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**School for Advanced Legal Studies – Faculty of Law**

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**AFFECTED PERSONS IN BUSINESS RESCUE PROCEEDINGS: HAS A  
BALANCE BEEN STRUCK?**

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

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# Abstract

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The Companies Act of 2008<sup>1</sup> (the Act) has revolutionised the corporate law landscape in South Africa. The Act has been drafted with the specific intention of promoting access to the economy and of ensuring that cumbersome and costly procedures are (to a large extent) a thing of the past. These objects are a necessity when striving to ensure that South Africa's alarming inequality is abated. One of the central features of the 2008 Act is the introduction of business rescue, a procedure which represents a blatant attempt at striving to preserve ailing companies.

The Act states that one of the main objects with regards to business rescue is ensuring that the procedure balances the competing interests involved. The purpose of this thesis therefore is to consider to what extent the 2008 Act has been able to achieve this. This will be done by analysing the rights given to employees, shareholders and creditors. This thesis will argue that though the procedure is a step in the right direction, it has failed to strike a proper balance by overly empowering employees and conversely leaving shareholders somewhat impotent. This thesis will also argue that some of the mechanisms employed, though they may be admirable in what they strive to achieve, leave far too much doubt as to their practicality.

The overall conclusion reached is that a major overhaul is not required in order to rid this much needed procedure of its flaws.

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<sup>1</sup> Act 71 of 2008

# DEDICATIONS

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I dedicate this dissertation to my son Asande, to my parents Sam and Nomcebo and to my siblings Mawande and Siyabonga.

# ACKNOWLEDGMENTS

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I'd like to thank my supervisor Jacqueline Yeats for her assistance in preparing this dissertation. I'd also like to thank each individual with whom I spent time discussing ideas or lamenting the arduous journey of preparing and producing this work. Lastly, I'd like to thank my son Asande, whose mere existence is a never-ending source of motivation.

# CHAPTER ONE: INTRODUCTION

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## 1.1 GENERAL BACKGROUND

*Bankruptcy “the state of things which exist when, a man being unable to pay his debts, his solicitor and an accountant divide all his property between them.”<sup>2</sup>*

The abovementioned quotation provides a stark illustration of the manner in which insolvency was perceived. It was the perception that of all the parties affected by a bankruptcy the debtor is the least important. Perhaps this perception was fuelled by the misguided belief that bankruptcy can almost always be attributed to excess and profligacy. Granted, one cannot successfully argue against the assertion that excess has been responsible for some of the most spectacular corporate collapses in recent history, but if one has a more nuanced understanding of business and commerce then one ought to know that there are myriad factors other than excess which can lead to bankruptcy. In some instances bankruptcy can be attributed to mere misfortune, perhaps the misfortune of not having any foresight, which when one looks at it possibly lends credence to an argument that business is a winner-takes-all arena and bankruptcy is its brutal version of natural selection and therefore, as a matter of course, the debtor ought to become a non-entity. This argument is a rather unfortunate example of myopia in that it represents a narrow view of bankruptcy as a bi-party process in which the only relevant participants are the debtor and the creditor. The reality is that bankruptcy has a devastating effect not only on these parties, but also on employees, shareholders and the economy in general.

By the 19<sup>th</sup> century countries became alive to this and began processes of revolutionising their bankruptcy laws so as to make them more debtor-friendly. This paradigm shift gave rise to what may be called a “rescue culture”.

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<sup>2</sup> BW Odgers *A Century of Law Reform* (1901) 14.

## 1.2 JUDICIAL MANAGEMENT

It is interesting to note that South Africa made its first attempt at departing from the creditor's pound of flesh approach to bankruptcy as far back as 1926.<sup>3</sup> This was through a procedure called judicial management. By the time the 1973 Companies Act<sup>4</sup> was enacted, South Africa had two corporate rescue procedures, namely judicial management and compromise with creditors. These could be found in sections 427 and 311 of the 1973 Companies Act respectively. The former is most pertinent for present purposes, however, it is not necessary to go into an in-depth discussion, it suffices to merely state that it was an abject failure. There were numerous reasons for this but it suffices to name only a few and these are:

- A. The procedure was very dependent on the courts which made it unduly cumbersome and expensive;
- B. The lack of regulation for judicial managers despite the immense power they wielded;<sup>5</sup>
- C. The judiciary's view of judicial management as an extraordinary procedure to be invoked only under exceptional circumstances ignored the fact that a successful turnaround of a failing company could potentially prove to be more beneficial to its creditors than a liquidation.<sup>6</sup>

These are only but a few of the shortcomings which negated the efficiency of judicial management and as a result a change was warranted and that change came in the form of business rescue.

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<sup>3</sup> Rajak and Henning, *Business rescue for South Africa*. 116 South African Law Journal 1999 at 262

<sup>4</sup> 61 of 1973

<sup>5</sup> Rajak op cit (n3) 268

<sup>6</sup> A Loubser *Some Comparative Aspects of Corporate Rescue in South African Company law* LLD (University of South Africa) (2010) 43.

### 1.3 RESEARCH OBJECTIVE

The Act brought about significant changes to South African company law. As a result, a number of principles have either been abolished or amended so as to achieve the stated objects of efficacy and greater accessibility. This dissertation concerns itself with one particular change and that is the introduction of business rescue. Although the notion of corporate rescue is not a novel one, business rescue represents something of a quantum leap in philosophy when it comes to corporate failure.

The crux of this dissertation is to explore one of the stated objects of the Act, namely the provision for the efficient rescue and recovery of financially distressed companies in a manner that *balances the rights and interests of all relevant stakeholders*.<sup>7</sup> This object is given effect to in Chapter 6 of the Act, particularly sections 128 to 154 which are the sections dealing with business rescue. Section 128(1)(a) of the Act defines a certain group of persons who are central to the business rescue process and these are '*affected persons*'. The section defines this group as a shareholder or creditor of the company, any registered trade union representing the employees of the company and those employees (or their representatives) of the company who are not represented by a registered trade union. This thesis will consider the rights given to each of these parties with the aim of ascertaining whether or not a balance has been achieved. In evaluating the mechanisms put in place, a comparative analysis of the treatment of similar parties in the Australian legal system will be undertaken.

### 1.4 DELINIATIONS AND LIMITATIONS

Although the entirety of the business rescue procedure will be traversed, the bulk of the attention will be devoted to those aspects which pertain to affected persons. Business rescue is still relatively new and as a result there isn't an abundance of judicial pronouncements on the procedure although the jurisprudence is gathering significant momentum. Reliance, on the most part, will thus be placed on academic articles of which there isn't a shortage of supply.

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<sup>7</sup> Companies Act 71 of 2008 Section 7(k) (Own emphasis)

## 1.5 SIGNIFICANCE OF THE STUDY

Business rescue is at the cutting edge of South Africa commercial law and therefore any study which purports to grapple with this topical issue will as a matter of course be relevant and also prove to be a worthwhile intellectual experience.

## 1.6 STRUCTURE OF THE DISSERTATION

The dissertation is divided into seven chapters with each chapter dealing with the following:

1. CHAPTER ONE: This is the current chapter which purports to introduce the topic and give an indication as to how the question posed will be answered;
2. CHAPTER TWO: This chapter will introduce business rescue, the procedure to be followed in initiating it as well as a glossary of terms;
3. CHAPTER THREE: This chapter will deal with creditors and their rights. It will also deal with those aspects which are common between creditors and any of the other affected persons;
4. CHAPTER FOUR: This chapter will deal with shareholders and their rights;
5. CHAPTER FIVE: This chapter will deal with employees and their rights. In addition to that, it will also comprise of the conclusion reached on whether a balance has been struck;
6. CHAPTER SIX: This chapter will comprise of the comparative analysis; and
7. CHAPTER SEVEN: The chapter will comprise of the conclusions reached.

Each chapter will have its own keywords and definitions. For ease of reference, the meaning of each of these will be provided at the beginning of each chapter. Some of the keywords are generic and will thus not be repeated in each chapter.

# CHAPTER TWO: BUSINESS RESCUE PROCEDURE

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In this Chapter the business rescue process will be discussed. The discussions will, however, be limited to those aspects which have a direct effect on the rights of affected persons and which are generic to the group.

For the purpose of this and subsequent chapters, the following words will have the following meaning:

- 1) **Business rescue:** Means the proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for:
  - a. the temporary supervision of the company, and of the management of its affairs, business and property;
  - b. a temporary moratorium on the rights of claimants against the property or in respect of property in its possession; and
  - c. the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company continuing on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company.<sup>8</sup>
  
- 2) **Financially distressed:** means that a company at any particular time appears to be reasonably unlikely to be able to pay all of its debts as they become due and payable within the immediately ensuing six months or appears likely to be insolvent within the immediately ensuing six months;<sup>9</sup>

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<sup>8</sup> Companies Act 71 of 2008 Section 128(1)(b)

<sup>9</sup> Companies Act 71 of 2008 Section 128(1)(f)

- 3) Independent creditor:** means a person who is a creditor of the company, including an employee of the company who is a creditor in terms of section 144(2) and is not related to the company, a director, or the practitioner;<sup>10</sup> and
- 4) Business rescue practitioner:** means a person (or persons) appointed to oversee a company during business rescue proceedings (hereinafter referred to as the 'practitioner').<sup>11</sup>

## **2.1 COMPANY RESOLUTION TO BEGIN BUSINESS RESCUE PROCEEDINGS**

There are two methods of initiating a business rescue and these are via the medium of a board resolution (the 'resolution') and a court order. In order to adopt a resolution voluntarily placing a company in business rescue, the board of the company must satisfy itself that the company is financially distressed and that there appears to be a reasonable prospect of rescuing the company concerned.<sup>12</sup> Such a resolution cannot be adopted if the company already has liquidation proceedings initiated against it and will have no force until it has been filed with the Companies and Intellectual Properties Commission (the Commission).<sup>13</sup> After filing the resolution, the company must publish a notice to all affected persons within five<sup>14</sup> days along with a sworn statement of the facts relevant to the grounds on which the board resolution was founded.<sup>15</sup> During this period the company must also appoint a practitioner with the practitioner consenting to this appointment in writing.<sup>16</sup>

The company must then file a notice of this appointment with the Commission and must publish a notice of the appointment to all affected persons within five days of the notice being filed.<sup>17</sup> The resolution will lapse if the company fails to file any of

<sup>10</sup> Companies Act 71 of 2008 Section 128(1)(g)

<sup>11</sup> Companies Act 71 of 2008 Section 128(1)(d)

<sup>12</sup> Companies Act 71 of 2008 Section 129(1)

<sup>13</sup> Companies Act 71 of 2008 Section 129(2)

<sup>14</sup> The company can apply to the commission for a longer time period

<sup>15</sup> Companies Act 71 of 2008 Section 129(3)(a)

<sup>16</sup> Companies Act 71 of 2008 Section 129(3)(b)

<sup>17</sup> Companies Act 71 of 2008 Section 129(4)

the notices within the prescribed time frames.<sup>18</sup> Furthermore, the company will be precluded from filing a further resolution for a period of three months after the date on which the lapsed resolution had been adopted.<sup>19</sup> The company may, however, apply to the High Court for an order approving the filing of a further resolution.<sup>20</sup> If the board of the company has reasonable grounds to believe that the company is financially distressed but does not adopt a resolution placing it in business rescue, they must deliver a notice to each affected person informing them of the basis on which this decision has been made and the reasons thereof.<sup>21</sup> From an early reading of Chapter Six of the Act one can clearly see how central to the business rescue process affected persons are. Their involvement in the process is so imperative that a failure to comply with the requirements of notifying them within the specified time periods is fatal to the board's resolution to commence business rescue.

## **2.2 OBJECTIONS TO COMPANY RESOLUTION**

In the intervening period between the adoption of the resolution and the adoption of the business rescue plan, an affected person may apply to a court for an order setting aside the resolution on either of the following grounds:

- A. That there is no reasonable basis for believing that the company is financially distressed;<sup>22</sup>
- B. That there is no reasonable prospect for rescuing the company;<sup>23</sup> or
- C. That the company has failed to satisfy the procedural requirements set out in section 129.<sup>24</sup>

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<sup>18</sup> Companies Act 71 of 2008 Section 129(5)(a)

<sup>19</sup> Companies Act 71 of 2008 Section 129(5)(b)

<sup>20</sup> Ibid

<sup>21</sup> Companies Act 71 of 2008 Section 127

<sup>22</sup> Companies Act 71 of 2008 Section 130(1)(a)(i)

<sup>23</sup> Companies Act 71 of 2008 Section 130(1)(a)(ii)

<sup>24</sup> Companies Act 71 of 2008 Section 130(1)(a)(iii)

The last ground for setting aside the resolution is peculiar in that section 129(5)(a) already states that the resolution “lapses and is a nullity” if the company fails to comply with the requirements of notice to the commission and to the affected persons. It then raises the question of when the resolution lapses. Loubser suggests that the resolution would not be nullified automatically but would have to be confirmed by an order of court.<sup>25</sup> This, she says, would explain why it has been made one of the grounds for setting aside the order in section 130.<sup>26</sup> More than that, such an interpretation would be in keeping with the peculiar section 218 which states that nothing in the Act renders a resolution void that is prohibited, voidable or may be declared unlawful in terms of the Act, unless a court has made a declaration to that effect regarding the resolution in question.<sup>27</sup> Loubser notes the lack of clarity regarding whether the section would apply to resolutions commencing business rescue.<sup>28</sup>

The resolution may also be set aside on the grounds that the practitioner appointed by the company lacks the necessary skills,<sup>29</sup> is not independent of the company or its management<sup>30</sup> or that they do not satisfy the requirements of section 138.<sup>31</sup> An affected person may also apply to the court for an order requiring the practitioner to provide security on terms the court deems necessary in order to secure the interests of the company and any affected person.<sup>32</sup> Affected persons who, as directors, voted in favour of the impugned resolution are precluded from bringing such an application unless they can satisfy the court that they supported the resolution in good faith relying on information that has subsequently been found to be false or misleading.<sup>33</sup> The Act grants each affected person the right to participate in the aforementioned application and as a corollary it places a positive duty on the affected person initiating the proceedings to notify

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<sup>25</sup> Loubser op cit (n6) 63

<sup>26</sup> Ibid

<sup>27</sup> Companies Act 71 of 2008 section 218(1)

<sup>28</sup> Ibid

<sup>29</sup> Companies Act 71 of 2008 Section 130(1)(b)(iii)

<sup>30</sup> Companies Act 71 of 2008 Section 130(1)(b)(ii)

<sup>31</sup> Companies Act 71 of 2008 Section 130(1)(b)(i)

<sup>32</sup> Companies Act 71 of 2008 Section 130(1)(c)

<sup>33</sup> Companies Act 71 of 2008 Section 130(2)

the other affected persons and to serve a copy of the proceedings on the company and the Commission.<sup>34</sup>

Granting affected persons the right to notification of and to participation in these proceedings raises interesting procedural and practical questions. These questions will be traversed in the context of section 131 and it is submitted that the conclusions reached therein will be applicable to section 130. Where the application is in terms of section 130(1)(a), the court may grant an order setting aside the resolution on the stated grounds or on grounds that it considers just and equitable.<sup>35</sup>

The court is also empowered to make an order affording the practitioner an opportunity to form an opinion on whether or not the company appears to be financially distressed or that there is a reasonable prospect of rescuing the company.<sup>36</sup> The practitioner must then compile a report upon which the court may reach a decision. It is submitted that empowering the court to make such an order is a commendable attempt at ensuring that the competing interests at stake are balanced. This is so because the court will have the benefit of an opinion from an independent expert who is also an officer of the court for the duration of their appointment.<sup>37</sup>

If the court makes an order setting aside the resolution it may also make an order placing the company under liquidation.<sup>38</sup> If the application was in terms of section 130(1)(b), the court may either uphold the appointment of the practitioner or set it aside. Where the court adopts the latter course of action, it must appoint an alternate practitioner who has been recommended by, or is acceptable to, the holders of the majority of the independent creditors' voting interests who were represented in the hearing in question.<sup>39</sup>

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<sup>34</sup> Companies Act 71 of 2008 Section 130(3)-(4)

<sup>35</sup> Companies Act 71 of 2008 Section 130(4)(a)

<sup>36</sup> Companies Act 71 of 2008 Section 130(4)(b)

<sup>37</sup> Business rescue practitioners are deemed to be officers of the court in terms of section 140(3)(a)

<sup>38</sup> Companies Act 71 of 2008 Section 130(5)(c)(i)

<sup>39</sup> Companies Act 71 of 2008 Section 130(6)

### 2.3 COURT ORDER TO BEGIN BUSINESS RESCUE PROCEEDINGS

The second avenue through which business rescue proceedings can be initiated is via the medium of a court order.<sup>40</sup> This process is limited to affected persons and, unlike a board resolution, may be initiated even if liquidation proceedings have commenced against the company.<sup>41</sup> As in section 130, the affected person who initiates the application in terms of section 131 is compelled to serve a copy of the application on the company and the commission as well as to notify all other affected persons in the prescribed manner.<sup>42</sup>

This section also grants affected persons the right to participate in the hearing.<sup>43</sup> As has been stated earlier, these rights and obligations raise interesting questions of procedure as well as questions of practicality. The latter question is compounded by the fact that Regulation 123 prescribes that notification across the board should include the delivery of a copy of the application. This goes against the explicit distinction in sections 130(3) and 131(2) where the prescribed method is the *notification* of affected persons and the *servicing* of a copy of the application on the company and the Commission<sup>44</sup>. Another important question relates to the issue of costs, particularly given that the section is silent on the matter.

