rescue plan on creditors' rights against sureties, was not the main issue of this case, the main area of debate turning on the interpretation of the meaning of a 'binding offer' made in terms of s 153 (1)(b)(ii).

¹⁶⁴ Supra note 153.

¹⁶⁵ Ibid para 19. See footnote reference 156 which details the terms of s 154.

¹⁶⁶ Supra note 116.

¹⁶⁷ Ibid.

¹⁶⁸ Ibid.

¹⁶⁹ Supra note 153.

¹⁷⁰ (12189/2014) 2015 ZAWCHC 73.

¹⁷¹ Supra note 116.

¹⁷² 2016 (5) SA 503 (SCA).

plaintiff, for the obligations of two companies to the bank arising from money borrowed. Notwithstanding that the entities for whom the defendants had stood surety were placed under final liquidation, these entities were taken out of liquidation, placed under business rescue and a business rescue plan was subsequently adopted.¹⁷³

Similarly to the decision in *Du Toit*,¹⁷⁴ it was argued by the defendants that the adoption and implementation of the business rescue plan had the effect of discharging them from their obligations as sureties.¹⁷⁵ Turning focus to the provisions of the executed suretyships, the court noted that the terms of the deed of suretyship made provision for the bank to claim from the sureties notwithstanding any dealings with the principal debtor, the grant of any extension of time, or any compromise in relation to the scope and extent of the principal debtor's indebtedness to the bank creditor.¹⁷⁶

Defendant's counsel's failure to advocate a defence based on the legal moratorium contained in s 133 was met with approval by Wallis J. The court also held that the defendants had not gone so far as to argue that s 128 to s 154 altered the application of the common law of suretyships and creditors' rights against sureties.¹⁷⁷ Although reliance was placed by the defendants on the decision in *Tuning Fork*,¹⁷⁸ the court in *obiter* mentioned that the reasoning of Rogers J was, in the view of Wallis J, by no means clear to him to be correct. The court's view was based on the fact that *Tuning Fork's*¹⁷⁹ reliance on *Moti*¹⁸⁰ was misplaced given that the latter case focused on provisions in the Old Insolvency Act for which there was no direct counterpart in the new Companies Act. Wallis J provided an interesting interpretation when considering the implications of s 154 (which section was considered crucial in Saldanha J's decision in *Du Toit*)¹⁸¹ stating that the provisions apply to a discharge of the debt between a financially distressed company and its creditors. Therefore and in other words, the provisions of s 154 find application only to the relationship between a company and its creditors, not creditors and third party sureties. Following this logic, the court in *New Port*¹⁸² held that the liability of third party sureties would

¹⁷³ Ibid paras 1-2.

¹⁷⁴ Supra note 153.

¹⁷⁵ Ibid para 8.

¹⁷⁶ Ibid para 10.

¹⁷⁷ Ibid para 13.

¹⁷⁸ Supra note 116.

¹⁷⁹ Ibid.

¹⁸⁰ Supra note 138.

¹⁸¹ Supra note 153.

¹⁸² Supra note 172.

therefore remain unaffected save to the extent that the provisions of the business rescue plan provided otherwise.¹⁸³

4.4. REFLECTION: TUNING FORK AND NEW PORT

Pausing to take stock of the decision in *New Port*,¹⁸⁴ it is clear the court adopted the view that notwithstanding the adoption of a business rescue plan by creditors of a financially distressed company, this did not compromise creditors' claims against third party sureties where the deeds of suretyship expressly preserved such rights. It is therefore unclear why, on the one hand, Wallis J's comment in *obiter* was made regarding the correctness of the judgment in *Tuning Fork*¹⁸⁵ and, on the other hand, why he remarked that '...the liability of the surety would be unaffected by the business rescue, unless the plan itself made specific provision for the situation of sureties.'¹⁸⁶

Turning to address the first of these comments, it is the contention of this research paper that the reasoning of Rogers J in *Tuning Fork*¹⁸⁷ was indeed correct. The court, similarly to that in the case of *Moti*,¹⁸⁸ was tasked with addressing a situation for which no answer could be derived from statute at the time. Although there was no direct counterpart in the Old Insolvency Act to the Companies Act, it is challenging to argue against the comparison which was drawn by Rogers J in reaching his determination. Rogers J sought to portray a circumstance whereby under the Old Insolvency Act creditors' rights were preserved against sureties in circumstances of compromise and rehabilitation, however the very same Act was silent on such rights where there had been a statutory assignment.¹⁸⁹ In such absence, the common law prevailed and given that the suretyships did not expressly preserve their rights in circumstances of compromise,¹⁹⁰ it is challenging to advocate that the reasoning underlying the release of the sureties in the case of *Tuning Fork*¹⁹¹ was incorrect.

Turning to address the second of these comments and in my view, Wallis J's remarks that a suretyship would remain unaffected by business rescue save for where

¹⁸³ Ibid para 14.

¹⁸⁴ Supra note 172.

¹⁸⁵ Supra note 116.

¹⁸⁶ Supra note 172 para 14

¹⁸⁷ Supra note 116.

¹⁸⁸ Supra note 138.

¹⁸⁹ Supra note 116 paras 54-6.

¹⁹⁰ Supra note 116 para 1.

¹⁹¹ Supra note 116.

the business rescue plan provides otherwise gives rise to confusion. In the sentences preceding these comments it was highlighted that Wallis J contemplates that s 154 only finds application between a financially distressed company and its creditors. In applying the common law principles of suretyships where the suretyships specifically preserve creditors' rights in circumstances subsequent to the adoption of a business rescue plan, surely such suretyships must prevail notwithstanding the terms of any adopted and implemented business rescue plan. If so, why would Wallis J state that this is the case 'unless the plan itself made specific provision for the situation of sureties?'¹⁹² As was clearly highlighted by Rogers J, the Companies Act simply does not address what the position of third party sureties is pursuant to the adoption of a business rescue plan.¹⁹³ Therefore the position in such circumstances must be administered by the common law and in this regard it has been established that creditors retain their rights against sureties notwithstanding the adoption and implementation of a business rescue plan, subject to the terms of the deed of suretyship.

Another view to be adopted is that Wallis J's comment in *obiter* was intended to refer to the fact that Rogers J was wrong to place reliance on the common law application of suretyships. Simply put and in Wallis J's view, one need only consider the provisions of s 154 of the Companies Act, which section is only of application between a principal debtor and its creditors, not the surety. Having said all of this, although it is appreciated that the ultimate decision in *New Port*¹⁹⁴ is correct, there remain several unanswered issues.

In applying the law of suretyships as set out by Rogers J in *Tuning Fork*,¹⁹⁵ I agree with Wallis J's remark that a creditor can enforce its claims against a third party of an entity in business rescue where there has been a preservation of such rights in the deed of suretyship.¹⁹⁶ This does not, however, address why Wallis J went on to comment that '...the liability of the surety would be unaffected by the business rescue, *unless the plan itself made specific provision for situation of surety.*'¹⁹⁷ Does this mean that where a business rescue plan grants the release of a surety that this has the potential to discharge such surety's liability? This would be directly contrary to

¹⁹² Supra note 172 para 14

¹⁹³ Supra note 116 para 14(i) and 45.

¹⁹⁴ Supra note 172.

¹⁹⁵ Supra note 116.

¹⁹⁶ Supra note 172 para 12.

¹⁹⁷ Ibid para 14.

what has just been explained whereby deeds of suretyship expressly preserve rights in such circumstances.

In light of Wallis J's remark, thought is to be afforded to what should transpire where a minority creditor has a suretyship in its favour, it votes against the adoption of a business rescue plan (which specifically caters for the release of the minority creditor's surety) and such plan is overwhelmingly voted in favour of and adopted by the majority of creditors. Can the adoption of a business rescue plan be challenged where it has been voted in favour of by the majority of creditors and releases a minority creditor's surety? Surely a business rescue plan cannot unilaterally change and affect personal rights of parties in a surety relationship and this may be an issue which our South African company law may need specifically address. A resolution to this is considered in chapter 7 below.

4.5. RECENT CASE LAW ON BUSINESS RESCUE

This 4.5 further explores recent decisions in respect of business rescue proceedings, with a central focus being on creditors' rights against sureties.

Haremza

In the case of *Haremza*¹⁹⁸ the court was once again tasked with determining the liability of a defendant who had stood surety for the debts of a financially distressed company which had been placed under business rescue. The facts in this case were materially similar to that of *Du Toit*,¹⁹⁹ whereby the company for which the defendant stood surety had concluded a finance document with the plaintiff and had failed to discharge its obligations and was subsequently placed under business rescue and, pursuant to this, a business rescue plan²⁰⁰ was adopted and implemented.²⁰¹

Similarly to the decision in *New Port*,²⁰² the surety's defence centred on the accessory nature of suretyships and that the adoption of the business rescue plan resulted in the extinction of the principal debt.²⁰³ No small part of reliance was placed by the surety on the decision of *Tuning Fork*,²⁰⁴ however, Bozalek J was conscious of

¹⁹⁸ Supra note 170.

¹⁹⁹ Supra note 153.

²⁰⁰ The provisions of the business rescue plan as well as the terms of the suretyship in this case identically mirrored wording of that specified in *Du Toit*.

²⁰¹ Supra note 198 paras 1-3.

²⁰² Supra note 172.

²⁰³ Supra note 198 para 6.

²⁰⁴ Supra note 116.

Rogers J's comments that notwithstanding that the adoption of a business rescue plan is a compromise between a principal debtor and its creditor, such compromise only affects creditors' claims against sureties where the deeds of suretyship are absent provisions specifically preserving such rights.²⁰⁵ Although there was a mere acknowledgment of Wallis J's comment²⁰⁶ in *New Port*,²⁰⁷ the court in *Haremza*²⁰⁸ expressed the view that it was obliged to follow the reasoning of the court in *Tuning Fork*²⁰⁹ and held that notwithstanding the compromise reached between the financially distressed company and the plaintiff, such compromise did not discharge the obligations of the defendant surety having regard to the preservation of the plaintiff creditor's rights in the deed of suretyship and/or the business rescue plan.²¹⁰ Therefore and especially having regard to the provisions of the business rescue plan in this case, clearly it was intended that any discharge between the debtor would not constitute an absolute release given that the plaintiff's rights against the surety were not forfeited.²¹¹ Bozalek J, surprisingly, did not place reliance on the decision in *New Port*,²¹² where the facts were materially similar, but rather sought to place greater reliance on the judgment of Rogers J in *Tuning Fork*.²¹³

It is interesting that the decision of *Du Toit*,²¹⁴ which contained carbon copy provisions of the business rescue plan and deed of suretyship and wherein summary judgment was refused, was not even mentioned or relied upon by the court in *Haremza*.²¹⁵ In my opinion, Bozalek J applied the law correctly in this case as no compromise could have been agreed in light of the business rescue plan and deed of suretyship specifically preserving the creditors' rights against the third party surety.