These and other issues were dealt with in the case of *Cape Point Vineyards (Pty) Ltd v Pinnacle Point Group Ltd and Another (Advantage Project Managers (Pty) Ltd intervening)*.<sup>45</sup> The facts of the case will only be mentioned where necessary, for the most part it suffices to merely state the principles. In relation to the issue of costs, the court accepted that the Act does not empower it to make a costs order but held that nothing turned on that as the High Court in any event has an inherent jurisdiction to make any costs order it deems fit.<sup>46</sup> The court continued and held that if a distressed company fails to take steps in terms of section 129 and an affected person successfully initiates a business rescue via section 131, then the

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<sup>40</sup> Companies Act 71 of 2008 Section 131(1)

<sup>41</sup> Companies Act 71 of 2008 Section 131(7)

<sup>42</sup> Companies Act 71 of 2008 Section 131(2)

<sup>43</sup> Companies Act 71 of 2008 Section 131(3)

<sup>44</sup> Own emphasis

<sup>45</sup> 2011 (5) SA 600 (WCC)

<sup>46</sup> Paragraph 5

latter party ought not to be left out of pocket.<sup>47</sup> This outcome, the court held, would serve as a disincentive for affected persons to use section 131 and might instead encourage them to apply for liquidation,<sup>48</sup> which would be contrary to the stated objectives of the Act.

The court drew parallels with section 97(3) of the Insolvency Act<sup>49</sup> which stipulates that a petitioning creditor may recover its costs taxed by the registrar of the High court from the debtor.<sup>50</sup> The court held that a similar qualification should apply to section 131 but that given that the court would not be in a position to know what costs the applicant has incurred and whether or not they are reasonable, an order entitling the applicant to all their costs would be undesirable.<sup>51</sup> The court therefore settled for costs taxed on the scale as between attorney and client.<sup>52</sup> It should be said, with respect, that this is a laudable approach in that it enables the legitimate applicant to recover a significant portion of their costs whilst simultaneously ensuring that those who intend to bring forward frivolous applications are to a large extent deterred by the costs of an unsuccessful application.

The court went on to deal with the issue of service and notice. It would be appropriate to state the facts briefly in this regard in order to understand why the court had to make a determination and also to lend context to the discussion that follows. Cape Vineyards had applied for an order placing Pinnacle Point under supervision, which application was granted by the court. Cape Vineyards duly served a copy of the application on the Commission as well as on Pinnacle Point but did not notify any of the affected persons. This requirement was complied with after Advantage Project Managers intervened, however, the notices were sent to shareholders and creditors and not to the employees of Pinnacle Point. With regards to the creditors of Pinnacle Point, the notice took the form of an email. The shareholders were a different proposition however. Given that Pinnacle Point was a listed company, the shareholding was diverse and it was therefore impractical to send a notice to each individual.

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<sup>47</sup> Paragraph 6

<sup>48</sup> Their costs would be part of the costs of liquidation and would receive preferential treatment

<sup>49</sup> 24 of 1936

<sup>50</sup> Paragraph 9

<sup>51</sup> Ibid

<sup>52</sup> Ibid

Cape Vineyards overcame this quandary by sending a SENS<sup>53</sup> announcement to the shareholders of Pinnacle Point which set out the nature of the proceedings and the relief sought. Before discussing the court's decision in this regard, it would be appropriate to outline briefly what would suffice as notification for purposes of the Act. Regulation 124 requires a copy of the application to be served on each affected person known by the applicant. This notification must be done in accordance with Regulation 7 which states that notices may be delivered in any manner contemplated in section 6(10)-(11) of the Act as well as through those avenues set out in Table CR3<sup>54</sup> of the Act.<sup>55</sup> Regulation 7 continues and states that where delivery is not possible, then an application can be made to the Companies Tribunal or to the High Court for an order of substituted service.<sup>56</sup>

The court looked at these provisions and concluded that the notice to the creditors was valid given that Table CR3 permits notification via email.<sup>57</sup> The only issue therefore was the notification to the shareholders via SENS. In this regard, the court acknowledged the practical challenges attendant upon notifying the shareholders of a listed company, notwithstanding the fact that these companies are compelled to keep shareholder registers.<sup>58</sup> The court criticised the fact that Regulation 124 departed from the distinction maintained in section 131(2), holding that the requirement to serve a copy of the application on affected persons went beyond the requirements of the section.<sup>59</sup> Taking the circumstances of the case into consideration, the court held that it sufficed for Cape Point Vineyards to have sent a notice via SENS given that liquidation proceedings had already commenced against Pinnacle Point Group and it was thus a matter of urgency.<sup>60</sup> The court issued a warning, however, stating that in future an applicant would have to seek leave from the court in advance before utilising substituted service.<sup>61</sup> Furthermore,

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<sup>53</sup> Stock Exchange News Service. The Johannesburg Stock Exchange prescribes that communications from listed companies to their shareholders should take place through this platform.

<sup>54</sup> Provides that notices to any person may be sent via email, fax or registered post to the last known address.

<sup>55</sup> Companies Act 71 of 2008 Regulation 7(1)

<sup>56</sup> Companies Act 71 of 2008 Regulation 7(3)

<sup>57</sup> *Cape Point Vineyards* supra (n45) paragraph 14

<sup>58</sup> Paragraphs 15 - 16

<sup>59</sup> Paragraph 16

<sup>60</sup> Paragraph 17

<sup>61</sup> Paragraph 18

where email addresses of shareholders and creditors are available, these should be utilised instead of resorting to substituted service.<sup>62</sup>

In relation to listed companies, the court held that where an applicant desires to use publication in addition to or as a substitute for personal notification, then they should not only publish via SENS but also in a national newspaper so as to ensure a broader reach.<sup>63</sup> With regards to employees, the explanation given for not notifying them was that Pinnacle Point had 11 employees who were not affiliated to any trade union but were aware of the application at the time. The court accepted this without more. It must be said that in all probability future courts might not look so kindly on similar acts of non-compliance. From a practical point of view it would not have been burdensome at all to furnish all 11 employees with a copy of the application.

The last issue dealt with pertained to the procedure through which affected persons could intervene in proceedings. The court held that the legislature could not have contemplated that an affected person would have to apply for leave to intervene if they wished to participate in a hearing.<sup>64</sup> However, where the interested person wished to file affidavits, the court held that the relevant court would have to regulate the procedure in order to ensure fairness to all concerned.<sup>65</sup> This was echoed in the case of *Engen Petroleum Ltd v Multi Waste(Pty) Ltd and Others*<sup>66</sup> where the court held that an interested party need not seek leave to intervene but that in some case leave might have to be sought as a procedural requirement.<sup>67</sup>

Continuing with the court application to commence business rescue, after considering an application in terms of section 131(1) the court may make an order placing the company under supervision and commencing business rescue proceedings if it is satisfied that:

A. the company is financially distressed;<sup>68</sup>

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<sup>62</sup> Ibid

<sup>63</sup> Ibid.

<sup>64</sup> Paragraph 21

<sup>65</sup> Ibid

<sup>66</sup> 2012 (5) SA 596 (GSI)

<sup>67</sup> Paragraph 33

<sup>68</sup> Companies Act 71 of 2008 Section 131(4)(a)(i)

- B. the company has failed to pay an amount due under a public regulation, a contract, or in respect of an employment matter;<sup>69</sup> or
- C. that it is just and equitable to do so.<sup>70</sup>

Further to this, the court must be satisfied that there are reasonable prospects for rescuing the company.<sup>71</sup> The court may also make an order dismissing the application, which order may be accompanied by any further necessary or appropriate order including an order placing the company in liquidation.<sup>72</sup>

Where the court makes an order placing the company under supervision, the court may then make a further order appointing a practitioner who has been nominated by the affected person who initiated the proceedings.<sup>73</sup> The practitioner must satisfy the requirements of section 138 and their appointment is subject to ratification by the holders of a majority of the independent creditors' voting interest at the first meeting of creditors.<sup>74</sup> A company which has been placed under supervision in terms of section 131 is precluded from adopting a resolution placing itself in liquidation until the business rescue proceedings have ended.<sup>75</sup>

Furthermore, the company is obligated to notify all affected persons about the order within five days.<sup>76</sup>

When one looks at the orders that a court may grant, there are two observations that can be made. The first is that affected persons are granted a wider basis upon which they may initiate business rescue proceedings.<sup>77</sup> The second observation is tied to the first one in that by extending the scope in the manner that it has (in particular those in subsection (4)(a)) one cannot help but get the sense that in an attempt to ensure that the interests of affected persons are catered for, the legislature might have taken it a step too far. There is the counter argument, however, that in affording such a broad array of grounds, the legislature intended

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<sup>69</sup> Companies Act 71 of 2008 Section 131(4)(a)(ii)

<sup>70</sup> Companies Act 71 of 2008 Section 131(4)(a)(iii)

<sup>71</sup> Ibid

<sup>72</sup> Companies Act 71 of 2008 Section 131(4)(b)

<sup>73</sup> Companies Act 71 of 2008 Section 131(5)

<sup>74</sup> Ibid

<sup>75</sup> Companies Act 71 of 2008 Section 131(8)(a)

<sup>76</sup> Companies Act 71 of 2008 Section 131(8)(b)

<sup>77</sup> J Rushworth 'A critical analysis of the business rescue regime in the Companies Act 71 of 2008' (2010) *Acta Juridica* 375. 381

to give affected persons who would not have access to the company's records an avenue through which they can approach the court for relief.<sup>78</sup> Keeping these considerations in mind, each of the grounds in subsection 4(a) (with the exception of 4(a)(i)) will be discussed and analysed.

**2.3.1 Failure to pay over amount due in terms of a contract, public regulation or in relation to employment.**

Loubser opines that too many categories of persons have been given the power to apply to court for an order in terms of section 131.<sup>79</sup> She is of the view that the inclusion of individual shareholders, trade unions and individual employees is excessive as well as unprecedented.<sup>80</sup> She does however temper her criticism somewhat by acknowledging that the inclusion of employees and trade unions is consistent with the prominently featured object of protecting the interests of workers within the new business rescue proceedings.<sup>81</sup> In relation to the grounds for granting the order, Loubser argues that they are disproportionate in the sense that on a reading of the section, it is clear that the company need only fail to pay the amount once and this would suffice for an affected person to approach the court for an order.<sup>82</sup> Loubser suggests that a practice should be developed where an affected person can only approach the court for an order where the company has missed at least two consecutive payments.<sup>83</sup>

It is true that the literal reading of the section means that the company need only miss one payment. One would be strained, however, to conceive of a situation where a court would entertain an application and grant an order under circumstances where it is clear from the facts that the payment was missed as a result of an administrative or banking error. As has been alluded to earlier, affected persons (creditors in particular) would not readily be aware if the company

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<sup>78</sup> It must be noted that section 31(3) of the Companies Act states that Trade unions must, through the Commission and under conditions determined by the Commission, be given access to company financial statements for purposes of initiating business rescue.

<sup>79</sup> A Loubser 'The business rescue proceedings in the Companies Act of 2008: Concerns and questions' (2010) *TSAR* 3 501. 509

<sup>80</sup> *Ibid*

<sup>81</sup> *Ibid*

<sup>82</sup> *Ibid.*

<sup>83</sup> *Ibid*

is financially distressed and the failure to pay over monies due in terms of contracts would, more often than not, be an indicator of such financial distress. Furthermore, there might be instances where the company has been in dire straits for a lengthy period with the directors keeping this concealed in the hopes that they might turn the company around themselves or perhaps in order to buy time so as to be able to conceal any incriminating evidence or evidence that might expose them to some other form of liability.

The legislature perhaps had this in mind when refraining from providing a minimum time period or a recurrence of non-payment. The permissive approach taken by the legislature may also explain why the section is silent on the issue of costs. It is conceivable that the legislature left the court's discretion regarding costs orders unrestricted so as to enable the court to grant an adverse costs order in instances where the section has been abused or used in a vexatious manner. This could go some way towards restraining the consequences of granting *locus standi* to the extent that the section has. All things considered, the legislature perhaps took the view 'that too much' is better than 'not enough' and saw that approach as the best avenue through which effect may be given to the objective of creating an inclusive framework for business rescue proceedings. Having said that, it is difficult to dismiss Loubser's concerns and the conclusion that the legislature overshot the mark is an inescapable one. It is submitted that a more nuanced approach had to have been taken in order to provide the desired protection.

### **2.3.2 *It is otherwise just and equitable to do so for financial reasons.***

This is the ground which appears to be the most peculiar of them all, with the problem rooted in its vagueness.<sup>84</sup> In this regard, the court in *Oakdene*<sup>85</sup> had this to say:

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<sup>84</sup>Delpont et al *Henocheberg on the Companies Act 71 of 2008* (2011-) 462. Loubser op cit (n79) also makes this observation at 510

<sup>85</sup>*Oakdene Square Properties (Pty) Ltd and others v Farm Bothasfontein (Kyalami) (Pty) Ltd and others; Farm Bothasfontein (Kyalami) (Pty) Ltd v Kyalami Events and Exhibitions (Pty) Ltd and others* [2012] 2 All SA 433 (GSJ)

The phrase "*it is otherwise just and equitable to do so for financial reasons*" is extremely vague. The immediate question arises: for financial reasons of whom, the company, the creditors, shareholders or the employees? Since the company cannot apply to court for a business rescue order, as it is not an "affected" person, one can immediately say that the financial reasons of the company are not referred to. However, that would render this provision absurd as it is primarily the financial health of the company which is at stake. I have little doubt that the Legislature never intended such an absurdity. I would, therefore, hold that financial reasons relating to all the stakeholders, except that of the practitioner, contemplated in the business rescue provisions, are to be considered by the court when applying this provision.<sup>86</sup>

The utility of such a provision is questionable and one can only speculate as to which instances will be accommodated within the phrase. It will, however, become clearer over time as the jurisprudence on business rescue gathers pace and momentum.