²⁰⁵ Supra note 198 paras 21 and 23.

²⁰⁶ Bozalek J specifically acknowledged that Wallis J's comments were in *obiter* and therefore he was not obliged to follow or provide a view on such comments.

²⁰⁷ Supra note 172.

²⁰⁸ Supra note 198.

²⁰⁹ Supra note 116.

²¹⁰ Supra note 198 para 24.

²¹¹ Ibid para 26.

²¹² Supra note 172.

²¹³ Supra note 116.

²¹⁴ Supra note 153

²¹⁵ Supra note 198.

4.6. BUSINESS RESCUE AND GUARANTEES

The consequences of the legal moratorium once again recently fell before the court in the summary judgment application of *Sapor Rentals (Pty) Limited v Tayob*.²¹⁶ Unlike focusing on the impact of suretyships, the central issue focused on the enforceability of a continuing guarantee executed by a respondent guarantor for the principal debtor's obligations to the applicant.²¹⁷ The terms of the business rescue plan had not been specified in any of the papers before the court and the court was therefore unable to determine whether the obligations of the principal debtor had been discharged which, in turn, may have had some bearing on the respondent guarantor's liability to the applicant creditor. The court stated that it was reluctant to place reliance on the decision in *Tuning Fork*²¹⁸ given that a deed of suretyship, not a guarantee, was the subject of debate in that case.²¹⁹ This notwithstanding, the court held that the Companies Act did not expressly preclude any action from being taken, or stayed, against a guarantor where a financially distressed company was placed under business rescue. It was on this basis that the court rejected the respondent guarantor's argument that the legal moratorium was to be extended to its benefit.²²⁰

Although in my view the decision of the court in *Sapor Rentals*²²¹ is ultimately correct, one cannot help but consider whether Ratshibvumo AJ's reasoning was correct. Based on the preceding decisions already discussed, it is clear that the legal moratorium in s 133 is not equally enjoyed by a third party surety, however, the reason for not extending the benefit to a guarantor is not because the Companies Act fails to expressly exclude this as was stated by the court in *Sapor Rentals*.²²²

There are several distinctions which are to be drawn between a suretyship and a guarantee which were highlighted in the case of *List v Jungers*.²²³ A guarantor guarantees a certain event, for example against registration of transfer of a property into the name of a purchaser it will pay out, and is responsible for indemnifying the creditor against any non-performance by the debtor. On other hand a surety is only

²¹⁶ (07897/2016) 2017 ZAGPJHC 37.

²¹⁷ Ibid para 1.

²¹⁸ Supra note 116.

²¹⁹ Supra note 216 para 12.

²²⁰ Ibid para 13.

²²¹ Ibid.

²²² Supra note 216 para 12.

²²³ 1979 (3) SA 106 (A).

liable where there has been a breach of contract by the debtor. The key distinction is therefore that, unlike a suretyship where the obligation is accessory in nature, the obligation under a guarantee is principal and a guarantor is obliged to pay in the event of certain circumstances transpiring, whereas a surety is an undertaking whereby, first, a debtor is required to perform and secondly, only pursuant to a failure to perform will recourse be had against the surety.²²⁴

Therefore, where an independent guarantee has been furnished for the obligations of a principal debtor to its creditor, and notwithstanding any compromise between the aforementioned parties, the guarantee establishes a principal obligation upon which a creditor can rely upon and proceed against the guarantor. Unlike a deed of suretyship, a guarantee is not dependent on the existence of a underlying principal debt and therefore creditors' rights would be preserved by the issue of such a guarantee. It is for the foregoing reasons that creditors' rights against guarantors should not be circumvented in circumstances of business rescue proceedings and it should have been on this basis that the decision in *Sapor Rentals*²²⁵ was constructed and delivered.²²⁶

²²⁴ Forsyth and Pretorius op cit note 53 at 32.

²²⁵ Supra note 216.

²²⁶ Although not part of the scope of this research paper, it is advocated that because of the primary obligations created by a guarantee, it is a more favourable form of security than suretyships.

5. CHAPTER 5: THE NATURE OF REORGANISATION PROCEEDINGS

5.1. INTRODUCTION

‘The principal purpose of the Bankruptcy Code is to grant a fresh start to the honest but unfortunate debtor.’²²⁷

Similarly to chapter 2 above, the purpose of this chapter 5 is to provide a high-level legal introduction and legal analysis on the Bankruptcy Codes²²⁸ which find application within the jurisdiction of the United States of America. This chapter also sets the foundation for the analysis of case law in chapter 6 and the comparative law analysis in chapter 7 below.

The South African legislature consulted the Bankruptcy Codes when populating chapter 6 of the Companies Act’s business rescue provisions given the numerous jurisdictions which have incorporated the Bankruptcy Codes processes and provisions.²²⁹ It is for this reason, and given the material similarities between the Companies Act chapter 6 and chapter 11 of the Bankruptcy Codes, that a review of American jurisprudence is undertaken in order to ascertain what creditors’ rights are against non-debtors where a non-consensual reorganisation plan seeks to release such non-debtors and how this compares to the legal position adopted in South Africa. Having said this, s 5(2) of the Companies Act provides that our South African courts may consider foreign company law to assist them in making informed decisions.²³⁰ That said and as will appear in particular from a review of American case law in chapter 6 and the comparative analysis conducted in chapter 7 below, caution should be exercised in placing too much reliance on American jurisprudence.

This chapter will focus, in brief, first on the statutory framework in which the Bankruptcy Codes find application. Secondly, the general principles underlying what the reorganisation process seeks to achieve will be discussed. Thereafter, the commencement and termination of reorganisation proceedings, the application of the automatic stay during such proceedings and, significantly, the confirmation of the reorganisation plan will be discussed.

²²⁷ *Marrama v Citizens Bank of Massachusetts*, 549 U.S. 365 (2007) at 367.

²²⁸ The terms ‘**Bankruptcy Codes**’ and ‘**Code**’ shall be used interchangeably. Unless provided for expressly provided for otherwise, reference in this chapter 5 and 6 to a section shall mean a reference to a section of the Bankruptcy Codes.

²²⁹ Stoop and Hutchison op cit note 3 at 3.

²³⁰ Ibid.

5.2. FRAMEWORK OF THE BANKRUPTCY CODES

The Bankruptcy Codes consist of 9 chapters.²³¹ The first three chapters find general application to every bankruptcy proceeding such as, among others, liquidation²³² and reorganisation,²³³ whilst the general rules of administration are contained in the remaining chapters and apply throughout the Code.²³⁴ For purposes of this research paper, particular consideration is afforded to chapter 11 of the Codes which sets out the statutory framework and principles applicable to reorganisations of bankrupt entities.

The Federal Rules of Bankruptcy Procedure²³⁵ govern proceedings within a bankruptcy case, whilst the Codes regulate the rights and procedures of such cases.²³⁶ There is a close interaction between the Code and the Rules such as, on the one hand, s 501 and s 502 of the Code which require that a creditor file a proof of claim and, on the other hand, Rule 3002 specifying the deadline by when such a claim must be filed.²³⁷

5.3. PRINCIPLES UNDERLYING THE REORGANISATION PROCESS

There are three overarching principles which underlie the reorganisation process which is regulated under chapter 11 of the Bankruptcy Codes.²³⁸ The first is to afford a debtor an opportunity to regather itself by evaluating and taking stock of the financial position of its business whilst simultaneously prohibiting any creditors of the debtor from taking any action against it. In this regard and forthwith after the filing of a bankruptcy petition for its reorganisation, this is accomplished by imposing an ‘automatic stay.’²³⁹ Creditors are therefore prohibited from taking any action, including the enforcement of any debt or seizure of any property of the debtor, and this therefore affords the debtor the breathing space it requires to take a step back, re-

²³¹ Steven H Rittmaster ‘Bankruptcy 101’ available at http://apps.americanbar.org/abastore/products/books/abstracts/5190454_chap1_abs.pdf, accessed on 27 December 2017 at 2. The first chapter contains definitions which are to be used for interpretation of all other chapters, the third chapter details administration rules and the fifth chapter addresses the concept of ‘property of the estate.’ The Bankruptcy Codes were introduced without even numbered chapters to allow for expansion of the Code, as was the case with the introduction of chapter 12.

²³² Liquidation proceedings are administered by chapter of the Codes.

²³³ Reorganisation proceedings, akin to South African business rescue proceedings, are administered by chapter 11 of the Codes.

²³⁴ Rittmaster op cit note 231 at 2.

²³⁵ Fed. R. Bankr. 101 (hereinafter referred to as the ‘Rules’).

²³⁶ Rittmaster op cit note 231 at 2-3.

²³⁷ Ibid at 3.

²³⁸ Ibid at 4.

²³⁹ Ibid.

evaluate its position and make decisions as to what would be in not only in its best interest, but also the interests of its creditors and other stakeholders.²⁴⁰ The ‘automatic stay’ is further discussed in 5.5 below.

The second principle underlying the reorganisation process is that it is intended to lead to a ratable sharing of assets among creditors of a similar class.²⁴¹ The term ‘ratable distribution to creditors’ simply implies that reorganisation seeks to achieve an orderly and equitable sharing of a debtor’s existing assets by its creditors. The ratable distribution is in accordance with a prescribed formula outlined in the Code.²⁴² Therefore, reorganisation is driven to ensure that, as near as may be possible, creditors receive a better return than that which would they would otherwise have received on the liquidation of the debtor.

The third and final principle underlying the reorganisation process is that it aims to provide a mechanism to a debtor whereby it can discharge its debts which arose prior to the filing of the reorganisation petition and continue trading under a ‘fresh start.’²⁴³ This is accomplished by a court confirming a reorganisation plan which has been voted on by creditors, such plan being implemented and distributions being ratably made to a debtor’s creditors.²⁴⁴ Significantly, not all discharge of debt is absolute. For example, should a debtor have misrepresented, or concealed, information in the reorganisation plan, a creditor can apply to have the debt declared non-dischargeable.²⁴⁵ In addition to this, the Code expressly specifies in s 523(a)(1) that, among other things, tax and customs duty will not be discharged and a debtor will continue to remain accountable for this.

5.4. COMMENCEMENT AND TERMINATION

Commencement

A debtor may either be placed under reorganisation voluntarily or involuntarily. In the former circumstance, reorganisation commences subsequent to the filing of reorganisation petition, consisting of the filling out and filing of a short,

²⁴⁰ Ibid.