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<sup>86</sup> Paragraph 17

# CHAPTER 3: CREDITORS

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For purposes of this chapter, the following phrase will have the following meaning:

1. **Independent creditor:** means a person who –
  - a. Is a creditor of the company, including an employee of the company who is a creditor in terms of section 144(2); and
  - b. Is not related to the company, a director, or the practitioner, subject to subsection (2).<sup>87</sup>

This chapter will look at the rights of creditors. The discussions in the previous chapter focused on the initiation of business rescue. Up until that stage, there is no real divergence in the rights given to affected persons. However, once the company is under supervision the distinctions become all the more palpable although there are instances where the rights are generic. One such instance is the removal of the business rescue practitioner. This issue will be discussed in this chapter, with the subsequent chapters dealing with employees and shareholders merely making reference to this discussion where necessary.

## 3.1 *LIMITATION OF CREDITORS' RIGHTS*

When one considers the rights given to creditors in business rescue one must bear in mind that, first and foremost, the commencement of supervision results in the immediate curtailment of the rights of creditors. This is so because once a company has been placed under supervision there comes into force a general moratorium on the institution of legal proceedings against said company.<sup>88</sup>

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<sup>87</sup> Companies Act 71 of 2008 s 128(1)(g). Subsection 2 states that an employee of a company is not related to that company solely as a result of being a member of a trade union that holds securities of that company.

<sup>88</sup> Companies Act 71 of 2008 Section 133

The effect of this moratorium is that no enforcement action may be taken against the company unless it is done with the consent of the practitioner or with leave from the court.<sup>89</sup> Furthermore, for the duration of the supervision no guarantees or sureties will be enforceable against the company unless leave is granted by the court.<sup>90</sup> Prescription (or any other time limit imposed on a claim) will not run for the duration of the supervision.<sup>91</sup> Although there are exceptions to this moratorium,<sup>92</sup> these need not be discussed in any detail. The point sought to be made is that it is a corollary of supervision that creditors are precluded from freely pursuing their claims against the company. For this curtailment, the legislature has granted creditors rights which enable them to play a central role in the business rescue process.

### **3.2 GENERAL PARTICIPATION RIGHTS GIVEN TO CREDITORS**

Section 145 is the provision which broadly outlines the participatory rights of creditors. This section states that each creditor is entitled to the following:

- A. Notice of each court proceeding, decision, meeting or other relevant event concerning the business rescue proceedings;<sup>93</sup>
- B. Participation in any court proceedings arising during the business rescue proceedings;<sup>94</sup>
- C. Formal participation in the company's business rescue proceedings to the extent provided for;<sup>95</sup> and
- D. Informal participation in the aforementioned proceedings by making proposals for a business rescue plan to the practitioner.<sup>96</sup>

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<sup>89</sup> Companies Act 71 of 2008 Section 133(1)(a) and (b)

<sup>90</sup> Companies Act 71 of 2008 Section 133(2)

<sup>91</sup> Companies Act 71 of 2008 Section 133(3)

<sup>92</sup> Companies Act 71 of 2008 Section 133(1)(d) and (f)

<sup>93</sup> Companies Act 71 of 2008 Section 145(1)(a)

<sup>94</sup> Companies Act 71 of 2008 Section 145(1)(b)

<sup>95</sup> Companies Act 71 of 2008 Section 145(1)(c)

<sup>96</sup> Companies Act 71 of 2008 Section 145(1)(d)

Further to these rights, each creditor has the right to vote to amend, approve or reject a proposed business rescue plan.<sup>97</sup> Should the proposed business rescue plan be rejected, each creditor then has the right to propose the development of an alternative plan<sup>98</sup> or to present an offer to acquire the interests of any or all of the other creditors.<sup>99</sup> These last two rights will be expanded upon when the adoption of a business rescue plan is discussed at a later stage.

Creditors are also given the right to form a creditors' committee through which they are entitled to be consulted by the practitioner.<sup>100</sup> Whether or not this committee will be formed is to be determined at the first creditors' meeting which must be convened and presided over by the practitioner within 10 business days of their appointment.<sup>101</sup> In addition to discussing the prospect of a creditors' committee, the practitioner must also inform the creditors whether or not they believe that there is a reasonable prospect of rescuing the company.<sup>102</sup> The practitioner may also receive proof of creditors' claims at this meeting.<sup>103</sup> Notice of the meeting must be sent to every creditor of the company whose name and address is known to, or can reasonably be obtained by the practitioner.<sup>104</sup> Such a notice must set out the date, time and place of the meeting as well as the agenda.<sup>105</sup> In relation to decision-making at these meetings, the Act states that a decision supported by the holders of a simple majority of the independent creditors' voting interests voted on a matter is the decision of the meeting on that matter.<sup>106</sup> This provision does not apply to meetings contemplated in terms of section 151.<sup>107</sup>

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<sup>97</sup> Companies Act 71 of 2008 Section 145(2)(a)

<sup>98</sup> Companies Act 71 of 2008 Section 145(2)(b)(i)

<sup>99</sup> Companies Act 71 of 2008 Section 145(2)(b)(ii)

<sup>100</sup> Companies Act 71 of 2008 Section 145(3)

<sup>101</sup> Companies Act 71 of 2008 Section 147(1)(b)

<sup>102</sup> Companies Act 71 of 2008 Section 147(1)(a)(i)

<sup>103</sup> Companies Act 71 of 2008 Section 147(1)(a)(ii)

<sup>104</sup> Companies Act 71 of 2008 Section 147(2)

<sup>105</sup> Ibid

<sup>106</sup> Companies Act 71 of 2008 Section 147(3)

<sup>107</sup> Ibid

### 3.3 THE CREDITORS' COMMITTEE

The creditors committee is not entitled to direct or instruct the practitioner.<sup>108</sup> The committee may receive and consider reports relating to the business rescue proceedings on behalf of the body of creditors.<sup>109</sup> Furthermore, the committee must act independently of the practitioner in order to ensure an unbiased representation of the creditors' interests.<sup>110</sup> In order to be a member of the committee a person must either be an independent creditor, an agent, proxy or attorney of an independent creditor or a person who has been authorised in writing by an independent creditor.<sup>111</sup>

### 3.4 PROTECTION OF PROPERTY INTERESTS

Before delving deeper into the rights given to creditors, it would be convenient to dispose of the issue of property interests as it relates to this group. One of the consequences of business rescue is that the company is precluded from disposing or agreeing to dispose of any property, unless it is in the ordinary course of business, is a *bona fide* transaction for fair value at arm's length, approved in advance and in writing by the practitioner or is a transaction contemplated within the business rescue plan.<sup>112</sup>

Where the property sought to be disposed of is property over which another person has a security or title interest, the company must obtain the prior consent of that person unless the proceeds of the disposal would be sufficient to fully discharge the indebtedness protected by that person's security or title interest.<sup>113</sup> The company may then either pay to the person in question the sale proceeds up to the amount of the company's indebtedness to that person,<sup>114</sup> or provide security for the amount of those proceeds to the reasonable satisfaction of the latter.<sup>115</sup>

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<sup>108</sup> Companies Act 71 of 2008 Section 149(1)(a)

<sup>109</sup> Companies Act 71 of 2008 Section 149(1)(b)

<sup>110</sup> Companies Act 71 of 2008 Section 149(1)(c)

<sup>111</sup> Companies Act 71 of 2008 Section 149(2)

<sup>112</sup> Companies Act 71 of 2008 Section 134(1)

<sup>113</sup> Companies Act 71 of 2008 Section 234(3)

<sup>114</sup> Companies Act 71 of 2008 Section 134(3)(a)

<sup>115</sup> Companies Act 71 of 2008 Section 134(3)(b)

### 3.5 RIGHTS IN RELATION TO THE BUSINESS RESCUE PRACTITIONER

Creditors (as well as the other affected persons) are entitled to approach the court to have the appointment of the practitioner by the company<sup>116</sup> set aside on any of the grounds listed in section 130(1)(b). These are that the practitioner does not satisfy any of the requirements listed in section 138, that they are not independent of the company or its management or that they lack the necessary skills when one has regard to the company's circumstances.<sup>117</sup> Where an objection to the appointment is upheld, the court must then appoint an alternate practitioner recommended by, or acceptable to, the holders of a majority of the independent creditors' voting interests represented at the hearing before the court.<sup>118</sup>

Where the business rescue is commenced through the avenue of a court order, the court may appoint an interim practitioner nominated by the affected person who initiated the proceedings.<sup>119</sup> This interim appointment is subject to ratification by the holders of a majority of the independent creditors' voting interests at the first meeting of creditors.<sup>120</sup> A practitioner may also be removed by any affected person at any time by approaching the court on a number of grounds such as incompetence or the engaging by the practitioner in illegal acts or conduct.<sup>121</sup> The creditor or company who nominated the practitioner must then appoint a new practitioner, subject to the right of affected persons to challenge this appointment in terms of section 130(1)(b).<sup>122</sup> It should be noted that the appointment of a practitioner by the company in terms of section 129(3)(b) need not be ratified by the creditors and therefore the only means through which such an appointment may be challenged is through the court. Bradstreet views this as a flaw.<sup>123</sup> He opines that such an appointment should also be subject to ratification at the first

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<sup>116</sup> Companies Act 71 of 2008 section 129(3)(b)

<sup>117</sup> Companies Act 71 of 2008 Section 130(1)(b)

<sup>118</sup> Companies Act 71 of 2008 Section 130(6)(a)

<sup>119</sup> Companies Act 71 of 2008 Section 131(5)

<sup>120</sup> Ibid

<sup>121</sup> Companies Act 71 of 2008 Section 139

<sup>122</sup> Companies Act 71 of 2008 Section 139(3)

<sup>123</sup> R 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' *SA Merc LJ* (2010) 195. 203

creditor's meeting with a court application being required for removal of a practitioner at any point beyond that.<sup>124</sup> Bradstreet premises this view on the fact that given the financial implications for creditors, they should not be compelled to expend further resources on court applications in order to enforce their rights in terms of the Act.<sup>125</sup>

Disregarding the merits of Bradstreet's argument for the moment, it must be said that the reasoning behind such a distinction is not particularly clear. Perhaps the legislature was of the view that the board would be best placed to appoint the most suitable practitioner given its intimate knowledge of the problems plaguing the company and as a result, such an appointment should only be challenged if it contravenes section 138. This supposition could be coupled with the fact that expediency is at the centre of business rescue and thus the protection of interests must at all times be coupled with measures to avoid undue delay. The expediency argument does lose much of its force however when one considers that the appointment of a practitioner by the court in terms of section 131(5) is subject to ratification by the creditors at the first creditors' meeting. That as well presupposes that the creditors will refuse to ratify the appointment.

There are glaring inconsistencies in the Act regarding the appointment of a practitioner but, having said that it should be acknowledged that affected persons are given significant rights in this regard. Creditors are given more of a say and few can argue against that, considering the significant powers which vest in the practitioner and the drastic effect the exercise of those powers can have on creditors. One such power is that which is given to the practitioner in terms of section 136(2). In terms of this section, the practitioner may suspend entirely, partially or conditionally, for the duration of the business rescue proceedings, any obligation of the company which arises under an agreement which precedes the supervision of the company and which would otherwise become due during this period.<sup>126</sup> The practitioner is also empowered to approach the court on an urgent basis for an order which cancels entirely, partially or conditionally any such

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<sup>124</sup> Ibid

<sup>125</sup> Ibid

<sup>126</sup> Companies Act 71 of 2008 Section 136(2)(a)

obligation on terms that are just and reasonable under the circumstances.<sup>127</sup>

These provisions do not apply to employment contracts and to contracts to which sections 35A and 35B of the Insolvency Act<sup>128</sup> apply.<sup>129</sup> Furthermore, where the practitioner suspends a provision of an agreement relating to security granted by the company, that provision will nevertheless continue to apply for purposes of section 134.<sup>130</sup>

### 3.6 REMUNERATION OF THE PRACTITIONER

The practitioner is entitled to charge an amount to the company as remuneration and for incurred expenses in accordance with a prescribed tariff.<sup>131</sup> In addition to this, the practitioner and the company may agree on any further remuneration which is to be calculated on a contingency basis.<sup>132</sup> This remuneration is subject to the approval of the creditors and shareholders of the company.<sup>133</sup> The voting on the remuneration must take place at a meeting which has been called specifically for that reason.<sup>134</sup> Any creditor or shareholder who has voted against this proposed remuneration may approach a court within ten days for an order setting aside the agreement on grounds that it is unjust and inequitable or that it is unreasonable considering the company's financial circumstances.<sup>135</sup>

Affording shareholders and creditors such control is sensible if not necessary. It is a significant factor especially if the company is eventually liquidated. This is so because all the expenses and remuneration of the practitioner which have not been paid rank above the claims of all other secured and unsecured creditors.<sup>136</sup> When one takes into consideration the fact that post-commencement financiers and the employees of the company also enjoy preference then one appreciates

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<sup>127</sup> Companies Act 71 of 2008 Section 136(2)(b)

<sup>128</sup> Act 24 of 1936

<sup>129</sup> Companies Act 71 of 2008 Section 136(2A)(a) and (b)

<sup>130</sup> Companies Act 71 of 2008 Section 136(2A)(c)

<sup>131</sup> Companies Act 71 of 2008 Section 143(1)

<sup>132</sup> Companies Act 71 of 2008 Section 143(2)

<sup>133</sup> Companies Act 71 of 2008 Section 143(3)

<sup>134</sup> Ibid

<sup>135</sup> Companies Act 71 of 2008 Section 143(4)

<sup>136</sup> Companies Act 71 of 2008 Section 143(5)

that it is of utmost importance to creditors (especially unsecured creditors) that the practitioner is not unreasonably remunerated.

### **3.7 VOTING INTEREST**

A secured or unsecured creditors' voting interest is equal to the value of the amount owed to that creditor by the company.<sup>137</sup> A concurrent creditor who would have been subordinated in liquidation has a voting interest which is computed altogether differently. Their voting interest is equal to the amount that they could reasonably expect to receive upon the company being liquidated.<sup>138</sup> Such an amount must be independently appraised by an expert at the request of the practitioner.<sup>139</sup> From the above it is clear that the creditors who have the greatest say in the business rescue process are secured creditors. This is so because in all probability they will be the ones to whom the most money is owed by the company and as a result they will have the highest proportion of the voting interest.

### **3.8 INDEPENDENT CREDITORS**

The Act creates a sub-category of creditors, namely independent creditors. A definition has already been proffered at the beginning of this chapter and need not be repeated. However it suffices to say that whether or not a creditor falls within this group is particularly important, especially when it pertains to the approval of the business rescue plan. The practitioner must make a determination as to whether or not a creditor is independent<sup>140</sup> and must give individual notice of this determination at least 15 business days prior to the consideration of the business rescue plan.<sup>141</sup> The practitioner must also within this period give notice of the aforementioned appraisal to the relevant subordinated creditors.<sup>142</sup> The recipients

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<sup>137</sup> Companies Act 71 of 2008 Section 145(4)(a)

<sup>138</sup> Companies Act 71 of 2008 Section 145(4)(b)

<sup>139</sup> Ibid

<sup>140</sup> Companies Act 71 of 2008 Section 145(5)(a)

<sup>141</sup> Companies Act 71 of 2008 Section 145(5)(c)

<sup>142</sup> Ibid

of these notices may apply to court within five business days for a review or reappraisal, whatever the case may be.<sup>143</sup>

### 3.9 PROPOSAL OF BUSINESS RESCUE PLAN

After consulting with the various affected persons, the practitioner must prepare a business rescue plan (the rescue plan) for consideration.<sup>144</sup> The overarching requirement of the rescue plan is that it must contain information which would be reasonably required to facilitate informed decision-making on the part of the affected persons who are to vote on it.<sup>145</sup> Furthermore, the plan must be divided into three parts namely:

- A. PART A – BACKGROUND: this part puts the affairs of the company into perspective and includes a list of the company’s material assets as well as an indication of which of those assets were being held as security by creditors at the commencement of business rescue.<sup>146</sup>
- B. PART B – PROPOSALS: this part of the plan outlines the manner in which the rescue of the company will be achieved.<sup>147</sup>
- C. PART C – ASSUMPTIONS AND CONDITIONS: this part must include a statement of the assumptions and conditions that must be met in order for the business rescue plan to be successful.<sup>148</sup>

The business rescue plan must be published within 25 days after the date on which the practitioner is appointed or such longer time as a court may grant on application by the company or the holders of a majority of the creditors’ voting interest.<sup>149</sup>

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<sup>143</sup> Companies Act 71 of 2008 Section 145(6)

<sup>144</sup> Companies Act 71 of 2008 Section 150(1)

<sup>145</sup> Companies Act 71 of 2008 Section 150(2)

<sup>146</sup> Companies Act 71 of 2008 Section 150(2)(a)

<sup>147</sup> Companies Act 71 of 2008 Section 150(2)(b)

<sup>148</sup> Companies Act 71 of 2008 Section 150(2)(c)(i)

<sup>149</sup> Companies Act 71 of 2008 Section 150(5)

### 3.10 A BETTER RETURN FOR CREDITORS (OAKDENE CASE)

When one looks at the requirements pertaining to the contents of Part B of the business rescue plan, one sees the interplay between the two objectives of business rescue as outlined in s128(1)(b)(iii) of the Act. This interplay, so to speak, was dealt with in the *Oakdene*<sup>150</sup> cases, a discussion of which will be undertaken presently.

#### 3.11 Facts

The company in question owned three immovable properties adjoining one another and held under separate title deeds.<sup>151</sup> The shares in the company were previously held by the Automobile Association of South Africa (AA) which sold these shares to the MJF Trust (duly represented by Micheal Fogg).<sup>152</sup> A suspensive condition of the sale agreement was that the company would repay its R42m debt to AA.<sup>153</sup> It would do so by obtaining a loan of R28m from Nedbank against registration of a mortgage bond on the immovable property.<sup>154</sup> To raise the shortfall of R15m, the Trust entered into a memorandum of understanding (MOU) with Imperial and Imperial Bank Ltd (a predecessor of Nedbank).<sup>155</sup> In terms of the MOU, Imperial and Nedbank would put up a bank guarantee of R15m and each would then be entitled to a 30% share of the company. Furthermore, the Trust, Imperial and Nedbank would each nominate a director to the board of the company with a chairman and a fifth director jointly nominated by all three. In addition to this, the Trust undertook to transfer the shares to Imperial and Nedbank, appoint their nominees as directors and to sign all documents necessary for the appointment of the remaining directors. When Imperial and Nedbank complied with the terms of the agreement, they sought a court order compelling the Trust to perform as it had failed to do so when called upon.

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<sup>150</sup> *Oakdene Square Properties (Pty) Ltd and others v Farm Bothasfontein (Kyalami) (Pty) Ltd and others* 2012 (3) SA 273 (GSJ)

<sup>151</sup> Paragraph 19

<sup>152</sup> Paragraph 24

<sup>153</sup> Paragraph 26

<sup>154</sup> Paragraph 27

<sup>155</sup> Ibid

When Imperial and Nedbank eventually became members of the company, they found that Fogg had leased the immovable property of the Company to Motortainment a company which was wholly owned by the Trust.<sup>156</sup> These lease agreements were for a seven year period and had a right of renewal for a further seven years.<sup>157</sup> Furthermore, Fogg and his wife had resigned as trustees and they, along with the other beneficiaries of the trust, had ceded their rights in the trust to a company called Educated Risk. The controllers of Educated Risk (the Theodosiou brothers) consequently became trustees of the Trust and thus controlled the company and Motortainment.<sup>158</sup>

Imperial and Nedbank launched court proceedings to have the lease agreements set aside and to enforce their pre-emptive rights in relation to the 40% share of the company which had passed from the Trust to Educated Risk. Meanwhile, ABSA Bank had launched liquidation proceedings against Motortainment and in an attempt to stave this off the controllers of Motortainment ceded its rights under the lease to Kyalamai Events (another company they controlled). This precipitated a further court application by Imperial and Nedbank to have Kyalami Events and Motortainment evicted from the immovable property. A business rescue application was then launched by the Theodosiou brothers and Educated Risk. This application was opposed by Imperial, Nedbank and the company.

The opposition by Imperial and Nedbank was based simply on the fact that they would reject any rescue proposal put forward by the practitioner. It should be noted that the company derived no income from its assets and this was common cause between the parties. As a result, the company was unable to reduce its liability to Nedbank under the mortgage bond thus prompting the latter to obtain judgment. The application for business rescue was premised on the argument that if the company's immovable property were to be sold in execution it would not realise as much as it would if it were to be sold in the normal course. There was thus no intention for the company to continue in existence on a solvent basis. A

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<sup>156</sup> Paragraph 28

<sup>157</sup> Ibid

<sup>158</sup> Paragraph 29

further important feature of the case was that there were no employees to take into consideration therefore the only competing interests were those of the company and the creditors.

### **3.11.1**      *High Court*

Classen J heard the matter in the High Court and declined to grant the order placing the Company under supervision. The judge provided a litany of reasons<sup>159</sup> which need not be replicated here. It suffices to say that chief amongst those reasons was the avowed intention of the creditors to vote against any business rescue plan<sup>160</sup> as well as the view on the part of the court that a liquidator would be best placed to grapple with the issues and to untangle the vast web of complexity that embroiled the numerous transactions involved.<sup>161</sup> A further factor, one which will be addressed in a bit more detail a later stage, was that Claasen J was of the view that given the circumstances of the case, the interests of creditors ought to carry more weight.<sup>162</sup>

### **3.11.2**      *Supreme Court of Appeal*

Three issues were presented to the Supreme Court of Appeal (SCA) for consideration.<sup>163</sup> These were:

- A. The nature of the court's discretion under s 131(4) of the Act;
- B. The meaning of 'reasonable prospect' in s 131(4)(a)(iii); and
- C. The meaning of 'rescuing the company'.

For current purposes only the third issue need be considered.

In terms of the Act, business rescue has two objectives namely, the restoring of the company to solvency via a restructuring of, inter alia, its debts, liabilities and

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<sup>159</sup> Paragraph 49

<sup>160</sup> Paragraph 47

<sup>161</sup> Paragraph 49.8-10

<sup>162</sup> Paragraph 49.7

<sup>163</sup> *Oakdene Square Properties (Pty) Ltd and others v Farm Bothasfontein (Kyalami) (Pty) Ltd and others* 2013 (4) SA 539 (SCA)

assets.<sup>164</sup> Where this is not possible then the result must be a better return for creditors or shareholders than would be the case if the company were to be immediately liquidated.<sup>165</sup>

The question that arises from this is whether these are primary and secondary objectives in the sense that at all times the objective must firstly be to restore the company to solvency? Or, is it that there is no such ranking and that these are both primary objectives in their own right and as a result a rescue can be premised solely on the objective of securing a better return for creditors and shareholders. The SCA opted for the latter interpretation. Although the court did not view them as both primary objectives, it did however rule that either of the objectives can be the basis of an application to court to commence business rescue. In order to get a grasp of the court's reasoning it would be salutary to make mention of the argument advanced in favour of the court adopting the contrary interpretation.

It was argued on behalf of the Respondents that when one looks at the ordinary dictionary meaning of the words 'rescue' and 'rehabilitate' then one sees that they both allude to a return to a normal healthy state.<sup>166</sup> Therefore, it was argued, when one looks at section 128(1)(b)'s definition of business rescue as 'proceedings to facilitate the rehabilitation of a company', it becomes clear that business rescue proceedings must be aimed at the primary goal of restoring the company to a normal healthy state of solvency.<sup>167</sup> The secondary goal, so the argument continued, can only be an alternative goal of the proposed rescue plan and therefore it follows that a proposed plan which is premised solely on that secondary objective cannot amount to a rescue.<sup>168</sup>

The court had no issue with the proffered dictionary meaning but stated that section 128(1)(b) gave its own meaning to the words 'rescue' and 'rehabilitate'.<sup>169</sup> The court stated that it understood the section to say that 'business rescue' meant to facilitate 'rehabilitation', which in turn meant the achievement of one of two goals namely, to return the company to solvency or to provide a better deal for

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<sup>164</sup> Companies Act 71 of 2008 Section 128(1)(b)(iii)

<sup>165</sup> Ibid

<sup>166</sup> Paragraph 25

<sup>167</sup> Ibid

<sup>168</sup> Ibid

<sup>169</sup> Paragraph 26

creditors and shareholders than they would receive through liquidation.<sup>170</sup> The court found this interpretation to be consistent with the reference in section 128(1)(h) to the achievement of the objectives set out in section 128(1)(b) and therefore concluded that the achievement of any of these would qualify as a business rescue.<sup>171</sup>

Another factor which influenced the court's decision was what it termed the 'historical context of Chapter 6'.<sup>172</sup> This is a reference to judicial management, particularly the requirements which had to be met for an order to be granted. In terms of section 427(1)(b) of the 1973 Companies Act, it was a prerequisite that there be a reasonable probability that a company placed under judicial management would be able to pay its debts or to meet its obligations and become a successful concern. As a result, an order would not be granted even though there was proof that it would be more advantageous to dispose of a company as one being under judicial management than as one in liquidation.<sup>173</sup> The court found that policy and practical considerations dictated that there should be a shift from this mindset.<sup>174</sup> The court stated that it saw no reason why a company in financial distress should not be temporarily protected from its creditors in order to allow it to be sold as a going concern where this would result in optimum value being attained.<sup>175</sup> The court further noted that an insistence on creditors being paid in full was one of the reasons why judicial management failed and therefore it could not be accepted that the legislature intended to repeat that same error.<sup>176</sup>

The court made a further point which, though not particularly apposite to the business rescue plan, is significant when considering the balancing of interests within the scheme of business rescue. In the court a quo one of the reasons relied upon by Claassen J for refusing to grant an order placing the company in question under business rescue was because a significant body of creditors had declared

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<sup>170</sup> Ibid

<sup>171</sup> Ibid

<sup>172</sup> Paragraph 27

<sup>173</sup> See *Millman, NO v Swarland Huis Meubileerders (Edms) Bpk: Repfin Acceptances Ltd intervening* 1972 (1) SA 741 (C)

<sup>174</sup> *Oakdene* op cit (n163) Paragraph 28

<sup>175</sup> Ibid

<sup>176</sup> Ibid

their intention of voting against any proposed business rescue plan.<sup>177</sup> This line of reasoning was criticised by the appellants who urged the SCA to adopt the approach of the court in *Bestvest*.<sup>178</sup> In that case the court held that a similar strategy was inconsistent with the overall purpose of business rescue which is aimed at saving rather than destroying businesses and which is premised on consultation and consensus-seeking.<sup>179</sup> The SCA disagreed with this approach to the extent that it purported to convey the message that the declared intention of a majority of the creditors to oppose a business rescue should in principle be ignored.<sup>180</sup> The court stated that an applicant for business rescue is bound to establish reasonable grounds for the prospects of rescuing the company and if the majority of creditors declare that they will oppose any business rescue scheme, then such a declaration ought not to be ignored.<sup>181</sup> The court concluded that it would only interfere in these circumstances if it was evident that the creditors were being unreasonable and therefore it approved of the court a quo's approach.<sup>182</sup> Ultimately the court dismissed the appeal and upheld the decision of Classen J.

### 3.12 INTERESTS OF COMPANY V INTERESTS OF CREDITORS

Reverting back to the High Court decision, Classen J made an interesting point regarding applications where the factual matrix resembled those of that case, that is, where the interests of the company and its creditors conflict. In the earlier case of *Swart v Beagles Run Investments*<sup>183</sup> the court stated that where an application for business rescue entailed the weighing-up of the interests of the creditors and the company, the interests of the creditors should carry the day.<sup>184</sup> The manner in which the court reached its decision does open the judgment to some criticism however. This is so because in dealing with the case before it, the court made reference to the judicial management provisions under the 1973 Act and the case

<sup>177</sup> *Oakdene Square Properties (Pty) Ltd and others v Farm Bothasfontein (Kyalami) (Pty) Ltd and others; Farm Bothasfontein (Kyalami) (Pty) Ltd v Kyalami Events and Exhibitions (Pty) Ltd and others* [2012] 2 All SA 433 (GSJ) At paragraph 47

<sup>178</sup> *Nedbank Ltd v Bestvest 153 (Pty) Ltd; Essa v Bestvest 153 (pty) Ltd 2012 (5) SA 497 (WCC).*

<sup>179</sup> Paragraph 55

<sup>180</sup> *Oakdene supra* (n163) at paragraph 38

<sup>181</sup> *ibid*

<sup>182</sup> *ibid*

<sup>183</sup> *Swart v Beagles Run Investments 25 (Pty) Ltd (four creditors intervening)* 2011 (5) SA 422 (GNP)

<sup>184</sup> Paragraph 41

law pertaining to those provisions.<sup>185</sup> It could be argued that the learned judge used these simply as a point of reference given that the case before him entailed a novel concept which, at the time, had not yet been confronted by the judiciary.<sup>186</sup> Notwithstanding that fact, it is rather disconcerting that the Makgoba J saw fit to resort to the law pertaining to judicial management for guidance in order to interpret legislation which is markedly different in substance and philosophy.<sup>187</sup> Be that as it may, the principle was established and later reiterated by Classen J in *Oakdene*.<sup>188</sup>

It would seem though that the pronouncement by Makgoba J is much broader in its scope than that of Classen J. Before expanding upon this, it should be noted that these cases have peculiarities which are both common amongst them and unique to each of them. In both cases employees were not involved and thus the competing interests were those of the company and the creditors. In *Oakdene*, the company was not involved in any business activities and there was no desire for it to be so involved after the supervision. As a result, the intention was purely to utilise business rescue to stave off liquidation and to sell the company's assets in the normal course. In *Beagles Run* it seemed that there was the intention to commence business after the supervision, however, the company in question was hopelessly insolvent and this rendered the proposed business rescue plan impracticable in the eyes of the court.<sup>189</sup> Within that context, Makgoba J stated that where an application entails weighing up the interests of the creditors and the company, the interests of the creditors should carry the day.