²⁴¹ Ibid.

²⁴² Ibid.

²⁴³ Ibid at 5.

²⁴⁴ Ibid.

²⁴⁵ s 523(a)(2).

standard form by the debtor with a bankruptcy court.²⁴⁶ Together with the filing of the reorganisation petition, a debtor must also file a schedule of its assets and liabilities, a statement detailing record of its financial affairs and a schedule setting out its current income and expenditure.²⁴⁷ In the latter circumstance, and depending on the number of creditors,²⁴⁸ bankruptcy also commences subsequent to the filing of a bankruptcy petition, comprising of materially similar documentation as in the case of a voluntary petition, save that the required documentation is populated by the debtor's creditors. Subsequent to the filing of a bankruptcy petition and forthwith from the date on which such petition is filed, a bankruptcy 'estate'²⁴⁹ is constituted in terms of s 541.²⁵⁰ The 'estate' comprises of all of the debtor's interest in property, or the proceeds, products, rents or earnings of such property interests, 'wherever located and by whomever held.'²⁵¹

Debtor in possession and appointment of a trustee

Under the Bankruptcy Codes the debtor remains in possession of its business and exercises control over its assets and business after the filing of the petition.²⁵² For all intents and purposes, the debtor retains control and operation of its business, its day to day administration and regulation of finances.²⁵³ That said, the debtor is said not to be 'in possession' where there has been an appointment of a trustee or where

²⁴⁶ s 301.

²⁴⁷ Chapter 11-Bankruptcy Basics available at <http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics>, accessed on 27 December 2017 at 1.

²⁴⁸ s 303(b)(1) contemplates that where a debtor has less than 12 creditors then any one creditor can file for bankruptcy, however, where there are more than 12 creditors then at least 3 creditors must be in agreement that bankruptcy will be petitioned. In either circumstance, the creditors must hold non-disputed, an at least partially non-contingent (or liquidated) claims which have a combined total of unsecured, non-contingent debt of at least \$10,000.

²⁴⁹ Rittmaster op cit note 231 at 8 'Property of the estate' is defined, in broad strokes, as being property in which the debtor had an interest in at the date of the filing of the bankruptcy petition.

²⁵⁰ Ibid at 6. Claims pre and post-petition filing are treated differently given that claims post-petition cannot be discharged following the adoption of a reorganisation plan and form part of the general administration expense of the debtor's bankrupt estate.

²⁵¹ s 541(a).

²⁵² A debtor in possession is referenced as such in s 1101(1) and is also commonly referred to as a 'DIP.'

²⁵³ s 1107(a) states that:

'Subject to any limitations on a trustee serving in a case under this chapter, and to such limitations or conditions as the court prescribes, a debtor in possession shall have all the rights, other than the right to compensation under section 330 of this title, and powers, and shall perform all the functions and duties, except the duties specified in sections 1106(a)(2), (3), and (4) of this title, of a trustee serving in a case under this chapter.'

reorganisation proceedings have been converted to liquidation proceedings.²⁵⁴ The trustee is a representative of the debtor's estate.²⁵⁵

Following the commencement of the reorganisation, but before confirmation of a reorganisation plan, a bankruptcy court may order the appointment of a trustee at any time on request of an interested party or the United States trustee,²⁵⁶ and after notice and a hearing.²⁵⁷ The trustee is appointed where there has been, among other things, any fraud or gross mismanagement of the affairs of the debtor by its current management, either before or after the commencement of the reorganisation case, or similar cause,²⁵⁸ or if such an appointment would be in the best interest of creditors as well as the debtor's estate.²⁵⁹ The powers of the trustee, if appointed, are comprehensively set out in s 1106, including being accountable for any property received, examining any proofs of claims submitted and providing interested parties, such as creditors, with information of the debtor's estate.²⁶⁰ Where a trustee is not appointed, and the debtor remains in possession of the estate, the debtor has, save for certain exceptions,²⁶¹ the powers, duties and functions of a trustee as set forth in s 1106.²⁶² Both debtor and trustee are empowered, in terms of s 1108, to operate the business of the reorganised entity, save for where a court has ruled otherwise.

²⁵⁴ Chapter 11-Bankruptcy Basics available at <http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics>, accessed on 27 December 2017 at 2.

²⁵⁵ s 323(a).

²⁵⁶ The Code also speaks of a 'United States trustee' who is a different individual to the trustee appointed by the bankruptcy court. The United States trustee appears to be a designee of the United States trustee and, as I understand, a representative of the bankruptcy court. Where for example a trustee has not been appointed, and in terms of s 341(a), the duties of the United States trustee includes occupying the role of a supervisor during reorganisation proceedings, convening a meeting of creditors in terms of s 341 and monitoring proceedings and the submission of operating reports and fees.

²⁵⁷ s 1104. The words 'after hearing and notice' mean:

(A) after such notice as is appropriate in the particular circumstances, and such opportunity for a hearing as is appropriate in the particular circumstances; but

(B) authorizes an act without an actual hearing if such notice is given properly and if— (i) such a hearing is not requested timely by a party in interest; or (ii) there is insufficient time for a hearing to be commenced before such act must be done, and the court authorizes such act.

²⁵⁸ s 1104(a)(1).

²⁵⁹ s 1104(a)(2).

²⁶⁰ s 1106(a), makes reference to the trustee having the duties of those of a trustee appointed in liquidation proceedings under chapter 7 (s 704).

²⁶¹ The debtor is exempt from administering the duties, powers and functions specified in s 1106 (a)(2), (3) and (4).

²⁶² s 1107(a).

Termination

In my view, it would appear that a debtor has the right to unilaterally terminate reorganisation proceedings. That said, a debtor cannot exercise such right where it is not in possession (in other words a trustee has been appointed),²⁶³ where creditors have applied for the reorganisation of the debtor²⁶⁴ or where the debtor was placed under reorganisation other than of its own volition.²⁶⁵ In addition to the foregoing, on request of an interested party, and after hearing and notice, a court may convert reorganisation proceedings to liquidation proceedings under chapter 7, where such conversion is in the best interests of a debtor's creditors and its estate.²⁶⁶ In terms of s 305, a court may dismiss a reorganisation process, or suspend all proceedings under such process, if at any time such dismissal or suspension would be in the interest of both a debtor and its creditors.²⁶⁷ Finally, the reorganisation process can also be terminated subsequent to the administration of the estate, in accordance with the confirmed reorganisation plan, and the discharge of the trustee.²⁶⁸

5.5. THE AUTOMATIC STAY

In terms of s 326(a), an 'automatic stay' is immediately imposed on the property of the estate of a debtor company against all creditors on the filing of the reorganisation petition. This materially amounts to, for all intents and purposes, the legal moratorium embedded in s 133(1) of the Companies Act. The court in *St Paul Fir and Marine Ins. Co. v Labuzan*²⁶⁹ remarked that:

'The automatic stay is one of the fundamental protections provided by the bankruptcy laws. It gives the debtor a breathing spell from his creditors. It stops all collection efforts, all harassment, and all foreclosure actions. It permits the debtor to attempt repayment or reorganisation plan, or simply to be relieved of the financial pressures that drove him into bankruptcy.'²⁷⁰

²⁶³ s 1112(a)(1).

²⁶⁴ s 1112(a)(2).

²⁶⁵ s 1112(a)(3).

²⁶⁶ s 1112(b)(1).

²⁶⁷ s 305(1)

²⁶⁸ s 350(a).

²⁶⁹ 579 F.3d 533 (5th Cir. 2009).

²⁷⁰ *Ibid* at 540

The automatic stay finds application in all circumstances specified in s 362(a)²⁷¹ and, similarly to business rescue proceedings in South Africa, finds application regardless of whether such proceedings have been commenced by a debtor or by its creditors.²⁷² Having said this, a party may apply to a court to have the automatic stay lifted in terms of s 362(d).²⁷³ The automatic stay is further discussed in case law in 6.2 below.

5.6. THE REORGANISATION PLAN

Meeting of creditors and constitution of creditors' committee

Following the filing of a bankruptcy petition, a meeting of creditors is scheduled by the debtor's trustee where one has been appointed, or by the United States trustee.²⁷⁴ Although creditors may attend the meeting, their participation is limited as the examination of the debtor is conducted by the trustee. In this regard, the

²⁷¹ s 362 (a) states that:

'Except as provided in subsection (b) of this section, a petition filed under section 301, 302, or 303 of this title, or an application filed under section 5(a)(3) of the Securities Investor Protection Act of 1970, operates as a stay, applicable to all entities, of—

- (1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;
- (2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;
- (3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;
- (4) any act to create, perfect, or enforce any lien against property of the estate;
- (5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;
- (6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;
- (7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and
- (8) the commencement or continuation of a proceeding before the United States Tax Court concerning a tax liability of a debtor that is a corporation for a taxable period the bankruptcy court may determine or concerning the tax liability of a debtor who is an individual for a taxable period ending before the date of the order for relief under this title.'

²⁷² Rittmaster op cit note 231 at 9.

²⁷³ s 362 (d) states that:

'On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section, such as by terminating, annulling, modifying, or conditioning such stay for cause, including the lack of adequate protection of an interest in property of such party in interest; with respect to a stay of an act against property under subsection (a) of this section, if—

- (A) the debtor does not have an equity in such property; and
- (B) such property is not necessary to an effective reorganisation.'

²⁷⁴ Rittmaster op cit note 231 at 15. The meeting of creditors is scheduled by the trustee of the debtor in possession in terms of s 341 and generally takes between place 30 to 60 days following the filing of the bankruptcy petition. In terms of s 323, the trustee is a representative of the estate and, for all intents and purposes, assists the debtor in possession with facilitating its reorganisation.

debtor is questioned on, among other things, its on-going insurance coverage, its financial records and the profitability of its continued business operations. Creditors are generally permitted to raise queries as to whether the debtor has committed bankruptcy fraud which would, in turn, affect its right to discharge its debts, an example of this being having concealed certain assets which it did not otherwise specify in its petition for bankruptcy. No substantive ruling or decisions are made at the meeting, the purpose simply being organisational and informational. That said, and although not expressly stated in the Bankruptcy Codes at s 341, informally a discussion is had at the creditors' meeting as to the composition of a creditors' committee.²⁷⁵

A creditors' committee is appointed as soon as may be practical after a debtor has filed for bankruptcy. As mentioned, this committee is generally constituted at the first meeting of creditors and is appointed by the trustee or the United States trustee, as the case may be.²⁷⁶ The creditors' committee assists with providing information to other creditors who hold claims against the debtor's estate and who have not been appointed to such a committee.²⁷⁷ The power and duties of the creditors' committee are more fully set out in s 1103 and include consulting with the trustee or debtor in possession concerning the administration of the case,²⁷⁸ investigating the assets, liabilities and financial position of the debtor²⁷⁹ and, significantly, participate in the formulation of the reorganisation plan.²⁸⁰

The reorganisation plan

In terms of s 1121, a debtor is afforded a 120 day exclusivity period, routinely extended to 180 days, in terms of which it has the exclusive right to populate and propose a plan of reorganisation. If a trustee replaces the debtor in possession, the exclusivity immediately terminates and any creditor, or the debtor, may propose a plan.²⁸¹ The content of the reorganisation plan is comprehensively detailed in s 1123 and must include, among other things, all claims against the debtor's estate²⁸² and the

²⁷⁵ Ibid at 15-6.