Classen J phrased it in much more restrictive terms by stating that the interests of creditors as opposed to those of the company should carry more weight in the circumstances of that case (where there was no business to be rescued). It is submitted that Classen J's approach is the more favourable one in that it exhibits the sort of balance envisaged by the Act. Claassen J was at pains to emphasise the fact that business rescue seeks to preserve the business of a company, that is the

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<sup>185</sup> Paragraphs 23-25

<sup>186</sup> In fact Makgoba J says as much in paragraph 23 of the judgment.

<sup>187</sup> E Mbiriri, 'Creditors' interests still carry the day in business rescue: *Swart v Beagles Run Investment 25 (Pty) Ltd 2011 (5) SA 422 (GNP)* (2014) 7 (1) *Int. J. Private Law* 82. At 86

<sup>188</sup> *Oakdene* supra (n177) paragraph 49

<sup>189</sup> *Beagles Run Investments* supra (n187) Paragraph 30

commercial activity of the company, and not the company itself.<sup>190</sup> Therefore, where this is not sought in an application to commence business rescue it seems defensible that the creditors should be given a greater say considering the financial exposure they face. As has already been said, these cases are peculiar in that they deal specifically with the balancing of the interests of the company with those of creditors. Employees were thus not taken into consideration and so these cases must be viewed within that context.

### **3.13 CONSIDERATION OF THE BUSINESS RESCUE PLAN**

Once the practitioner has published the plan they must convene a meeting for its consideration. This meeting must be convened within 10 days of the plan being published and must be attended by the creditors or any other party with a voting interest.<sup>191</sup> A notice of this meeting must be sent to all affected persons at least five days before the date of the meeting.<sup>192</sup> At this meeting, creditors are entitled to propose changes to the business rescue plan which changes must be satisfactory to the practitioner.<sup>193</sup> This is essential in maintaining the latter's independence. Creditors may also call for the meeting to be adjourned in order for the practitioner to revise the plan for further consideration.<sup>194</sup> Where this does not transpire, the practitioner must call for a vote for preliminary approval of the proposed plan.<sup>195</sup>

In order for the plan to be approved it must be supported by the holders of more than 75% of the creditors' voting interests that were voted as well as 50% of the independent creditors' voting interests, if any.<sup>196</sup> If these requirements are met, the plan will be approved on a preliminary basis if it alters the rights of the holders of any class of the company's securities.<sup>197</sup> What happens under those circumstances will be discussed in subsequent chapters. For present purposes it will be presumed that the plan does not alter any rights of securities holders, in

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<sup>190</sup> *Oakdene* supra (n177) paragraph 12

<sup>191</sup> Companies Act 71 of 2008 Section 151(1)

<sup>192</sup> Companies Act 71 of 2008 Section 151(2)

<sup>193</sup> Companies Act 71 of 2008 Section 152(1)(d)(i)

<sup>194</sup> Companies Act 71 of 2008 Section 152(1)(d)(ii)

<sup>195</sup> Companies Act 71 of 2008 Section 152(1)(e)

<sup>196</sup> Companies Act 71 of 2008 Section 152(2)

<sup>197</sup> Companies Act 71 of 2008 Section 152(3)(c)

which case the plan will have been adopted on a final basis. A corollary of this is that the plan would become binding on all the creditors of the company whether or not they were present at the meeting, voted in favour of adoption of the plan or had proven their claims against the company.<sup>198</sup> Where the plan is not adopted there are various routes that can be taken and these will be discussed presently.

### 3.13.1 *Court application to have vote set aside*

Where the plan is not adopted, the practitioner may seek a vote of approval from the holders of voting interests to prepare and publish a revised plan.<sup>199</sup> The practitioner may also inform the meeting that the company will be approaching the court for an order setting aside the vote on the grounds that it is 'inappropriate'.<sup>200</sup> Where the practitioner refrains from doing so, any affected person who attended the meeting may call for a vote of approval from the holders of voting interests requiring the practitioner to prepare and publish a revised plan.<sup>201</sup> The affected person may also apply to the court to have the result of the vote set aside on grounds that it is inappropriate.<sup>202</sup> The lack of clarity with regards to what the term 'inappropriate' envisages has been noted.<sup>203</sup> The particular point made is that if creditors are to be allowed to exercise their votes freely then it has to be assumed that they would only do so in supporting a business rescue plan if it would be to their benefit.<sup>204</sup> Therefore, according to the author, it is difficult to conceive of circumstances where the creditors' vote would be inappropriate.<sup>205</sup> The author does acknowledge the guidance offered by section 153(7) in this regard.<sup>206</sup> The section states that when a court is considering an application to set aside the vote on the grounds that it is inappropriate, the court may grant the order if it is satisfied

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<sup>198</sup> Companies Act 71 of 2008 Section 152(4)

<sup>199</sup> Companies Act 71 of 2008 Section 153(1)(a)(i)

<sup>200</sup> Companies Act 71 of 2008 Section 153(1)(a)(ii)

<sup>201</sup> Companies Act 71 of 2008 Section 153(1)(b)(i)(aa)

<sup>202</sup> Companies Act 71 of 2008 Section 153(1)(b)(i)(bb)

<sup>203</sup> Delpont et al op cit (n84) 529

<sup>204</sup> Ibid

<sup>205</sup> Ibid

<sup>206</sup> Ibid

that it is reasonable and just to do so.<sup>207</sup> The Court must also have regard to the following factors:

- A. The interests represented by the person(s) who voted against the proposed plan;
- B. The provision, if any, made in the proposed plan with respect to the interests of that person(s); and
- C. A fair and reasonable estimate of the return to that person(s) if the company were to be liquidated.<sup>208</sup>

It is submitted that the lack of particularity with regards to the meaning of the term 'inappropriate' serves a purpose. It provides potential applicants with a broad basis upon which they can approach the court for relief where the business rescue process is being hamstrung by an unreasonable and fractious creditor. Although creditors are entitled to exercise their votes freely, this should not amount to the sanctioning of the kind of self-interest that flies in the face of the inclusive and broad stakeholder approach sought to be promoted in the business rescue provisions.

There are some practical concerns with regards to the provision however. For example, the Act states that if the practitioner informs the meeting that an application as discussed above will be made to court, then the meeting must be adjourned for five days unless the court application is initiated within that period, in which case the meeting will be adjourned until the court proceedings have been concluded.<sup>209</sup> Loubser notes that this is a very short time period within which court papers may be drafted for the relevant application.<sup>210</sup> Loubser also opines that the onerous notification requirements could potentially have been relaxed under these circumstances for practical and cost-saving reasons.<sup>211</sup> Be that as it may, the option of approaching the court for an order setting aside the vote is a potentially useful tool and it will be interesting to see how it is utilised.

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<sup>207</sup> Companies Act 71 of 2008 Section 153(7)

<sup>208</sup> *ibid*

<sup>209</sup> Companies Act 71 of 2008 Section 153(2)

<sup>210</sup> Loubser *op cit* (n6) 134

<sup>211</sup> *ibid*

### 3.13.2 *Purchasing of voter's interest*

In the event that neither of the aforementioned options are utilised, affected persons (whether acting individually or collectively) may make a binding offer to purchase the voting interests of one or more persons who opposed the adoption of the plan.<sup>212</sup> The voting interest in question must be independently valued by an expert on the request of the practitioner, which valuation must be a fair and reasonable estimate of the return to the person or persons to whom the offer is made, if the company were to be liquidated.<sup>213</sup> This option is available to all affected persons and not merely those who attended the meeting. Therefore, any discussion here will also be applicable to shareholders and employees and will thus not be repeated in subsequent chapters.

Loubser has several reservations about this particular option. The first concern she raises is with regards to what constitutes “voting interest”. What is undisputed is that the term pertains to the voting interest of dissenting creditors however it is far less clear whether it also includes the votes of dissenting shareholders.<sup>214</sup> Loubser notes that section 128(1)(j) defines “voting interest” as the votes creditors are entitled to on account of their claims against the company as determined in terms of section 145(4) to (6) and that this, on the face of it, precludes the votes of shareholders.<sup>215</sup> This exclusion is made less certain when one considers that section 151(1) states that the “creditors and any other holders of a voting interest” must be called to the meeting to determine the rescue plan.<sup>216</sup>

Loubser suggests that the answer to this conundrum is to be found in section 146(e)(ii), which states that the holders of the company’s securities are entitled to present an offer to acquire the interests of any or all of the creditors or other holders of the company’s securities in the manner contemplated in section 153.<sup>217</sup> Although this section is indicative of the fact that the interests of securities holders may be purchased, it is submitted that there is much more to it. That is that it is also indicative of the fact that only securities holders and employees may

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<sup>212</sup> Companies Act 71 of 2008 Section 153(1)(b)(ii)

<sup>213</sup> Ibid

<sup>214</sup> Loubser op cit (n6) 137

<sup>215</sup> Ibid

<sup>216</sup> Ibid

<sup>217</sup> Ibid

purchase the voting interests of other securities holders. This can be inferred from the fact that the abovementioned section is to be found in the section in the Act dealing with the participation of securities holders. The section expressly gives securities holders the right to acquire the interests of dissenting creditors as well as the holders of the companies securities.

In similar terms, the section dealing with employees' rights stipulates that employees are entitled to present an offer to acquire the interests of one or more *affected persons* in the manner contemplated in section 153.<sup>218</sup> This clearly suggests that employees may also acquire the interest of shareholders as well as those of creditors. This is to be contrasted with section 145(2)(b)(ii) which stipulates that creditors are entitled to present an offer to acquire the *interests of any or all of the other creditors* in the manner contemplated in section 153.<sup>219</sup> This is a clear limitation as to the interests that a creditor may purchase in terms of section 153. These issues must be noted as the discussions under this topic progress.

The fact that the interests of securities holders could also be purchased in terms of section 153 brought Loubser to another feature of this option which is of concern to her. That is the fact that the purchase price of the offer must be equal to the independently and expertly determined, fair and reasonable estimate of what the holder of the voting interest would receive if the company were liquidated.<sup>220</sup> To Loubser this is an alarming provision in that the liquidation value of a concurrent creditor's claim would be close to nothing and a share in a liquidated company would be equally worthless.<sup>221</sup> Therefore, according to Loubser, persons to whom the offer is made would much rather attempt to have an amended plan prepared than to (virtually) donate their votes.<sup>222</sup> Consequently, Loubser questions why the offeror has not been allowed to offer more than the liquidation value in order to make the offer more enticing.<sup>223</sup>

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<sup>218</sup> Companies Act 71 of 2008 Section 144(3)(g)(ii). Own emphasis

<sup>219</sup> Own emphasis

<sup>220</sup> Loubser op cit (n6) 138

<sup>221</sup> Ibid

<sup>222</sup> Ibid

<sup>223</sup> Ibid

It is worth mentioning that the offeree and the offeror are both entitled to apply to court to have the determination made by the expert reviewed, re-appraised and re-valued.<sup>224</sup> To Loubser, this indicates that the word ‘binding’ in relation to the offer could potentially mean that the offer is binding on both the offeror and the offeree.<sup>225</sup> This is so because if the offer was not binding on the offeree, they could simply refuse it without having to go to court.<sup>226</sup> It would be salutary to expand on this concept by examining how the courts have approached it and to this end the *DH Brothers*<sup>227</sup> and *Kariba*<sup>228</sup> cases will be analysed.

### 3.13.2.1 *Kariba*

In *Kariba* the court stated that whilst an offer is ordinarily made freely and voluntarily, the offer envisaged under section 153(1)(b)(ii) is a binding offer in the sense that once it is made it creates a *vinculum juris* on the part of the offeror and may not be withdrawn.<sup>229</sup> The court distinguished the binding offer from an option or an agreement in the contractual sense by stating that it is a set of statutory rights and obligations from which neither party may resile.<sup>230</sup> The binding offer is thus, according to the court, binding on both the offeror and the offeree.<sup>231</sup> The court continued and stated that the purpose of this is predominantly to ensure compliance with the procedure to revive a business rescue and enforce a revised business rescue plan.<sup>232</sup>

The court added that this is achieved by prescribing a swift and efficient procedure to be completed within five days, the purpose of which is to revive the business rescue procedure, after rejection of the business rescue plan, by allowing the

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<sup>224</sup> Companies Act 71 of 2008 Section 153(6)

<sup>225</sup> Ibid

<sup>226</sup> Ibid

<sup>227</sup> *DH Brothers Industries (Pty) Ltd v Gribnitz NO and Others* 2014 (1) All SA 173 (KZP)

<sup>228</sup> *African Bank Corporation of Botswana v Kariba Furniture Manufacturers (Pty) Ltd and Others* 2013 (6) SA 471 (GNP)

<sup>229</sup> Page 29

<sup>230</sup> ibid

<sup>231</sup> Ibid

<sup>232</sup> ibid

purchase of a voting interest of one or more persons who opposed the adoption of the plan.<sup>233</sup>

The court continued and stated that the determination of the voting interest will only be effected after adoption of the revised business plan, as the five day intervening period prescribed in section 153(2)(a) is purely to afford the practitioner the opportunity to make the necessary changes to the rescue plan.<sup>234</sup>

In relation to the offeree, the court held that they are adequately protected as they may approach a court if they are dissatisfied with the valuation of their interest.<sup>235</sup> Furthermore, according to the court, the fact that the consideration for the voting interest ought not to be less than what the offeree would receive should the company be liquidated is a further means through which their interests are protected by the Act.<sup>236</sup> With regards to adoption and implementation of the rescue plan, the court held that the offeree would be divested of their voting interest as soon as the binding offer is made and as a result the offeror would be able to procure the adoption of the plan by utilising the acquired voting interest.<sup>237</sup> The court held however that the plan may not be implemented until such a time as the offeree has been paid the purchase price for their voting interest.<sup>238</sup>

### 3.13.2.2 *DH Brothers*

The court in *DH Brothers* was scathing in its criticism of the *Kariba* judgment and it is, with respect, submitted that the criticism is justified. The court held that the reasoning in the judgment was based on unstable foundations.<sup>239</sup> It held that on a purely grammatical level, a 'binding offer' could not, itself, be a 'set of statutory rights and obligations'.<sup>240</sup> It may, the court continued, give rise to these but this is not what the Act says.<sup>241</sup> The court stated that it did not understand how, if the

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<sup>233</sup> Ibid

<sup>234</sup> *DH Brothers* supra (n227) 30

<sup>235</sup> *DH Brothers* supra (n227) 31

<sup>236</sup> *DH Brothers* supra (n227) 32

<sup>237</sup> *DH Brothers* supra (n227) 34

<sup>238</sup> Ibid

<sup>239</sup> Paragraph 39

<sup>240</sup> Ibid

<sup>241</sup> Ibid

opposing creditor (the offeree) is divested of voting interests 'on approval or adoption' of a plan, the votes could be exercised by the offeror to approve the plan.<sup>242</sup> In relation to the aspects of adoption and implementation of the plan, the court stated that whilst the use of these words lends superficial attraction to the conclusion drawn in *Kariba*, it cannot mean that a plan once adopted could not be implemented.<sup>243</sup> In this regard, the court referenced section 140(1)(d)(ii) of the Act which imposes a duty on a practitioner to implement any business rescue plan that has been adopted.<sup>244</sup>

The court went further and stated that nowhere in the Act is it mentioned that implementation of the plan is conditional on payment even if the practitioner was not obliged to implement it.<sup>245</sup> The court held that the use of the word 'offer' in section 153(1)(b)(ii) is consistent with the settled legal meaning of the word and the legislature must be presumed to know that meaning.<sup>246</sup> An offer, the court continued, imposes an obligation on the offeror only and it is only when it is accepted that an obligation is imposed on the offeree.<sup>247</sup> The court found it significant that the offer was 'to purchase'. This, the court held, is also an established legal concept and when used together with the word 'offer' connotes that a contract is envisaged and as a corollary there must be an acceptance or agreement.<sup>248</sup> The court noted that the word 'binding' qualifies the word 'offer' and nothing else.<sup>249</sup> If it was intended for the creditor to whom the offer is made to be bound by said offer then, according to the court, the legislature would have stated this in much clearer terms.<sup>250</sup> According to the court therefore, the word 'binding' means that once the offer is made it cannot be retracted until it is either accepted or rejected.<sup>251</sup>

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<sup>242</sup> Ibid. My understanding of the *Kariba* judgment on this aspect is that the offeree is divested of their voting interest as soon as the binding offer is made and as a result the offeror is then able to utilise the acquired voting interest to have the plan approved.

<sup>243</sup> Ibid

<sup>244</sup> Ibid

<sup>245</sup> Ibid

<sup>246</sup> Paragraph 41

<sup>247</sup> ibid

<sup>248</sup> Ibid

<sup>249</sup> Paragraph 42

<sup>250</sup> Ibid

<sup>251</sup> Ibid

The court reasoned that the fact that an offer necessitated an adjournment of the meeting meant that there had to be certainty as to its authenticity and *bona fides* and this is achieved by prescribing that the offer cannot be retracted until it is either accepted or rejected.<sup>252</sup>

The court continued and stated that the interpretation of 'binding offer' adopted in *Kariba* contradicts certain provisions of the Act.<sup>253</sup> One such provision is section 145(2)(a). This section provides that creditors are entitled to vote to amend, approve or reject a proposed business rescue plan in the manner contemplated in section 152. If, according to the court, the legislature intended for this right to be relinquished in the manner postulated in *Kariba*, it would have stated so in no uncertain terms.<sup>254</sup> Another provision which, according to the court, militated against the interpretation adopted in *Kariba* is section 153(6). This section provides that a holder of a voting interest, or a person acquiring that interest in terms of a binding offer, may apply to a court to review, re-appraise and re-value a determination by an independent expert in terms of subsection (1)(b)(ii). According to the court the offeree would not be able to make use of this provision since they would not be holders of a voting interest on account of the divestiture that takes place.<sup>255</sup> With regards to the purposive approach adopted in *Kariba*, the court held that the objectives in section 7(k) of the Act do not support an interpretation leading to the adoption of business rescue plans at all costs.<sup>256</sup> The court alluded to the broad stakeholder approach avowed in the Act and held that it is in keeping with the aim of ensuring an equitable balance of competing interests that the rights of creditors are not to be ridden over roughshod.<sup>257</sup> The court was also critical of the assertion in *Kariba* that the offeree is adequately protected by the fact that they could not receive less than what they would expect to receive if the company was to be liquidated.<sup>258</sup>

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<sup>252</sup> Paragraph 43 - 45

<sup>253</sup> Paragraph 46

<sup>254</sup> Ibid

<sup>255</sup> Paragraph 52

<sup>256</sup> Paragraph 54

<sup>257</sup> Ibid

<sup>258</sup> Paragraph 55

The court noted the difficulty of arriving at an accurate determination on account of the myriad permutations that would have to be taken into account.<sup>259</sup> In this regard, the court held that it would be cold comfort to an offeree to say that they could have to recourse to the courts when the courts themselves would not be in a position to make a more accurate determination.<sup>260</sup>

### 3.13.3 *Analysis*

Though it may be obiter, it is submitted that the court in *DH Brothers* adopted a more realistic interpretation. Furthermore, it is an interpretation which shows awareness of the potential for abuse highlighted by Loubser.<sup>261</sup> What is disconcerting about the *Kariba* judgment is that the set of facts before that court presented as clear an example as possible about these potential abuses. The approach adopted in *Kariba* leaves creditors infinitely exposed and is thus contrary to section 7(k)'s avowed pursuit of equity and the balancing of interests. As already mentioned by the court in *DH Brothers*, the 'rescue at all costs' approach adopted in *Kariba* does not accord with the Act and is in fact inimical to business rescue's prospects of success. In relation to the section itself, one cannot help but agree with Loubser's perceptions of it. If the interpretation of *Kariba* is to be favoured, then it is clearly an inimical provision which lends itself to abuse. If, however, the interpretation in *DH Brothers* is to be favoured, then the facts of that case themselves indicate that more often than not the offer will be rejected with the offeree in all probability opting to take their chances with an actual liquidation dividend. The intention of having such a provision is a laudable one it must be said. It affords the opportunity to force through the adoption of a business rescue plan by buying out recalcitrant or obstinate creditors. Its practicality is, however, a different story altogether.

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<sup>259</sup> Ibid

<sup>260</sup> Paragraph 56

<sup>261</sup> Loubser op cit (n7) 138

### 3.14 ADOPTION AND IMPLEMENTATION OF THE PLAN

Once the plan has been adopted, it will be binding on all creditors whether they were present at the meeting where the plan was considered, voted in favour of adoption of the plan or proved their claims against the company.<sup>262</sup> This is uncontroversial and is in fact necessary in order to ensure that there is certainty with regards to the business rescue process. The technical name given to this phenomenon is 'cramdown'.<sup>263</sup> Besides the fact that it binds dissenting creditors, the cramdown is seen as having the incidental effect of discouraging creditors from resisting or holding out for better treatment and enables the business rescue to proceed despite the objections of a few disgruntled creditors.<sup>264</sup>

### 3.15 DISCHARGE OF DEBTS AND CLAIMS

An interesting provision in the Act is section 154(1). This section states that 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.<sup>265</sup> This raises an important question. Does it then mean that in order for a debt to be discharged the specific creditor must have acceded to such discharge? The lack of clarity with regards to this issue has been noted, in particular the fact that an approach whereupon an individual creditor may refuse to accede to a business rescue plan seems to be foreclosed by section 150(2).<sup>266</sup> This section provides that a business rescue plan may make provision for the company to be released from its debts and in order for the plan to be adopted it must be voted on by the body of creditors.<sup>267</sup> The court in *DH Brothers* was unwilling to countenance any interpretation of section 154(1) other than that the section required individual consent on the part of a creditor.

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<sup>262</sup> Companies Act 71 of 2008 Section 152(4)

<sup>263</sup> FHI Cassim Et al *Contemporary Company Law* 2ed Claremont [South Africa]: Juta, 2012. Page 907

<sup>264</sup> Ibid

<sup>265</sup> Companies Act 71 of 2008 Section 154(2)

<sup>266</sup> Delpont et al op cit (n84) 532

<sup>267</sup> Ibid

Adopting a literal interpretation of the section, the court held that it could be seen that a plan may only provide that a creditor who has acceded to the discharge of the whole or part of a debt may be deprived of the right to enforce its claim.<sup>268</sup> The court continued and stated that since section 152(4) makes an adopted plan binding on non-consenting creditors and section 154(2) allows enforcement of pre-business rescue debts only to the extent allowed for in a plan, any provision in a plan which goes beyond a voluntary discharge of a whole or part of a debt would not be competent.<sup>269</sup> The court premised its view on the presumption against legislative deprivation of rights.<sup>270</sup> It is submitted, with respect, that this interpretation of the section is inconsistent with the scheme of the business rescue provisions. From an individual creditor's perspective this interpretation is ideal as it ensures a greater protection of rights. However, it could potentially hamstring the business rescue if each and every creditor had to accede individually to a discharge. Furthermore, the procedure with regards to the adoption of a rescue plan is clearly outlined in section 152 and it is telling that in it no mention is made of an individual vote for creditors in any instance, let alone where the discharge of claims is concerned. It would thus stretch credulity to say that the legislature implicitly prescribed a procedure for the discharge of a debt in a section concerned with the consequences of the adoption of a plan on creditors.

In *Tuning Fork*<sup>271</sup> the court, commenting on section 154(1), stated that the use of the word 'acceded' is inapt in that the legislature could not have intended that the discharge contemplated therein would depend on whether or not the creditor had agreed to the term in question.<sup>272</sup> The court continued and stated that the fact that individual agreement is not necessary appears from section 152(4) which states that a business rescue plan once adopted will bind all creditors whether they voted in favour of the plan or not.<sup>273</sup> It is submitted that this approach to the meaning of section 154(1) is the correct one. The fact that there is a 'cramdown' provision in section 152(4) clearly indicates that the legislature envisaged that there would be

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<sup>268</sup> *DH Brothers* supra (n227) paragraph 67

<sup>269</sup> *Ibid*

<sup>270</sup> *Ibid*

<sup>271</sup> *Tuning Fork (Pty) Ltd t/a Balanced Audio v Greef* (3) ALL SA 500 (WCC)

<sup>272</sup> Paragraph 77

<sup>273</sup> *Ibid*

disgruntled creditors but that the whole purpose of business rescue is to ensure that the interests of the majority trump those of individuals.

In addition to the consequences of a discharge of debts, section 154 provides that the approval and implementation of the business rescue plan disentitles a creditor from enforcing any debt owed by the company immediately before the beginning of the business rescue process unless this is provided for in the plan.<sup>274</sup> This section is uncontroversial and, to a certain extent, unnecessary as was noted by the court in *Tuning Fork*.<sup>275</sup>

### 3.16 POST COMMENCEMENT FINANCE

Not much will be said with regards to this particular issue save to say that it could be a potential cause for concern for the company's existing creditors, particularly in the event of a liquidation. The Act stipulates that during its business rescue proceedings a company may obtain financing and that such financing may be secured by utilising any asset of the company to the extent that it is unencumbered.<sup>276</sup> The section then goes further and states that the financing will be paid in the order of preference set out in subsection (3)(b). Subsection (3) sets out the preferences in less than clear terms, however, the court in the unreported case of *Merchant West*<sup>277</sup> provided clarification by stating that the preferences are in the following order:

1. The practitioner, for remuneration and expenses, as well as claims arising out of the costs of the business rescue proceedings;<sup>278</sup>
2. Employees for any remuneration which became due and payable after business rescue proceedings began;<sup>279</sup>
3. Secured post-commencement financiers;

<sup>274</sup> Companies Act 71 of 2008 Section 154(2)

<sup>275</sup> *Tuning Fork* supra (n271) at paragraph 77

<sup>276</sup> Companies Act 71 of 2008 Section 135(2)(a)

<sup>277</sup> *Merchant West Working Capital Solutions (Proprietary) Limited v Advanced Technologies & Engineering Company (Proprietary) Limited & Gainsford* (Unreported, Case No. 2013/12406).

<sup>278</sup> Companies Act 71 of 2008 Section 135(3)

<sup>279</sup> Companies Act 71 of 2008 Section 135(3)(a)

4. Unsecured post-commencement financiers;
5. Secured pre-commencement financiers;
6. Employees for any remuneration which became due and payable before business rescue proceedings began; and
7. Unsecured pre-commencement creditors.<sup>280</sup>

The section concludes by stating that in the event of the business rescue proceedings being superseded by a liquidation order, the abovementioned preferences will remain in force except to the extent of any claims arising out of the costs of liquidation.<sup>281</sup> The potential point of concern does not pertain to post-commencement financing and the ranking *per se*. It is submitted that the ranking is essential in order to entice financiers to aid the ailing company as well as to retain employees who might feel the compulsion to jump ship. The importance of post commencement financing was highlighted in the 2004 UNCITRAL legislative guide on insolvency law wherein it was stated that the continued operation of a company in financial distress after the commencement of insolvency proceedings is critical to reorganisation.<sup>282</sup> Therefore, the document continued, in order to maintain its business activities the company must have access to funding so as to able to pay for crucial supplies of goods and services.<sup>283</sup> Recognising the need to induce post-commencement financiers, the document suggested the provision of priority or security as potential mechanisms.<sup>284</sup> Therefore, that section 135 makes provision for post-commencement financing and for priority is in and of itself an uncontroversial subject. What is potentially an issue is the authorisation for post-commencement finance. It would seem that the Act does not require the input of the company's existing creditors despite the fact that the acquisition of the post-

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<sup>280</sup> Paragraph 21.

<sup>281</sup> Companies Act 71 of 2008 Section 135(4)

<sup>282</sup> United Nations Commission on International Trade Law, *UNCITRAL Legislative Guide on Insolvency Law 2014*: Available from [http://www.uncitral.org/pdf/english/texts/insolven/05-80722\\_Ebook.pdf](http://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf). Paragraph 94

<sup>283</sup> Ibid

<sup>284</sup> Paragraph 100

commencement financing could potentially have a significant financial effect on them. *UNCITRAL* states that it may be desirable to link the issue of authorisation for new lending to the damage that may occur or the benefit that is likely to be provided as a result of the provision of new finance.<sup>285</sup> The document notes, however, that given that new finance may be required on a fairly urgent basis, it is desirable to keep the number of authorisations required to a minimum.<sup>286</sup> This consideration could have possibly weighed heavily on the mind of the legislature hence the absence of any requirement that the creditors or the court approve of the procurement of post-commencement financing. Though this may result in the disadvantaging of pre-commencement creditors, it is submitted that the pursuit is a legitimate and in fact necessary one.

### 3.17 CONCLUSION

Creditors are granted significant rights and control over the business rescue process. They have extensive participatory rights as well as the right to be kept informed at all relevant stages. It is submitted that this is a fair reflection of the interest that they have in the debtor company's affairs. This is not a novel phenomenon however in that under judicial management creditors were also given extensive powers. There was the acknowledgement, however, that those powers resulted in a procedure which was overtly creditor-centric, a procedure which did not take into consideration the interests of other stakeholders. As this dissertation progresses it is important to note one thing with regards to the striking of balance. The striking of a balance in the context of this does not connote equality. Instead it is whether or not the rights that the stakeholders have been granted adequately reflect their interest in the outcome. Furthermore, do those rights facilitate a smooth process in the sense that they do not empower certain stakeholders to the extent that they can be unduly obstructive? It is clear that creditors have been granted extensive powers and one can find very little fault with this.

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<sup>285</sup> Paragraph 105

<sup>286</sup> Ibid

There are, however, potential concerns for creditors, especially when it comes to the issue of post-commencement finance. It is submitted though that in that regard the legislature adopted an approach which is in keeping with the aforementioned UNCITRAL recommendations. It is true that creditors, particularly unsecured creditors, get the short end of the stick, but one needs to look at the benefit that accrues to the body of creditors as a whole. In fact, the perception that creditors are prejudiced in this instance is informed by what Bradstreet correctly identified as a lack of faith in business rescue.<sup>287</sup> All things considered, (theoretically at least) a business rescue which is adequately financed and has a feasible turnaround strategy is bound to succeed and will eventually benefit all involved.

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<sup>287</sup> R Bradstreet 'The new business rescue: Will creditors sink or swim' (2010) *SALJ* 352. At 360

# CHAPTER 4: SHAREHOLDERS

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It has been stated that shareholders have a right to be involved in corporate rescue proceedings on account of the financial interest they have in the outcome.<sup>288</sup> This is so because a successful rescue will revive their shares with these shares regaining at least some of their previous value.<sup>289</sup> With the aforementioned in mind, this chapter will consider the rights afforded to shareholders in the business rescue process. As has already been mentioned in preceding chapters, a number of issues already discussed largely apply to shareholders as well. These discussions will not be replicated, save for commentary where necessary.