²⁷⁶ Ibid at 16.

²⁷⁷ In terms of s 1102(b)(1), the creditors' committee generally comprises of those creditors who hold the seven largest claims against the debtor's estate.

²⁷⁸ s 1103(c)(1).

²⁷⁹ s 1103(c)(2).

²⁸⁰ s 1103(c)(3).

²⁸¹ s 1121(c).

²⁸² s 1123(a)(1).

manner in which it is proposed that the plan will be implemented.²⁸³ Before the plan is put to a vote by creditors, the debtor is required to submit a disclosure statement to the court which is, to a large extent, a repetition of the terms of the plan.²⁸⁴ For all intents and purposes, the disclosure statement must detail sufficient information in respect of the debtor's assets, liabilities and business affairs such that the creditors who will vote on the reorganisation plan are in a position to make an informed decision.²⁸⁵

In terms of s 1126 'at least two-thirds in amount and more than one-half in number of the allowed claims in such class' are required to accept the plan. If the plan is accepted by creditors it is then placed before the bankruptcy court for confirmation in terms of s 1128 and s 1129 respectively. s 1129, in particular, comprehensively details over several requirements which a court is to take into account when confirming a plan and, significantly, the plan is only adopted once confirmed by a court. The binding effect between a debtor and its creditors subsequent to the confirmation of the plan is specified in s 1141(a) and (d)(1) which respectively state that:

's 1141(a) - except as provided in subsections (d)(2) and (d)(3) of this section, the provisions of a confirmed plan bind the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the plan and whether or not such creditor, equity security holder, or general partner has accepted the plan.'

's 1141(d)(1) Except as otherwise provided in this subsection, in the plan, or in the order confirming the plan, the confirmation of a plan—

(A) discharges the debtor from any debt that arose before the date of such confirmation...'

The provisions of s 1141 are clear that, save for certain exceptions,²⁸⁶ a confirmed reorganisation plan is binding on, among others, a debtor and its creditor. It is at this stage of the reorganisation process, the confirmation of the plan, that a discord has been struck between various courts of the United States of America, particularly where courts have been requested to confirm non-consensual

²⁸³ s 1123(a)(5).

²⁸⁴ Rittmaster op cit note 231 at 26.

²⁸⁵ Chapter 11-Bankruptcy Basics available at <http://www.uscourts.gov/services-forms/bankruptcy/bankruptcy-basics/chapter-11-bankruptcy-basics>, accessed on 27 December 2017 at 2

²⁸⁶ See, for example s 141(d)(6)(B), which provides that the confirmation of a plan does not release a debtor from its obligations to discharge any tax or customs duty.

reorganisation plans. In this regard and turning to afford consideration to the legal consequences of the confirmation of a plan, consideration is afforded to s 524(e) of chapter 11 of the Code which states that a ‘...discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt.’ It has been advocated however that this can be outweighed by placing reliance on s 105 which affords courts broad equitable powers by stating that:

‘[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte,²⁸⁷ taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.’

The interplay between these two sections is heavily disputed in the circuit courts of the United States of America in circumstances where confirmation of a non-consensual reorganisation plan is sought. This is because s 524 clearly specifies that a discharge of debt, as contemplated in s 1141(d)(1), does not release a third party, such as a surety, from its obligations, however, s 105 affords the court a discretionary power to potentially disregard this. This issue is further explored in chapter 6 below.

²⁸⁷ ‘Sua sponte’ means ‘of its own accord.’

6. CHAPTER 6: REORGANISATION: UNITED STATES OF AMERICA

6.1. INTRODUCTION

This chapter 6 will primarily focus on the interplay between s 524(e) and s 105(a) of the Bankruptcy Codes. Unlike under South African law where the position is currently regulated by the common law, creditors' rights against third parties, such as sureties and guarantors, of bankrupt companies in the United States of America falls to be regulated by statute. First, this chapter examines the various courts' interpretations and decisions in respect of extending the benefit of the automatic stay to co-debtors in terms of s 362 under chapter 11. Secondly, this chapter also explores whether creditors' rights against non-debtors are preserved notwithstanding their release following the confirmation of a non-consensual reorganisation plan.²⁸⁸ It is undoubtedly clear from the cases to be discussed below that there is a divide in opinion between the various courts as to whether non-debtors should be released following the confirmation of a non-consensual reorganisation plan, or whether such a release can even be introduced into a plan.

6.2. AUTOMATIC STAY

Unlike chapters 12²⁸⁹ and 13,²⁹⁰ chapter 11 of the Bankruptcy Codes, which administers bankruptcy and reorganisation, fails to extend the benefit of the 'automatic stay' to co-debtors.²⁹¹ Therefore, chapters 12 and 13 expressly extend the benefit of the automatic stay to non-debtors whilst chapter 11 does not do so. The absence of such mention has been interpreted by some courts as legislative intent that the benefit of the automatic stay does not extend to parties other than the principal

²⁸⁸ Reference is consistently had in American case law to a 'non-consensual reorganisation plan' which entails that it is one which has not received the support of creditors, or there a certain provisions in the plan, such as the release of non-debtors, which has not been received favourably by creditors.

²⁸⁹ Chapter 12 is titled 'Adjustment of Debts of a Family Farmer or Fisherman with Regular Annual Income.' The automatic stay in this chapter is catered for in s 1201 and specifically finds application to third parties who have agreed to be held liable for the obligations of the principal debtor concerned.

²⁹⁰ Chapter 13 is titled 'Adjustment of Debts of an Individual with Regular Income.' Similarly to chapter 12, and at s 1301, the automatic stay is extended to co-debtors.

²⁹¹ The Bankruptcy Codes, and case law, refer interchangeably to 'non-debtors' and 'co-debtors' which, for all intents and purposes, is a reference to third parties who have undertaken to be jointly liable to a creditor for the obligations of a principal debtor, whether such liability arises by means of a guarantee, deed of suretyship or otherwise.

debtor.²⁹² This notwithstanding however, the automatic stay has been granted by some courts to non-debtors under chapter 11 having regard to s 362²⁹³ and s 105 respectively.²⁹⁴ That said and regardless of which section courts rely on in determining whether the automatic stay finds application, it is generally appreciated that ‘unusual circumstances’ must exist for such stay to be extended to non-debtors.²⁹⁵

In the case of *Williford v Armstrong World Industries Inc*,²⁹⁶ the fourth circuit rejected the co-debtors’ contention that the automatic stay was to extend to their benefit. This case centred on a plaintiff’s claim arising from exposure to, and harm caused by, various asbestos products which had been manufactured by the defendants. During trial proceedings several of the defendants filed for bankruptcy and the remaining co-defendants advocated that as a result of this the automatic stay was to be extended to their benefit as well. The defendants alleged that all claims against the defendants, including those defendants which had filed for bankruptcy, were inextricably interwoven and the matter could not proceed without bankruptcy proceedings first having been concluded.²⁹⁷ This defence was rejected by the court on the basis that joint tortfeasors²⁹⁸ are not indispensable parties.²⁹⁹ The defendants also alleged that failure to extend the automatic stay would violate s 362, however, this was also rejected by the court on reasoning that s 362 finds application to ‘debtors’ only and not co-debtors.³⁰⁰ Finally, the non-debtors also raised the defence that the court was to exercise the discretionary powers afforded to it under s 105 to extend the benefit of the stay to them, however, the court ruled that the co-debtors had failed to

²⁹² Katherine J. Clayton and Martha R. Sacrinty ‘Bankruptcy and Guarantors,’ presented at the Middle District of North Carolina Bankruptcy Seminar, April 29, 2011, available at http://www.brookspierce.com/sites/default/files/attachments/KAC_Bankruptcy_and_Guarantors_Manuscript.pdf, accessed on 27 December 2017 at 11-2.

²⁹³ s 362(a) states, among other things, that save for as provided in subsection (b) of that section the circumstances under which the automatic stay will find application are in respect of the commencement or continuation judicial, administrative or other action or proceedings against the debtor (s 362(a)(1)). s 362(b) states, among other things, that the automatic stay does not apply where there has been a commencement, or there is a continuation, of criminal action or proceedings against the debtor.

²⁹⁴ In the case of *Williford v Armstrong World Industries, Inc*, 715 F. 2d 124 (4th Cir. 1983) the extension of the automatic stay was refused under s 362, however, in *A.H. Robins Company Incorporated v Piccinin*, 788 F.2d 994 (4th Cir. 1986) a stay was granted under s 362.

²⁹⁵ Clayton and Sacrinty op cit note 292 at 12.

²⁹⁶ 715 F.2d 124 (4th Cir. 1983).

²⁹⁷ Ibid at 126.

²⁹⁸ ‘Tortfeasors’ refers to claims arising against parties under the law of delict where, for example, damage has negligently been caused by two or more people and their liability is joint and several to the person against whom harm has been caused.

²⁹⁹ Ibid para 127.

³⁰⁰ Ibid.

advocate sufficient grounds upon which not to enforce the stay and therefore the court did not extend the automatic stay.³⁰¹

The case of *A.H. Robins Company Incorporated v Piccinin*³⁰² is illustrative of circumstances where the court did extend the automatic stay to co-debtors. The case centred on defective contraceptives which had been marketed and had caused numerous unplanned pregnancies and infertility issues. As a result of this, thousands of lawsuits were filed against the company concerned as well as co-defendants who were involved in the administration of the company. The company ultimately filed for bankruptcy and numerous plaintiffs sought to sever their ties with the bankrupt company and to proceed against the co-defendants who were not bankrupt.³⁰³ The company filed an action against the plaintiffs seeking a determination by the court that its product liability policy was the property of the bankruptcy estate and that all of the plaintiffs' claims against all of the defendants should be prohibited.³⁰⁴ The court stated that unusual circumstances arise 'when there is such identity between the debtor and the third-party defendant that the debtor may be said to be the real party defendant and that judgement against the third-party defendant will in effect be a judgment or finding against the debtor.'³⁰⁵ The court ruled to extend the automatic stay in favour of the co-debtors, placing particular reliance on s 362(a)(3), on reasoning that such a stay was necessitated when required to secure possession or exercise control over the property of the debtor.³⁰⁶ The court therefore exercised its discretion to extend the automatic stay in this section, notwithstanding that such stay is not specifically granted to co-debtors under chapter 11.