For purposes of this chapter it is important to note the following definitions:

- A. **SHAREHOLDER:** The holder of a share issued by a company and who is entered as such in the certificated and uncertificated securities register, as the case may be.<sup>290</sup>
- B. **SECURITIES:** Any shares, debentures or other instruments, irrespective of their form or title, issued or authorised to be issued by a profit company.<sup>291</sup>

From the above definitions it is clear that reference to 'shareholders' would entail a much narrower group than would reference to a 'securities holder' as the latter includes the former but not vice versa. This distinction is an important one in that in the definition of affected persons the Act utilises the more narrow terminology of 'shareholders'.<sup>292</sup> It would seem therefore that where rights in the Act are afforded to affected persons, those rights would accrue to shareholders and not to securities holders as a broad group.

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<sup>288</sup> A Loubser 'The Role of Shareholders during Corporate Rescue Proceedings: Always on the Outside Looking In?' (2008) 20 *SA Merc LJ* 372. Page 372

<sup>289</sup> *Ibid*

<sup>290</sup> Section 1

<sup>291</sup> *Ibid*

<sup>292</sup> Companies Act 71 of 2008 Section 128(1)(a)(i)

This is off course inconsequential to debenture holders who would qualify as creditors of the company. Nevertheless, the distinction is an important one and ought to be kept in mind.

#### 4.1 GENERAL PARTICIPATION RIGHTS

During business rescue proceedings, the holders of the company's securities are entitled to the following rights:

- A. The right to notice of each court proceeding, decision, meeting, or other relevant event concerning the business rescue proceedings;<sup>293</sup>
- B. The right to participate in any court proceedings arising during the business rescue;<sup>294</sup>
- C. The right to participate in the company's business rescue as provided for in the Act;<sup>295</sup>
- D. The right to vote to approve or reject a proposed business rescue plan if the plan would alter the rights associated with the class of securities held by that person;<sup>296</sup> and
- E. if the rescue plan is rejected , the right to:
  - a. Propose the development of an alternative plan;<sup>297</sup> or
  - b. Present an offer to acquire the interests of any or all of the creditors or other holders of the company's securities.<sup>298</sup>

The above presents a good point of departure when discussing the rights of shareholders in business rescue. It is clear that shareholders in general are

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<sup>293</sup> Companies Act 71 of 2008 Section 146(a)

<sup>294</sup> Companies Act 71 of 2008 Section 146(b)

<sup>295</sup> Companies Act 71 of 2008 Section 146(c)

<sup>296</sup> Companies Act 71 of 2008 Section 146(d)

<sup>297</sup> Companies Act 71 of 2008 Section 146(e)(i)

<sup>298</sup> Companies Act 71 of 2008 Section 146(e)(ii)

granted extensive rights to consultation and to participation. However, the most telling question is, to what end? This is so because when it comes to the crux of business rescue, that is the adoption of the business rescue plan, shareholders are permitted to vote only when the plan purports to alter rights associated with the class of securities they hold. Of course shareholders will be entitled to vote as creditors in instances where they have made loans to the company, however, they will not be construed as independent creditors. It follows therefore that where the rescue plan has no effect on shareholders' rights they would be precluded from voting. This seems quite an acute limitation on the rights of shareholders considering their financial interest.

Another issue is that of shareholders committees, or the lack of one thereof. Creditors and (as will be seen later) employees are entitled to form committees through which they can liaise with the practitioner. Furthermore, the Act prescribes that the practitioner must hold meetings with each of the aforementioned stakeholders in order to inform them about the state of the company and to determine whether said committees ought to be formed. Shareholders, on the contrary, are not so empowered and one has to wonder why. Loubser seems to suggest that the duty to liaise with the shareholders remains with the board of the company.<sup>299</sup> In making this suggestion, she places reliance on section 137(2)(a) which states that during business rescue directors must continue to exercise their functions but subject to the authority of the practitioner.<sup>300</sup> She finds, however, that this provision is contradicted by section 140(1)(a) which states that during business rescue the practitioner has full management control of the company in substitution for the company's board and pre-existing management.<sup>301</sup> It is submitted that the latter section does not militate against Loubser's assumption as it serves only to emphasise that the board becomes subject to the authority of the practitioner. Therefore, the practitioner may liaise with the shareholders by delegating the task to the board. One could only speculate as to why shareholders are not afforded similar rights to those of creditors and employees. It could be that the legislature thought it time

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<sup>299</sup> Loubser op cit (n288) 387

<sup>300</sup> Ibid

<sup>301</sup> Loubser op cit (n288) 388

consuming as well as administratively onerous. This perception was perhaps informed by the fact that shareholders are often scattered and numerous in number and it would thus be difficult to convene a meeting considering the stringent requirements and timeframes involved. In addition to this, it could be that the legislature perceived that the interests of the shareholders would be adequately represented by the directors of the company. These potential explanations are unconvincing and it is submitted that in this instance shareholders have been unduly prejudiced.

#### **4.2 RIGHTS OF SHAREHOLDERS IN RELATION TO THE BUSINESS RESCUE PLAN**

The Act stipulates that during business rescue proceedings no alteration in the classification or status of any issued securities of a company, other than by way of a transfer of securities in the ordinary course of business, will be valid unless a court orders otherwise or it is contemplated in the business rescue plan.<sup>302</sup> In the event that the business rescue plan purports to have such an effect, shareholders will have to approve the plan before it is adopted. In preparing the plan, the practitioner is compelled to consult with the affected persons.<sup>303</sup> It is submitted that this is where the lack of a committee will place shareholders at a disadvantage. Loubser suggests, with much cynicism, that the practitioner is unlikely to consult the shareholders on account of the fact that the general body of members do not have the power to accept or reject the plan or even to influence the outcome.<sup>304</sup> She then juxtaposes the position of shareholders with that of employees (who are expressly given the opportunity to address the meeting called for the consideration of the rescue plan)<sup>305</sup> and concludes that there would be a greater incentive for the practitioner to consult meaningfully with that group than with the seemingly impotent shareholders.<sup>306</sup>

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<sup>302</sup> Companies Act 71 of 2008 Section 137

<sup>303</sup> Companies Act 71 of 2008 Section 150(1)

<sup>304</sup> Loubser op cit (n288) 387

<sup>305</sup> Companies Act 71 of 2008 Section 152(1)(c)

<sup>306</sup> Loubser op cit (n288) 387

### 4.3 ADOPTION OF THE BUSINESS RESCUE PLAN

It has already been stated that shareholders will only be able to vote on a plan if it purports to alter the rights of the holders of any class of the company's securities.<sup>307</sup> If the plan has no such purported effect, then it will be voted on without any involvement by the shareholders. Where the plan does purport to have such an effect, the practitioner must hold a meeting of the holders of the class, or classes of securities whose rights will be altered by the plan, and call for a vote by them to approve the adoption of the plan.<sup>308</sup> If the majority of the voting rights that were exercised support adoption of the plan, then the plan will have been finally adopted.<sup>309</sup> If not, then section 153 applies.<sup>310</sup>

Once the plan has been adopted, it will be binding on all shareholders regardless of whether or not they were present at the meeting or voted on the plan.<sup>311</sup> Where the business rescue plan has been voted on and approved by the shareholders, the practitioner is empowered to amend the company's Memorandum of Incorporation to authorise and determine the preferences, rights, limitations and other terms of securities that are otherwise unauthorised but contemplated to be issued in terms of the plan.<sup>312</sup> In this regard, the pre-emptive rights of shareholders will not apply unless the business rescue plan stipulates otherwise.<sup>313</sup>

### 4.4 CONCLUSION

Shareholders have all the rights afforded to affected persons as a broad group and these are wide-ranging rights which ensure participation in the business rescue process. The extent to which this participation can be construed as meaningful is questionable however. The fact that shareholders are not entitled to have a shareholders committee is a factor which, it is submitted, is unfairly prejudicial.

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<sup>307</sup> Companies Act 71 of 2008 Section 152(3)(c)

<sup>308</sup> Companies Act 71 of 2008 Section 152(3)(c)(ii)

<sup>309</sup> Companies Act 71 of 2008 Section 152(3)(c)(ii)(aa)

<sup>310</sup> Companies Act 71 of 2008 Section 152(3)(ii)(bb)

<sup>311</sup> Companies Act 71 of 2008 Section 152(4)

<sup>312</sup> Companies Act 71 of 2008 Section 152(6)(b)

<sup>313</sup> Companies Act 71 of 2008 Section 152(7)

It could be that the legislature envisaged that shareholders meetings for purposes of business rescue will be convened in the same manner that they would have been in the normal course. As a result, it could have been deemed superfluous to make provision for a committee. Be that as it may, these committees serve an important purpose in maintaining adequate lines of communication between the practitioner and affected persons, as well as giving affected persons a unified voice. Shareholders would have benefited greatly from being empowered to form one. When one considers that shareholders are only entitled to participate in the adoption of the business rescue plan when the plan purports to alter the securities they hold, then one gets an idea why Loubser perceived them as being 'on the outside looking in'. It seems as though they have been placed at the bottom of the pecking order when juxtaposing their rights with those of the other affected persons. Consider the previous chapter's discussion of *Beagles Run Investments*<sup>314</sup> and *Oakdene*,<sup>315</sup> whereupon both courts propounded the view that under the circumstances of those cases, creditors' interests should trump those of the company. The unique element of those cases was that neither dealt with employees and so it was the weighing of the interests of the company (ergo the shareholders) against those of the creditors. It could be that much is being made of what in essence could apply in the rarest of cases but be that as it may, it is telling that both courts were prepared to lay down a principle to that effect.

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<sup>314</sup> *Beagles Run Investments* supra (n183)

<sup>315</sup> *Oakdene* supra (n177)

# CHAPTER 5: EMPLOYEES

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Whenever one considers the rights of employees it is a good starting point to acknowledge section 23 of the Constitution<sup>316</sup> which entrenches the right to fair labour practices. This has been described as a unique feature and is seen as a corollary of the significant role played by black trade unions in the downfall of apartheid.<sup>317</sup> This chapter focuses on the rights given to employees in business rescue. It should be noted that the rights of employees have been given significant protection in instances of employer insolvency long before the coming into force of the Companies Act of 2008. In fact, the pursuit of fair labour practices has been seen as one of the driving forces behind the establishment of a business rescue procedure.<sup>318</sup> It is thus significant that the Act specifically prescribes that the Labour Relations Act (LRA)<sup>319</sup> should take precedent in instances where there are conflicts between the two.<sup>320</sup>

## 5.1 EFFECT OF BUSINESS RESCUE ON EMPLOYMENT CONTRACTS

During business rescue, the employees of the company continue to be employed on the same terms and conditions.<sup>321</sup> This is not absolute however as the Act makes provision for changes which occur in the ordinary course of attrition<sup>322</sup> and where the company and the employees agree on different terms.<sup>323</sup> Where any retrenchment of employees is contemplated within the business rescue plan, the Act stipulates that this must be done in accordance with sections 189 and 189A of

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<sup>316</sup> Constitution of the Republic of South Africa Act 108 of 1996

<sup>317</sup> I Currie, J De Wall: *The Bill of Rights Handbook* 6ed. Cape Town: Juta, 2013. At 473

<sup>318</sup> S Van Eck, A Boraine, L Steyn 'Fair Labour Practices in South African Insolvency Law' (2004) 121 *SALJ* 902. At 906

<sup>319</sup> Act 66 of 1995

<sup>320</sup> Companies Act 71 of 2008 Section 5(4)(b)(i)(bb)

<sup>321</sup> Companies Act 71 of 2008 Section 136(1)(a)

<sup>322</sup> Companies Act 71 of 2008 Section 136(1)(a)(i)

<sup>323</sup> Companies Act 71 of 2008 Section 136(1)(a)(ii)

the LRA as well as any other applicable employment related legislation.<sup>324</sup>

Employment contracts are further protected by being excluded from the scope of the practitioner's powers to suspend contracts that the company may be party to.<sup>325</sup>

## 5.2 REMUNERATION

The Act provides that employees will rank as preferred concurrent creditors for any employment-related remuneration or expenses incurred which becomes due and payable before the commencement of business rescue and remains unpaid at the commencement thereof.<sup>326</sup> In relation to remuneration or reimbursement for employment-related expenses which became due and payable during the business rescue, the Act stipulates that these are to be regarded as post-commencement finance.<sup>327</sup> The consequences of this classification have already been dealt with and need not be repeated. A medical scheme or a pension scheme (including a provident scheme) for the benefit of past or present employees is deemed to be concurrent creditor.<sup>328</sup> However, this is only to the extent that any amount was due and payable by the company to the trustees of the scheme before commencement of business rescue and remained so unpaid.<sup>329</sup> In the case of a defined benefit pension scheme, the limitation is the present value of any unfunded liability under the scheme at the commencement of business rescue. The Act goes further and stipulates that the rights mentioned herein (as well those to be discussed immediately hereafter) are in addition to any other rights accruing in terms of any law, contract, collective agreement, shareholding, security or court order.<sup>330</sup>

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<sup>324</sup> Companies Act 71 of 2008 Section 136(1)(b)

<sup>325</sup> Companies Act 71 of 2008 Section 136(2A)

<sup>326</sup> Companies Act 71 of 2008 Section 144(2)

<sup>327</sup> Companies Act 71 of 2008 Section 135(1)(a)

<sup>328</sup> Companies Act 71 of 2008 Section 144(4)

<sup>329</sup> Companies Act 71 of 2008 Section 144(4)(a)

<sup>330</sup> Companies Act 71 of 2008 Section 144(5)

### 5.3 GENERAL PARTICIPATION RIGHTS

Once the practitioner has been appointed, they must, within 10 days, convene and preside over a meeting of employees' representatives.<sup>331</sup> At this meeting the practitioner must inform the representatives whether they believe there is a reasonable prospect of rescuing the company.<sup>332</sup> In addition to that, the representatives must decide at this meeting whether or not an employees' committee is to be formed and may appoint its members at this meeting. Notice of this meeting must be sent to every registered trade union representing employees of the company and, if there are any employees who are not represented by such a registered trade union, to those employees or their representatives.<sup>333</sup> The notice must set out the date, time and place of the meeting as well as the agenda.<sup>334</sup>

In addition to the rights of affected persons already discussed, employees are given further specific rights in section 144 which they may exercise through a registered trade union, if they are a member of one.<sup>335</sup> If not, they may exercise these rights directly or by proxy through an employee organisation or a representative.<sup>336</sup> The employee or trade union (whatever the case may be) is afforded the right to notice of court proceedings, decisions, meetings or any other relevant event concerning the business rescue.<sup>337</sup> Furthermore, they are afforded the right to participate in said court proceedings.<sup>338</sup> As already alluded to above, the section also makes provision for the employees to form a committee of representatives.<sup>339</sup> This committee is no different in nature to the creditors' committee already discussed in previous chapters and therefore the composition and functions outlined therein will apply equally here. The practitioner is obligated to consult with the employees during the development of the business rescue

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<sup>331</sup> Companies Act 71 of 2008 Section 148(1)

<sup>332</sup> Companies Act 71 of 2008 Section 148(1)(a)

<sup>333</sup> Companies Act 71 of 2008 Section 148(2)

<sup>334</sup> Ibid

<sup>335</sup> Companies Act 71 of 2008 Section 144(1)(a)

<sup>336</sup> Companies Act 71 of 2008 Section 144(1)(b)

<sup>337</sup> Companies Act 71 of 2008 Section 144(3)(a)

<sup>338</sup> Companies Act 71 of 2008 Section 144(3)(b)