6.3. INTERPLAY BETWEEN S 524(E) AND S 105(A)

Purpose of reorganisation plan

As discussed under 5.6 above, reorganisation proceedings culminate with the confirmation of a reorganisation plan by the court which amounts to, for all intents

³⁰¹ Ibid at 127.

³⁰² 788 F.2d 994 (4th Cir. 1986).

³⁰³ Ibid at 996.

³⁰⁴ Clayton and Sacrinty op cit note 292 at 14.

³⁰⁵ Supra note 302 at 999.

³⁰⁶ Ibid at 1002.

and purposes, a contract between the debtor and its stakeholders.³⁰⁷ It is the intent of a reorganisation plan to resolve all matters affecting the bankrupt debtor, including resolving any indemnification claims which are brought by non-debtors where they have had to settle creditors' claims on behalf of the bankrupt debtor.³⁰⁸ Therefore and in an attempt to provide a bankrupt debtor with a truly 'fresh' start, the scope of the reorganisation plan is expanded to include the release of non-debtors, even where such release is non-consensual by creditors.³⁰⁹

As mentioned under 5.6 above, s 524(e) restricts the release of non-debtors following the discharge of a principal debtor under a reorganisation plan, however, s 105(a) affords the bankruptcy courts broad equitable powers to take such action as is necessary and appropriate to give effect to the provisions of the Bankruptcy Codes.³¹⁰ Although some courts have relied on their discretionary power in terms of s 105(a) to release non-debtors following the confirmation of a non-consensual reorganisation plan, such power and authority has been challenged by other courts on the basis that it is prohibited by the provisions of s 524(e). The interplay between these two sections is of particular importance when determining whether a non-consensual reorganisation plan, which seeks to release a non-debtor from liability, is valid. The interplay between these two sections is examined below in the context of releasing non-debtors from their security instruments following the confirmation of a reorganisation plan notwithstanding the express mandate of s 524(e).

Terminology of s 524(e) and s 105(a)

The starting point of consideration is the wording expressed in both of s 524(e) and s 105(a). It is clear from the language stated in s 524(e) that the discharge of the debt is personal to a debtor and does not affect *any other entity*.³¹¹ Therefore the wording in this section clearly suggests that no person, other than the principal debtor, is released from their liability to creditors following the confirmation of a

³⁰⁷ Michael S Etkin and Nicole M Brown, 'Third-Party Releases?-Not So Fast! Changing Trends and Heightened Scrutiny' (2015) 29 *AIRA Journal* available at <https://www.lowenstein.com/media/3182/third-party-releases-not-so-fast.pdf>, accessed on 27 December 2017 at 22.

³⁰⁸ American Bankruptcy Journal, 'Are non-debtor releases permanent injunctions authorised under the bankruptcy codes,' available at <https://www.abi.org/abi-journal/are-non-debtor-releasespermanent-injunctions-authorized-under-the-bankruptcy-code> accessed on 27 December 2017 at 1.

³⁰⁹ *Ibid.*

³¹⁰ Peter M. Boyle, 'Non-Debtor Liability in Chapter 11: Validity of Third Party Discharge in Bankruptcy', 61 *Fordham L. Rev.* 421 (1992) at 422.

³¹¹ *Ibid* at 423.

reorganisation plan. This finds support in the case of *Mellon Bank v Siegel*³¹² where it was held that the Bankruptcy Code finds application to the relationship between a principal debtor and its creditors, and not between the non-debtor and creditors.³¹³

On the other hand, s 105(a) is a blanket provision affording courts the power to ‘...issue any order, process, or judgment that is necessary or appropriate to carry out the provisions...’ of chapter 11. This has been relied upon by courts to confirm and uphold provisions in a non-consensual reorganisation plan granting the release of non-debtors in certain circumstances notwithstanding the mandate of s 524(e). This interpretation by the courts finds support in *Republic Supply v Shoaf*³¹⁴ where it was held that s 524(e) did not specifically prohibit courts from discharging non-debtors where such discharge was an integral part to the reorganisation plan and had been accepted by creditors. Significantly, the Bankruptcy Codes fail to provide a scale upon which these two competing sections can be weighed up against each other in order to determine which section is to be afforded greater consideration. What is clear though is that where a reorganisation plan is silent on the release of a non-debtor’s liability, the general consensus is that a non-debtor is not released from liability and creditors are therefore free to pursue their claims against such non-debtors.³¹⁵

The divide in opinion is clear between the United States circuit courts when considering the difference in interpretation on the interplay between s 105(a) and s 524(e) having regard to the issue of whether creditors’ rights are preserved against non-debtors notwithstanding their release following the confirmation of a non-consensual reorganisation plan. Courts, such as the Ninth and Eleven Circuits, have held that such a release is prohibited under s 524(e).³¹⁶ Other courts, such as the Second and Fourth Circuits, have held that the provisions of s 105(a) afford them equitable powers in terms of which they have the right, after having taken into consideration particular circumstances, to sanction a non-consensual reorganisation plan and consequently safeguard non-debtors against the claims of creditors.³¹⁷

³¹² 96 B.R. 505 (E.D. Pa. 1989).

³¹³ Boyle op cit note 310 at 506.

³¹⁴ 815 F.2d 1046 (5th Cir. 1987).

³¹⁵ Boyle op cit note 310 at 422-23.

³¹⁶ Clayton and Sacrinty op cit note 292 at 23. See the cases of *In re Sure-Snap*, 983 F. 2d 1015 (11th Cir. 1993) and *Underhill v Royal*, 769 F. 2d 1426 (9th Cir. 1985).

³¹⁷ See the case of *A.H. Robins v Mabey*, 880 F. 2d 694 (4th Cir. 1989) at 701, where the court held that it was entitled to exercise equitable powers and confirm the adoption of a plan which allowed for the release of certain non-debtors. The court placed reliance on the decision in *Shoaf* supra note 314 at 1050, where it was held that confirmation of a reorganisation plan has a *res judicata* effect on subsequent action against a guarantor.

Significantly, following the Enron collapse,³¹⁸ there has been a departure by some courts, such as the Second Circuit, on their previous views expressed on being able to freely exercise their equitable powers under s 105(a). This was evidenced in the case of *In re Metromedia Fiber Network Incorporated*,³¹⁹ discussed further below, where the court specifically acknowledged the factors to be taken into account when considering to release non-debtors in the confirmation of a reorganisation plan as laid out in the case of the *In re Dow Corning Corp.*³²⁰

s 105(a): Discharge of Non-Debtors

It is apparent that the Second, Third and Fourth Circuit courts have adopted a more flexible approach in their interpretation of the Bankruptcy Codes and that non-debtor releases under a non-consensual plan of reorganisation has been treated as acceptable under certain circumstances.³²¹ In the case of *In re Continental Airlines*,³²² the court was unwilling, based on the circumstances of the particular case concerned, to exercise the powers afforded to it under s 105(a) on the basis that the discharge of the non-debtors concerned was inappropriate as they did not satisfy even the most flexible tests of fairness and necessity by supporting factual findings.³²³ The court therefore did not specifically state that it was against the release of non-debtors under a non-consensual plan. The court seemed to suggest that although it may not have been prepared to grant a discharge in this particular matter, it would grant such discharge under a non-consensual reorganisation plan where sufficient evidence was placed before it evidencing that it would be fair to do so. The court held that the ‘hallmarks of permissible non-consensual releases [are] fairness, necessity to the reorganisation and specific factual findings to support these conclusions.’³²⁴ This statement has flowed from the court’s favourable reference³²⁵ to the cases of *A.H.*

³¹⁸ Enron was an American energy, commodities, and services related company. The senior management of Enron was accused of federal charges including conspiracies to commit securities and wire fraud, insider trading and, among other things, making false representations to their auditors. Enron filed for bankruptcy in the early 2000s and the event significantly contributed to the introduction of the Sarbanes-Oxley Act of 2002. Available at <https://en.wikipedia.org/wiki/Enron>, accessed on 1 February 2018.

³¹⁹ 416 F. 3d 136 (2d Cir. 2005).

³²⁰ 280 F. 3d 648 (6th Cir. 2002).

³²¹ Etkin and Brown op cit note 307 at 23.

³²² 203 F.3d 203 (3d Cir. 2000).

³²³ Ibid at 214.

³²⁴ Ibid.

³²⁵ Ibid.

*Robins*³²⁶ and *Securities and Exchange Commission v Drexel Burnham Lambert Group Inc (In re Drexel Burnham Lambert Group Inc)*.³²⁷

In the case of *Drexel Burnham Lambert Group*,³²⁸ the court held that notwithstanding the inclusion of non-debtor release provisions in the reorganisation plan and that such a release was non-consensual by creditors, it was prepared to confirm such plan based on the compensation to be awarded to creditors.³²⁹ The court held that it may ‘...enjoin a creditor from suing a third party, provided that the injunction plays an important role in the debtor’s reorganisation plan.’³³⁰ Therefore, the court in this case was of the view that confirming the release of non-debtors was appropriate in the circumstances as it was a crucial component to the settlement and reorganisation of the bankrupt entity that claims against the non-debtors were not pursued.³³¹ This was taken a step further in the case of *Monarch Life Ins. Co. v Ropes & Gray*³³² where the court held that:

‘...in extraordinary circumstances it has been held that a bankruptcy court can grant permanent injunctive relief essential to enable the formulation and confirmation of a plan of reorganisation if, for example non-debtors who would otherwise contribute to funding the plan will not settle their mutual claims absent protection from potential post-confirmation lawsuits arising from their pre-petition relationship with the chapter 11 debtor.’³³³

It was also substantiated in the case of *Matter of Munford Inc*,³³⁴ where it was held that non-debtors should be released from their obligations to creditors where it would in the circumstances be fair and equitable to do so, in particular where such non-debtors are an integral part to the success of the reorganisation plan.³³⁵ Therefore, another factor to be taken into consideration when confirming the release of non-debtors under a reorganisation plan is whether they will materially contribute to the reorganisation, mainly in the form of a monetary contribution and, in so doing, satisfy creditors’ claims. The notion of substantial contribution by non-debtors was also

³²⁶ Supra note 302.

³²⁷ 960 F. 2d 285 (2d Cir 1992).

³²⁸ Ibid.

³²⁹ Ibid at 293.

³³⁰ Ibid.

³³¹ Ibid.

³³² 65 F. 3d 973 (1st Cir. 1995).

³³³ Ibid at 980-81.

³³⁴ 97 F. 3d 449 (11th Cir. 1996).

³³⁵ Ibid at 455.

afforded recognition in the case of *In re Transit Group Inc*³³⁶ where the release provision specified in the reorganisation plan was particularly broad and extended such release to, among others, the debtor, the debtor's professional corporation and pension plan for the debtor's professional corporation.³³⁷ The court in this matter held that s 524(e) does not restrict the release of non-debtors where such debtors have made significant contributions to the principal debtor's reorganisation.³³⁸ The court therefore aligned itself with those courts which have previously adopted a similar view that, notwithstanding the mandate of s 524(e), they have the discretionary power to make a determination on the confirmation of a non-consensual reorganisation plan which releases non-debtors. In doing so, reliance was had on the factors set out in the case of *In re Dow Corning Corp.*³³⁹

In the matter of *In re Dow Corning Corp.*,³⁴⁰ the court was reluctant to grant the release of non-debtors where creditors had not consented to the same, however, it did state that an open mind would be kept in 'unusual circumstances' which would otherwise necessitate the release of non-debtors.³⁴¹ That said, the court examined the decisions of *A.H. Robins*³⁴² and *Drexel Burnham Lambert Group*³⁴³ and sought to articulate on what factors a court would be required to afford consideration to when exercising its powers under s 105(a) having regard to non-debtor releases under a non-consensual reorganisation plan. This includes considering whether:

- (i) 'the identity of interests between debtor and third party, such as an indemnity relationship, are such that a suit against the third party is in essence a suit against the debtor or will deplete the assets of the estate;
- (ii) the non-debtor has contributed substantial assets to the reorganisation;
- (iii) the injunction is essential to reorganisation to permit the debtor to be free from indirect suits that would cause indemnitor contribution claims against the debtor;
- (iv) the impacted creditors overwhelmingly voted to accept the plan;
- (v) the plan provides a method to pay creditors affected by the injunction;
- (vi) the plan provides payment in full to those creditors who choose not to settle; and
- (vii) the bankruptcy court's records support the injunction or release.³⁴⁴

³³⁶ 286 BR 811 (Bankr. M.D. Fla. 2002).

³³⁷ *Ibid* at 814-15.

³³⁸ *Ibid* at 817-18.

³³⁹ *Supra* note 320.

³⁴⁰ *Ibid*.

³⁴¹ *Ibid* at 658.

³⁴² *Supra* note 302.

³⁴³ *Supra* note 327.

³⁴⁴ *Supra* note 320 at 658.

s 524(e): Restriction on Discharge of Non-Debtors

Courts in both the Ninth and Tenth Circuits have adopted a strict interpretation of the Bankruptcy Codes concerning releases of non-debtors under a non-consensual reorganisation plan and have relied on the provisions of s 524(e), as opposed to s 105(a), when making a determination.³⁴⁵ In the case of *Union Carbide Corp v Newboles*³⁴⁶ the court stated that the provisions of bankruptcy laws could not be waived by private parties through the confirmation of a reorganisation plan.³⁴⁷ s 1129(a) specifically states that where a plan of reorganisation is contrary to the Codes such a plan cannot be confirmed and these courts have adopted the view that a non-debtor discharge is contrary to s 524(e).³⁴⁸ In the case of *In re American Family Enterprises*,³⁴⁹ the Third Circuit Court made a determination that the contribution of one non-debtor party to the reorganisation of the bankrupt entity was sufficient reason to release not only that non-debtor, but all other non-debtors as well.³⁵⁰ In this regard, the court held that

‘...this court must determine only that sufficient compensation is being paid to the class, and need not speculate as to appropriate contribution of each defendant. The release of the non-contributing defendants through a settlement agreement is no reason for disapproving the compromise.’³⁵¹

Interestingly and post the Enron collapse, the court in *In re Washington Mutual Incorporation*³⁵² rejected the release of non-contributing directors and officers which had been determined in a markedly different manner by the court in *In re American Family Enterprises*.³⁵³ In doing so, the court, among other things, cited the factors set out by the court in *In re Master Mortgage Investment Fund, Inc*,³⁵⁴ which factors were materially similar to those set out in the case of *In re Dow Corning*

³⁴⁵ Etkin and Brown op cit note 307 at 23.

³⁴⁶ 686 F.2d 593 (7th Cir. 1982).

³⁴⁷ Ibid at 595.

³⁴⁸ Boyle op cit note 310 at 428. See for example the case of *In re Future Energy Corp*. 83 B.R. 470 (Bankr. S.D. Ohio 1988) at 486, where a reorganisation plan seeking to release non-debtors in exchange for their funding contribution to the reorganisation was held to be contrary to s 524(e). The court in *Union Carbide* supra note 346 at 595, held that contributions by non-debtors cannot serve as consideration for purposes of discharging non-debtors.

³⁴⁹ 256 B.R. 377 (D.N.J. 2000).

³⁵⁰ Although, strictly speaking, the release in this matter was decided in the context of a settlement, there was a funding agreement releasing the parties which was the true means by which the debtors could secure funds to discharge their obligations under the plan and is therefore materially similar to the reorganisation plan context.

³⁵¹ Supra note 349 at 428.

³⁵² 422 B.R. 314 (Bankr. D. Del. 2011).

³⁵³ Supra note 349.

³⁵⁴ 168 B.R. 930 (Bankr. W.D. Mo. 1994).

*Corp.*³⁵⁵ In taking these factors into account, the court stated held that directors or officers' right of recourse against a debtor does not constitute sufficient grounds for release and that to hold so otherwise would '...justify a release of directors and officers in every bankruptcy case.'³⁵⁶ The court also disregarded the debtors' contention that the plan had overwhelmingly been voted in favour of by creditors, stating that this was irrelevant in affording consideration to whether directors and officers had made a contribution.³⁵⁷ The case of *In re Washington Mutual, Incorporation*³⁵⁸ evidences a departure by the Third Circuit of approving incidental releases of non-contributing non-debtors and the increased difficulty in proving relevant factors to release non-debtors, even where creditors have voted in favour of their release in the reorganisation plan.

The court in the case of *In re Lowenschuss*³⁵⁹ refused to confirm a non-consensual reorganisation plan which purported to release non-debtors. In this case, the debtor's reorganisation plan extended the release not only to the debtor, but also, among others, the debtor's professional corporation and pension fund of that corporation.³⁶⁰ The court rejected the confirmation of the reorganisation plan on the basis that the release of non-debtors was inappropriate and furthermore, significantly, that it lacked the authority to confirm a plan on the basis that did not comply with the Bankruptcy Codes as specified in s 1129(a)(1). The court further ruled that the inclusion of non-debtor release provisions in a reorganisation plan are inconsistent with s 524(e).³⁶¹ The court rejected the notion that equitable powers under s 105(a) would permit such releases and stated that s 105(a) '...does not authorise relief inconsistent with more specific law...[and] the specific provision of s 524 displaces the court's equitable powers under s 105(a) to order permanent relief [against the non-debtor] sought by [the debtor].'³⁶² The court in this matter also considered the 1994 amendments to the Bankruptcy Codes and the inclusion of s 524(g) which followed as a result of such amendments. In terms of s 524(g) courts are afforded the right, where

³⁵⁵ Supra note 320.

³⁵⁶ Supra note 352 at 349.

³⁵⁷ Ibid at 350.

³⁵⁸ Supra note 352.

³⁵⁹ 67 F. 3d 1394 (9th Cir. 1995).

³⁶⁰ Ibid at 1401.

³⁶¹ Ibid at 1401-2. The reasoning of the court in *Lowenschuss* (supra note 359) was consistent with a host of other Ninth Circuit Court decisions such as *Underhill v Roay*, 769 F. 2d 1426 (9th Cir. 1985) and *Commercial Wholesalers Inc. v Investors Commercial Corp*, 172 F. 2d 800 (9th Cir. 1949).

³⁶² Ibid at 1402. The court cited *American Hardwoods Inc* (supra note 361) at 625-26.

certain conditions have been satisfied, to issue injunctions against third parties so as to prevent litigation. Having regard to this, the court stated that

‘[t]he numerous conditions of s 524(g) make it clear that this subsection constitutes a narrow rule specifically designed to apply in asbestos cases only...That Congress provided explicit authority to bankruptcy courts to issue injunctions in favour of third parties in an extremely limited class of cases reinforces the conclusion that s 524(e) denies such authority in non-asbestos cases.’³⁶³

Similarly to the decision in *In re Washington Mutual Incorporation*,³⁶⁴ the court in *National Heritage Inc*³⁶⁵ denied the release of non-debtors where such non-debtors were the bankrupt entity’s directors and officers. The court was not prepared to release these non-debtors where they had only satisfied one of the factors laid out by the court in *In re Dow Corning Corp.*³⁶⁶ In making its determination not to release the non-debtors the court, among other things, held that the non-debtors had not undertaken to continue contributing to the success of the reorganisation plan, the release of the non-debtors was not so material such that if they were not released from liability the reorganisation plan would fail and the creditors’ vote of the plan was frowned upon given that the creditors’ who were significantly impacted were ineligible to vote.³⁶⁷

In the more recent decision of *In re Metromedia Fiber Network Incorporated*,³⁶⁸ the court refused to confirm a plan of reorganisation where the findings of the court were insufficient to support the validity of the plan’s non-consensual debtor release provisions. The reorganisation plan proposed establishing a trust by insiders of the debtor which would undertake and implement material contributions to creditors and, in return for such contributions, creditors would forfeit their rights to claim from certain non-debtors.³⁶⁹ The court in this case was reluctant to confirm the non-consensual non-debtor release provision in the reorganisation plan and remarked that ‘...a non-debtor release is a device that lends itself to abuse...[i]n form, it is a release; in effect, it may operate as a bankruptcy discharge arranged without filing and without the safeguards of the Code.’³⁷⁰ Notwithstanding that it was

³⁶³ Ibid.

³⁶⁴ Supra note 352.

³⁶⁵ 760 F. 3d 344 (4th Cir. 2014).

³⁶⁶ Supra note 320.

³⁶⁷ Supra note 365 at 348-51.

³⁶⁸ Supra note 319.

³⁶⁹ Ibid at 141.

³⁷⁰ Ibid at 142.

argued by the non-debtors that the trust contribution was material to the success of the reorganisation plan, the court placed reliance on the decision of *Drexel Burnham Lambert Group*,³⁷¹ and held that the non-debtors had failed to establish grounds upon which to illustrate that their actual release was significant to the success of the plan.³⁷²

6.4. CREDITORS' RELIANCE: S 524(E) OR S 105(A)?

s 524(e)

As has been evidenced by the examination of cases set out in 6.3 above, the confirmation of a non-debtor release under a non-consensual reorganisation plan is left to the discretion of the court. Therefore, unlike South African common law where creditors' rights against sureties can be preserved in the deed of suretyship, this is not the case under American law where the preservation of creditors' rights is sought to be regulated in statute. There is sound legal and commercial reasoning why courts would not uphold a release provision of a non-debtor contained in a non-consensual reorganisation plan.

Legally, it is specified in s 524(e) that the discharge of a principal debtor does not affect the liability of any third party.³⁷³ Commercially and in favouring that section of the Code, it would maintain the integrity of third party security such as guarantees and suretyships and this would provide comfort to creditors knowing that their security has not been compromised.³⁷⁴ It is somewhat unimaginable that courts have the freedom under s 105(a) to compromise creditors' rights against non-debtors, especially where such creditors have not voted in favour of the release. In my view, I agree with the reasoning of the court in *Siegel*³⁷⁵ that the Bankruptcy Codes operate for the benefit of a debtor and regulate its relationship with its creditors and does not extend beyond such a relationship so as to include non-debtors. If any such extension were to be afforded to non-debtors, they themselves would need to submit to the bankruptcy courts and file for reorganisation in order to realise a relief from creditors,

³⁷¹ Supra note 327.

³⁷² Supra note 319 at 27.

³⁷³ This view was shared by the court in *In re Texaco Inc*, 84 B.R. 893 (Bankr. S.D.N.Y. 1988) at 900, where is stated that '[t]he confirmation of a chapter 11 plan of reorganisation should not release the obligations of a non-party entities to creditors of a debtor.'

³⁷⁴ Boyle op cit note 310 at 422.

³⁷⁵ Supra note 312.

however, this cannot be accomplished by entering through the back door and forcing this issue upon courts during the reorganisation proceedings of a debtor.³⁷⁶

The impact of courts exercising such discretion would undoubtedly have caused a ripple effect to filter through to the commercial sphere, in particular financial institutions. One would have thought that financial institutions such as banks would have strongly advocated against courts' reliance on s 105(a) given the underlying financial risk associated with advancing funding under a security instrument which may, or may not, be disregarded.

s 105(a)

Having said this, it is also appreciated, although to a lesser extent in my view, why courts would exercise their discretionary powers under s 105(a) in confirming the release of a non-debtor under a non-consensual reorganisation plan. In doing so, it may result in a non-debtor's contribution to facilitating the successful implementation of a reorganisation plan which would not otherwise have been achieved if the non-debtor were not released from liability to the creditor. Such release would also sever any claim for indemnification or contribution that the non-debtor would pursue against the debtor and this would, in turn, afford a 'true' fresh start to the bankrupt debtor, free from any worry or doubt that non-debtors right of recourse would ensue.³⁷⁷

The court in *In re Continental Airlines*³⁷⁸ remarked that consideration must be afforded to fairness, necessity to the reorganisation and specific factual findings to support the release of a non-debtor under a non-consensual reorganisation plan.³⁷⁹ That said, such a comment is not without merit, however in my opinion, dangerously flirts with commercial uncertainty. It is somewhat impossible to determine what a court may, or may not, find fair or necessary in a particular circumstance, in particular if such factors are beyond the control of the creditor, In other words and following the examination of cases in 6.3 above, courts appear to afford greater consideration to whether it would be fair and necessary to a non-debtor that they are released as opposed to taking into consideration creditors' interests. On this interpretation it is

³⁷⁶ Boyle op cit note 310 at 429.

³⁷⁷ Ibid.

³⁷⁸ Supra note 322.

³⁷⁹ Ibid at 214.

near impossible for a creditor to influence what may, or may not, be fair and necessary to restrict the release of a non-debtor.

It can also be argued that to allow creditors to proceed to claim against a non-debtor would be tantamount to a claim against the debtor itself given a non-debtor's right of recourse under surety law or state corporations laws³⁸⁰ and support is found for this in the case of *A.H. Robins*,³⁸¹ where for all intents and purposes it was found that it would undermine the reorganisation process if creditors' claims against non-debtors could be pursued who would, in turn ultimately, look to the bankrupt company under their rights of recourse and deny the company a fresh start.³⁸²

The various factors to be taken into account by the courts set out in *In re Dow Corning Corp*³⁸³ are also indicative of courts' growing reluctance to grant release to non-debtors under a non-consensual reorganisation plan. As was clearly evidenced by the court in *In re Metromedia Fiber Network Incorporated*,³⁸⁴ it was not prepared to grant a release where it could not, among other factors, be shown the release of the non-debtors concerned was crucial to the success of the plan. Although the factors to be satisfied in confirming non-debtors release in the aforementioned cases are to be lauded, given their more conservative and certain approach, they are not above reproach. These factors still afford courts a discretion in ultimately determining whether or not to grant the release of non-debtors under a non-consensual plan of reorganisation. Again, creditors who initially thought that their claims may be secure would be left shooting into the darkness of uncertainty if commercial sense does not prevail sooner rather than later in these decisions and the broad equitable powers bestowed upon courts in s 105(a) are disregarded.

³⁸⁰ Ibid. In the case of *Menard-Sanford v Mabey (in re A.H. Robins Co.)* 880 F.2d 694 (4th Cir. 1989) at 702, the reorganisation plan was dependent on non-debtor discharges who would otherwise have had indemnification or contribution claims against the debtor.

³⁸¹ Supra note 302.

³⁸² Supra note 302 at 999.

³⁸³ Supra note 320.

³⁸⁴ Supra note 319.

7. CHAPTER 7: COMPARATIVE ANALYSIS AND CONCLUSION

7.1. INTRODUCTION

From the outset, it is undoubtedly clear that South Africa's business rescue process contained in chapter 6 of the Companies Act has sought to materially replicate the process set out in chapter 11 of the Bankruptcy Codes. In this regard and similarly to reorganisation proceedings in America, business rescue aims to rehabilitate a company which is financially distressed³⁸⁵ and enable it to continue with its business operations on a solvent basis.³⁸⁶ It is expressly stated that the purpose of the Companies Act is to promote, among other things, the development of the South African economy by 'encouraging entrepreneurship and enterprise efficiency'³⁸⁷ and 'provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders.'³⁸⁸ Creditors play no small part in assisting entrepreneurs by advancing funding in assisting them to satisfy their working capital requirements; which funding, in the case of juristic persons, is often secured by a deed of suretyship. This has called into question a creditor's right of enforceability of an underlying deed of suretyship in circumstances where the entrepreneurs fail and are placed under business rescue.

The Companies Act 'is to be interpreted and applied in manner'³⁸⁹ that gives effect to its purpose. In doing so and where appropriate, courts may turn to consider foreign company law in interpreting and applying the Companies Act in order to promote its purpose.³⁹⁰ It is against this background that an analysis of the Bankruptcy Codes was undertaken in chapters 5 and 6 above. This chapter 7 sets out a comparative analysis on chapter 11 reorganisation proceedings under American Bankruptcy Codes and chapter 6 business rescue proceedings under the South African Companies Act. First, a brief comparison will be undertaken on the role of a business rescue practitioner and whether this should be developed. Secondly and more significantly, a comparative analysis and conclusion will be presented on creditors' rights to enforce third party suretyships of financially distressed companies.

³⁸⁵ s 128(b).

³⁸⁶ Klopper and Bradstreet op cit note 7 at 550.

³⁸⁷ s 7(b)(i).

³⁸⁸ s 7(b)(k).

³⁸⁹ s 5(1).

³⁹⁰ s 5(2).

7.2. THE BUSINESS RESCUE PRACTITIONER

Undoubtedly, the success of business rescue hinges on a business rescue practitioner who is tasked with populating a business rescue plan. As discussed throughout this research paper, the business rescue plan has an effect on creditors' rights to enforce their claims against sureties. Under South African law a business rescue practitioner is appointed³⁹¹ and is tasked with supervising a financially distressed company's management and operations.³⁹² Under the Bankruptcy Codes the appointment of a trustee,³⁹³ who would occupy a role similar to that of a business rescue practitioner, is not the default position and the bankrupt debtor remains in possession of its business and exercises control over its assets and business.³⁹⁴

Under South African law and following the commencement of business rescue proceedings, the business rescue practitioner has 'full management control of the company in substitution for its board and pre-existing management.'³⁹⁵ Therefore the business rescue practitioner is the person ultimately tasked with facilitating the rehabilitation of the operational enterprise of a financially distressed company. Although under no obligation to do so, a business rescue practitioner may consult with directors of a financially distressed entity in order to make management decisions³⁹⁶ and the directors are also required to act in accordance with instructions received from the practitioner.³⁹⁷ This is not the case under the Bankruptcy Codes where, unless a trustee has been appointed, the management and control remains under the supervision of the current management of the bankrupt entity. In my view, this is an aspect of South African law which the legislature should contemplate revisiting as it is central to the success of business rescue proceedings.

Although it is fully appreciated that it is most likely as a consequence of existing management's actions that a company has commenced business rescue, in my opinion such management should be afforded the opportunity to reorganise their mismanagement and resuscitate the financially distressed company. Management and the board are familiar with the affairs of the distressed entity and are in the position to direct where attention should be focused to facilitate the rehabilitation process.

³⁹¹ s 129(3)(b) and s 131(5).

³⁹² Bradstreet *op cit* note 3 at 195.

³⁹³ s 322 of the Bankruptcy Codes.

³⁹⁴ s 1101(1).

³⁹⁵ s 140(a).

³⁹⁶ s 137(3).

³⁹⁷ s 137(2)(b).

In any event and as can be drawn from the Bankruptcy Codes, an individual with functions similar to those of the U.S. trustee can be appointed to supervise the business rescue process without actively being involved in management decisions.³⁹⁸ To the extent that management and the board remain incapable of facilitating the rehabilitation of the financially distressed company³⁹⁹ then an independent, third party business rescue practitioner can be appointed to step in and attempt to save the company. In my opinion this is a crucial component of business rescue proceedings which needs to be reconsidered by the legislature to assist in the business rescue process.

In my view, the business rescue practitioner should in fact take a step back from being actively involved and running with the affairs of a distressed entity. Having the correct person in place to administer the business rescue process, which I suggest should be the debtor's management and board itself as opposed to the business rescue practitioner, is a crucial first step for the success of the process. In my opinion and in the absence of such redevelopment, we will continue to see business rescue fail until such time as the people who were initially responsible for a company's commencement of such proceedings regain the reigns of management and assume responsibility. If the board and management are unable to facilitate the rehabilitation process then, and in such an event, a business rescue practitioner should be appointed.

7.3. CREDITORS' RIGHTS AGAINST SURETIES

In the case of *Tuning Fork*⁴⁰⁰ it was held that the Companies Act fails to expressly regulate what creditors' rights are against a surety of a financially distressed company where there has been a discharge of such a company's debt under a business rescue plan.⁴⁰¹ The position is markedly different in America where creditors' rights against non-debtors are embedded in the Bankruptcy Codes and fall to be regulated under s 524(e). This section of the Bankruptcy Codes states that a '...discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt.' This notwithstanding, courts in America have sought to escape the express mandate of s 524(e) by placing reliance on s 105(a) of the

³⁹⁸ See commentary had on the U.S. trustee under footnote reference 256.

³⁹⁹ See footnote references 258 and 259.

⁴⁰⁰ Supra note 116.

⁴⁰¹ Supra note 116 paras 14(i) and 45.

Bankruptcy Codes which grants to them the power to ‘...issue any order, process, or judgment that is necessary or appropriate to carry out...’ reorganisation proceedings under the Bankruptcy Codes.

As mentioned in 7.1 above, chapter 11 of the Bankruptcy Codes was carefully considered by the legislature when populating chapter 6 of the Companies Act. It is therefore somewhat surprising that the legislature failed to expressly state whether the principle underlying s 524(e) of the Bankruptcy Codes applies to business rescue. Given that American law specifically regulates the position of creditors at s 524(e) of the Bankruptcy Codes, one would be forgiven for being of the view that a line has been drawn in the sand on this issue and sureties are not released following the confirmation of a non-consensual reorganisation plan. This is not the case however as has been evidenced by the cases of *Drexel Burnham Lampert Group*⁴⁰² and *In re Transit Group Inc.*⁴⁰³ In my view, American jurisprudence is operating in greater uncertainty on this issue than its South African counterpart, notwithstanding that this issue is regulated by statute in America.

As discussed at length in 4.3 above and in my opinion, the reasoning underlying the decision of Rogers J in *Tuning Fork*⁴⁰⁴ is correct. Having said this, there is still unresolved confusion following Wallis J’s comment in *obiter*⁴⁰⁵ in the case of *New Port*.⁴⁰⁶ Although it is clear from the decision in *New Port*⁴⁰⁷ that a deed of suretyship specifically preserving a creditor’s right is enforceable against a surety pursuant to business rescue proceedings,⁴⁰⁸ there are still questions which remain unanswered.⁴⁰⁹ In my opinion and for the most part, although the law in South Africa on creditors’ rights against sureties of distressed companies appears to have been determined correctly, consideration is to be afforded whether there can be any potential development of the law on this issue. Although I strongly advocate the need for commercial certainty, I do appreciate, even though this may be to a lesser extent, that a degree of flexibility could be exercised by our courts to discharge sureties where necessitated by the circumstances of a particular matter. If South African courts

⁴⁰² Supra note 327.

⁴⁰³ Supra note 336.

⁴⁰⁴ Supra note 116.

⁴⁰⁵ Supra note 172 para 14.

⁴⁰⁶ Supra note 172.

⁴⁰⁷ Ibid.

⁴⁰⁸ Ibid para 12.

⁴⁰⁹ See chapter 4.4 of this research paper for a discussion reflecting on the decisions in *Tuning Fork* and *New Port*.

are in the future tasked with exercising their discretion as to whether to uphold a business rescue plan and order the absolute release of sureties, comparative reliance can most certainly be placed on the Bankruptcy Codes.

Commercial certainty: Advocating a restrictive approach

Before turning to address the development of creditors' rights against sureties, I maintain the view that commercial certainty is critical. To provide otherwise would not only significantly impact on creditors' rights, but would cripple the South African economy given that creditors would have no way of knowing whether they can exercise their remedial rights of enforcement under security instruments such as suretyships. In my view, the certainty which exists and allows creditors to confidently proceed against sureties, notwithstanding the legal moratorium in favour of a financially distressed entity, is also called for when seeking to determine creditors' ability to enforce their claims against sureties following the adoption of a business rescue plan. As has been evidenced by the decisions of *Bruyns*,⁴¹⁰ *Tsakiroglou*⁴¹¹ and *Zevoli*,⁴¹² it is now trite law that the protection of the legal moratorium does not extend to the benefit of any party other than a financially distressed entity.⁴¹³

Although the Bankruptcy Codes impose an automatic stay against creditors⁴¹⁴ similar to that of the legal moratorium, and as was illustrated by the examination of *A.H. Robins Company Incorporated*,⁴¹⁵ courts in America have the self-imposed right to extend the automatic stay to sureties. The extension of the benefit is not consistently applied throughout America and therefore it is not a reliable comparative source and I am of opinion that South African courts have in any event correctly determined the issue in ruling that the legal moratorium is for the benefit of a financially distressed company, not its sureties. In my view, this makes logical sense given that business rescue proceedings are initiated by a financially distressed company and chapter 6 as a whole is geared towards such a company and not its sureties. After all, the purpose and focus of chapter 6 is the rehabilitation of entities which are financially distressed, not their sureties. If any such extension were to be afforded to sureties, they themselves would need to similarly submit to business

⁴¹⁰ Supra note 65.

⁴¹¹ Supra note 83.

⁴¹² Supra note 108.

⁴¹³ Ibid paras 28-9.

⁴¹⁴ s 362(a) of the Bankruptcy Codes.

⁴¹⁵ Supra note 302.

rescue to realise a relief from creditors, however, this cannot be accomplished by entering through the back door and forcing this issue upon courts during the business rescue of a debtor.⁴¹⁶

In further developing South African company law on the issue of whether creditors are able to enforce their rights against sureties of entities under business rescue, one can look to the Bankruptcy Codes to regulate the position by means of statute. If it were not for the broad equitable powers afforded to courts under s 105(a) of the Bankruptcy Codes, it would be clear from the provisions of s 524(e) of such Codes that a discharge of a principal debtor does not release sureties regardless of whether this is purportedly achieved by a business rescue plan which has been voted in favour of by creditors. Therefore and in my view, South African company law on the issue of creditors' right against sureties of entities under business rescue needs to be taken a step further than what it has been in the decisions of *Tuning Fork*⁴¹⁷ and *New Port*.⁴¹⁸ This can be accomplished with comparative reference to s 524(e) of the Bankruptcy Codes which makes it clear that under no circumstances does a discharge of the principal debtor consequently result in the release of third party sureties. The statutory introduction in the Companies Act of a provision materially similar to s 524(e) would leave the issue beyond reproach and significantly promote commercial certainty.

Flexibility: Advocating a liberal approach

Although to a lesser extent, I do appreciate why an open-mind must be kept in developing South African company law such that it allows for courts to exercise their discretion in upholding the absolute release of sureties following the discharge of a principal debtor under a business rescue plan. In doing so, it may result in a surety's contribution to facilitating the implementation of a business rescue plan which would not otherwise have been achieved if they had not been released from their liability to creditors.

Comparative reference can be drawn from the court's remarks in *In re Continental Airlines*⁴¹⁹ where the notions of fairness and necessity were considered in whether to release a surety under a reorganisation plan which had not been supported

⁴¹⁶ Boyle op cit note 310 at 429.

⁴¹⁷ Supra note 116.

⁴¹⁸ Supra note 172.

⁴¹⁹ Supra note 322.

by creditors. As was advocated by the introduction of text materially similar to s 524(e) for commercial certainty, the same can be said for introducing a provision in the South African Companies Act materially similar to that of s 105(a) of the Bankruptcy Codes in terms of which courts are afforded broad equitable powers. That said and significantly, what can be extracted from American jurisprudence is that a regulatory framework needs to be established in statute which specifically sets out the factors on which courts can place reliance when making decisions to exercise their discretion and release sureties.

Although it can be advocated that a degree of flexibility is to be introduced in South African company law, a situation similar to that which currently exists in America, where there is a division of opinion, needs to be avoided. In my view, there must be tried and tested factors regulated by statute against which courts can measure their discretion. I agree with the commentary in the case of *In re Dow Corning Corp*⁴²⁰ where the court held that ‘unusual circumstances’ would need to exist to otherwise necessitate the release of sureties.⁴²¹ Therefore, hand in hand with the introduction of a provision materially similar to that of s 105(a), my suggestion would be the inclusion of several factors similar to those which the court laid out in *In re Dow Corning Corp*.⁴²² For example, these factors could include, among other things, examining the relationship between a debtor and the surety to determine whether a claim against the surety is essentially a claim against the debtor, considering whether the surety has contributed significantly to the rehabilitation of the distressed entity and determining whether the absolute release of the surety is essential to the business rescue process. This would provide some background against which courts can test granting the absolute release of sureties following the adoption of a business rescue plan especially where, among other things, such sureties are crucial to the success of the plan and a claim against the surety would be tantamount to a claim against the debtor.

Having said all of this, careful consideration would need to be afforded by proponents of this approach to the way in which amendments are introduced in a regulatory framework. s 105(a) of the Bankruptcy Codes has far-reaching consequences and therefore any introduction of a materially similar provision would

⁴²⁰ Supra note 320.

⁴²¹ Ibid at 658.

⁴²² Ibid.

need to be administered with caution so as not to have an undesirable effect on other provisions of the Companies Act where the exercise of discretion by a court is undesired. It is proposed that such amendments specifically be introduced under, and only find application to, chapter 6 to avoid the aforementioned concerns.

In my opinion and as can be noted from my support of the restrictive approach by introducing a provisions similar to s 524(e) of the Bankruptcy Codes, a more flexible approach brings with it a host of challenges of its own volition which, in turn, would cause a ripple effect of uncertainty to filter through to the commercial sphere.

7.4. CONCLUSION

In this research paper, I considered the nature of business rescue and suretyships. In doing so, I considered the current legal position on creditors' rights against sureties during business rescue proceedings, specifically pre and post the adoption of a business rescue plan. As was identified in chapter 4 above and in my opinion, South African company law on this issue has for the most part been determined correctly, however, there remain several unresolved issues. In reference to American jurisprudence, I elaborated on the legal position of creditors' rights against non-debtors of entities which have filed for bankruptcy reorganisation proceedings. In doing so, I reviewed how American courts have differently applied the interplay between s 524(e) and s 105(a) of the Bankruptcy Codes in determining whether to release non-debtors under a non-consensual reorganisation plan. My comparative analysis undertaken on the respective legal positions adopted by the South African and American courts advocated the importance of commercial certainty and that whilst there is potential to develop South African company law having reference to the Bankruptcy Codes, caution is to be exercised when doing so.

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