<sup>339</sup> Companies Act 71 of 2008 Section 144(3)(c)

plan.<sup>340</sup> Further to that, the practitioner must afford the employees a sufficient opportunity to review the plan.<sup>341</sup>

Once this has been done and a meeting to consider the business rescue plan has been convened in terms of section 151, the Act provides that a representative of the employees must be given an opportunity to address that meeting.<sup>342</sup> As has been mentioned earlier, employees will qualify as creditors of the company if there is any remuneration due to them which is outstanding at the commencement of business rescue. Where this is the case, that employee will be able to vote on the business rescue plan.<sup>343</sup> Where the plan is voted on and is not approved, the employees are entitled to all the rights afforded to affected persons in terms of section 153. It should be reiterated that in relation to the purchasing of a voting interest, employees (like shareholders) are entitled to purchase the voting interests of all affected persons and not just creditors.<sup>344</sup>

#### 5.4 ANALYSIS

One cannot criticise the rationale behind affording employees an active role in business rescue for they have a vested interest in the process as well as its outcome. It is therefore justifiable for them to be informed if the company is in dire straits and what steps are being taken to remedy the situation. The main question however is whether or not the legislature has gone too far in protecting these interests. The preponderate view is that it has. Loubser argues that in giving an individual employee the right to initiate business rescue proceedings, the legislature has not only gone too far, but has exposed the process and indeed companies to potential abuse. She opines that, cumulatively, the rights that accrue to employees during business rescue so far outweigh those that accrue in liquidation that there is a real incentive for the employees in seeing that the company goes into business rescue, thus increasing the potential for abuse.<sup>345</sup>

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<sup>340</sup> Companies Act 71 of 2008 Section 144(3)(d)

<sup>341</sup> *ibid*

<sup>342</sup> Companies Act 71 of 2008 Section 152(1)(c)

<sup>343</sup> S Companies Act 71 of 2008 section 144(3)(f)

<sup>344</sup> Companies Act 71 of 2008 Section 144(3)(g)(ii)

<sup>345</sup> Loubser *op cit* (n79) 510

She argues that this right may be utilised for completely unrelated grievances and may also be utilised as a bargaining tool by trade unions in wage negotiations.<sup>346</sup>

Loubser continues and points out that comparable jurisdictions have not afforded such a right to employees and opines that in order to mitigate the potential damage, courts should grant punitive cost orders against rogue employees seeking to abuse the process.<sup>347</sup> Loubser's perceptions in this regard are echoed by Joubert *et al*<sup>348</sup> as well as Schoeman.<sup>349</sup> One cannot help but agree with this assessment, indeed it is nothing short of baffling that the drafters of the Act deemed it appropriate for a single employee to have the ability to commence business rescue in the manner provided. Worse of all, the employee need not even be a creditor of the company.

Joubert *et al* are of the opinion that this is not the only instance where the legislature has overstepped. The authors argue that the super-preference given to employees in terms of section 135 (1) is not only deleterious to the interests of creditors but to business rescue as a whole.<sup>350</sup> They opine that the preferences created in section 135 would dissuade financiers from providing the post-commencement finance that companies so desperately need.<sup>351</sup> The authors argue that this is so because post-commencement financiers would see themselves as effectively "bankrolling the practitioner's fees and the employees' salaries during the business rescue process".<sup>352</sup> The authors' disquiet is further heightened by the fact that the Act stipulates that employees are entitled to the entirety of the remuneration that is outstanding at the time that the company goes into business rescue. This is unlike the situation when the company is liquidated, where the employees are only entitled to three month's salary in arrears and a maximum amount of R12 000.<sup>353</sup>

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<sup>346</sup> Ibid

<sup>347</sup> Ibid

<sup>348</sup> Joubert, Tronel, Stefan van Eck & David Burdette. 'Impact of Labour Law on South Africa's New Corporate Rescue Mechanism'. *The International Journal of Comparative Labour Law and Industrial Relations* 27, no. 1 (2011): 65. Page 82

<sup>349</sup> HC Schoeman 'The Rights Granted to Trade Unions Under the Companies ACT 71 of 2008' *PER/PELJ* (2013) 16 237. Page 248

<sup>350</sup> Joubert et al op cit (n348) 80

<sup>351</sup> Ibid

<sup>352</sup> Joubert et al op cit (n348) 79

<sup>353</sup> Joubert et al op cit (n348) 80

It should be noted that the preferences outlined in section 135 continue to apply even when the business rescue is superseded by liquidation. This, the authors argue, undermines the Insolvency Act<sup>354</sup> as well as the interests of the company's existing creditors.<sup>355</sup> Though the authors raise valid points, their assessment that the current preferences will dissuade post-commencement financiers is flawed. First and foremost, it is submitted that once you premise your critique of the position of employees in business rescue by juxtaposing it with their position in insolvency, you have already embarked on a perilous journey. Though they may be intertwined, the Insolvency Act and the business rescue provisions are markedly different in philosophy and purpose. The one facilitates the orderly demise of a company whilst the other attempts to create a temporary environment conducive for a company's revival.

There four significant factors for turnaround success and these are new, competent management, a viable core operation, adequate bridging financing and improved employee motivation.<sup>356</sup> The third and fourth elements are achieved by ensuring that employees as well as post-commencement financiers rank in the manner provided. Financiers will look at numerous factors before deciding to provide post-commencement funding. One of those factors will be whether or not a good strategy is in place to ensure a turnaround of the company's fortunes. To this end it is imperative to ensure that the practitioner is guaranteed to receive their remuneration regardless of the company's fortunes. Further to that, a successful strategy requires a motivated workforce to implement it. Without guaranteeing employees their full remuneration, distressed companies would be faced with resignations and a generally uninspired workforce. This would not be an ideal environment, especially at a time where it has to be all hands on deck in an attempt to stave of liquidation.

On a more basic level, it is quite difficult to understand how the prioritising of employees salaries would dissuade post-commencement financiers when they are guaranteed to rank above pre-commencement creditors. At the end of the day what is the financing for if not to cover operating expenses of which salaries are a

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<sup>354</sup> Act 24 of 1936

<sup>355</sup> Joubert et al op cit (n348) 83

<sup>356</sup> W du Preez *The Status of Post-Commencement Finance for Business Rescue in South Africa* MBA (Pretoria) (2012). 20

major component.<sup>357</sup> Notwithstanding the merits of granting the preferences discussed above, it is clear that in an attempt to adequately protect the interests of employees, the legislature took it a step too far. There is no discernible rationale for enabling a single employee to initiate business rescue proceedings on account of a single payment being skipped by the company. The fact that a court could impose a punitive cost order for vexatious applications (as suggested by Loubser) offers very little comfort. This is so because it is conceivable that the news of a company being involved in business rescue proceedings (even if only at the application stage) could have a palpable impact on its relationship with its creditors. When one considers the comparatively limited involvement of shareholders, it becomes especially difficult to understand the stance adopted by the legislature in this regard.

### **5.5 HAS A BALANCE BEEN STRUCK?**

Drawing together the conclusions reached in the previous chapters on affected persons, the ultimate conclusion reached is that the legislature failed to strike a satisfactory balance between the competing interests. The legislature failed to adequately reflect the interests of shareholders in the process and simultaneously overemphasised the rights of employees. It is submitted that creditors are adequately protected and though there may be potential points of discontent, overall the legislature made satisfactory policy decisions in that regard.

In relation to the imbalance, the legislature could potentially remedy this by only allowing a trade union to apply for a company to be placed under supervision. Even then, this can be done only where the company has failed to make employment-related payments for two months or where it has missed one payment and the trade union has inspected the company's financial records and reasonably concluded that it is financially distressed. Where the employees of the company are not members of a trade union, then they may only approach the court where the company has failed to make an employment-related payment for at least two months and for at least a third of the workforce or for a month for the

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<sup>357</sup> Du Preez op cit (n356) 6

entire workforce and they have inspected the company's financial records and reasonably concluded that it is financially distressed.

In relation to the shareholders, the legislature could empower them to form a committee and to also address the meeting where the business rescue plan is to be voted on. This would afford shareholders more of a say even though they would not at all times be entitled to vote on the business rescue plan.

# CHAPTER 6: COMPARATIVE ANALYSIS

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This chapter will consider the Australian voluntary administration procedure which can be found in Part 5.3A of the Australian Corporations Act.<sup>358</sup> Voluntary administration commenced in 1993 and is the Australian equivalent of business rescue.<sup>359</sup> It replaced official management, a court-centric and cumbersome procedure based largely on South Africa's judicial management.<sup>360</sup> In this chapter, regard will only be had to the participatory rights given to employees, shareholders and creditors and will thus not be an analysis of the procedure as a whole. The method of analysis to be employed will however entail a cursory consideration of the procedure in order to lend context to the discussions of the rights of various stakeholders. In order to facilitate this discussion, the analysis will broadly be divided into the three distinct steps of corporate rescue legislation as propounded by Anderson. These are commencement, investigation and development of plans and decision-making.<sup>361</sup>

## 6.1 VOLUNTARY ADMINISTRATION

Section 435A stipulates that the purpose of voluntary administration is to provide for the business, property and affairs of an insolvent company to be administered in a way that maximises the chances of the company, or as much as possible of its business, continuing in existence.<sup>362</sup> Where this is not possible, the procedure may be utilised to secure a better return for the company's creditors and shareholders than would result from an immediate winding up of the company.<sup>363</sup>

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<sup>358</sup> Corporations Act 2001

<sup>359</sup> C Anderson 'Viewing the Proposed South African Business Rescue Provisions from an Australian Perspective' (2008) 11 No 1 *PER* 6. Page 10

<sup>360</sup> *Ibid*

<sup>361</sup> Anderson *op cit* (n359) 14

<sup>362</sup> Corporations Act 2001 section 435A(a)

<sup>363</sup> Corporations Act 2001 section 435A(b)

These objects are identical to those outlined by the Companies Act of 2008 for business rescue.<sup>364</sup> As a matter of fact, in concluding that a business rescue may be premised solely on the basis of securing a better return for creditors and shareholders, the Supreme Court of Appeal in *Oakdene*<sup>365</sup> made reference to the Australian case of *Dallinger v Halcha Holdings*.<sup>366</sup>

## 6.2 COMMENCEMENT

There are three avenues through which a company may enter voluntary administration. Firstly, the board of a company may resolve to appoint an administrator if they are of the opinion that the company is insolvent or is likely to be insolvent at some future date.<sup>367</sup> Secondly, the liquidator or provisional liquidator of a company may appoint an administrator if they are of the opinion that the company is insolvent or is likely to be insolvent.<sup>368</sup> Lastly, a secured creditor who is entitled to enforce a security interest in the whole or substantially the whole, of a company's property may also appoint an administrator if the security interest has become, and is still, enforceable.<sup>369</sup> Where the company is already in liquidation, only the liquidator or provisional liquidator may appoint an administrator.<sup>370</sup>

Anderson notes the unique nature of voluntary administration in that provision is not made for an administrator to be appointed by a court order.<sup>371</sup> He opines that presumably the legislature found it consistent with its aim of creating a swift and cost effective procedure which is the antithesis of the erstwhile official management.<sup>372</sup> Unlike the case with business rescue, official management limits the individuals/entities who may initiate the procedure to the three aforementioned. It is a very limited group which excludes shareholders, employees and their trade unions as well as creditors who do not meet the requisite threshold.

<sup>364</sup> Companies Act 2008 section 128(1)(b)(iii)

<sup>365</sup> *Oakdene* supra (n163) at Paragraph 24

<sup>366</sup> *Dallinger v Halcha Holdings (Pty) Ltd* [1995] FCA 1727

<sup>367</sup> Corporations Act 2001 section 436A

<sup>368</sup> Corporations Act 2001 section 436B(1)

<sup>369</sup> Corporations Act 2001 section 436C(1)

<sup>370</sup> Corporations Act 2001 section 436A(2) and 436C(2)

<sup>371</sup> Anderson op cit (n362) 14

<sup>372</sup> Ibid

Where there are doubts as to the validity of the appointment, the person appointed, the company or a creditor may approach the court for an order declaring whether or not the appointment is valid.<sup>373</sup> The appointment of an administrator is irrevocable.<sup>374</sup> The court may however remove the administrator upon application by, inter alia, a creditor or a liquidator of the company.<sup>375</sup> The remuneration of the administrator is to be determined by agreement between them and the creditors' committee and where there is no such committee the remuneration is to be determined by a resolution of the creditors or by the court.<sup>376</sup>

### 6.3 INVESTIGATION AND DEVELOPMENT OF PLANS

Once the administrator has been appointed, the company will be in voluntary administration. The administrator must convene a meeting of creditors within eight business days of being appointed.<sup>377</sup> At this meeting it must be decided whether or not a creditor's committee will be appointed and if so, who its members are to be.<sup>378</sup> The creditors may also resolve to remove the administrator and appoint another in their stead.<sup>379</sup>

The aforementioned meeting must be convened by sending a notice to as many creditors of the company as reasonably possible and by publishing a notice in the prescribed manner.<sup>380</sup> These notices must be sent at least five business days before the meeting.<sup>381</sup> The creditors committee, if formed, serves the purpose of liaising with the administrator but may not give any directions to the latter, save to require them to give a report about matters relating to the administration.<sup>382</sup> The creditors' meeting provided for in section 147 of the Companies Act is not markedly dissimilar in effect and purpose, save for the fact that there is no default

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<sup>373</sup> Corporations Act 2001 section 447C

<sup>374</sup> Corporations Act 2001 section 449A

<sup>375</sup> Corporations Act 2001 section 449B

<sup>376</sup> Corporations Act 2001 section 449E(1)

<sup>377</sup> Corporations Act 2001 section 436E(2)

<sup>378</sup> Corporations Act 2001 section 436E(1)

<sup>379</sup> Corporations Act 2001 section 436E(4)

<sup>380</sup> Corporations Act 2001 section 436E(3)

<sup>381</sup> Ibid

<sup>382</sup> Corporations Act 2001 section 436F(3)

right to remove the practitioner as provided for in the Corporations Act.<sup>383</sup> Under the voluntary administration, the establishment of a committee is the sole preserve of creditors and thus employees are precluded from establishing a committee, unlike the case with business rescue.

#### 6.4 INVESTIGATION

The practitioner must investigate the affairs of the company as soon as practically possible after the commencement of the administration.<sup>384</sup> The purpose of this investigation is for the administrator to form an opinion on whether it would be in the interests of the creditors for the company to either execute a deed of company arrangement,<sup>385</sup> for the administration to end<sup>386</sup> or for the company to be wound up.<sup>387</sup> Anderson notes the overt creditor-centricity exhibited here and distinguishes it from the approach under business rescue whereby the investigation is largely in order to determine whether or not a rescue of the company is still a viable pursuit.<sup>388</sup> Another element worth noting is that unlike the position under business rescue, the voluntary administration provisions do not provide for employees and shareholders to be informed of the outcome of this investigation.

#### 6.5 THE MORATORIUM

The provisions pertaining to the moratorium in the Corporations Act are relatively extensive and are to be found in Divisions Six and Seven of Part 5.3A. In general terms, parties are precluded from exercising rights in the property of the company, or other property used or occupied by, or in the possession of the company.<sup>389</sup> Where the property is subject to a possessory security interest and is in the lawful possession of the secured party, they may continue to possess the property during

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<sup>383</sup> Anderson op cit (n359) 21. It should be noted however that the appointment of a practitioner in terms of section 131(5) is subject to ratification by the creditors at the first creditors' meeting

<sup>384</sup> Corporations Act 2001 section 438A(a)

<sup>385</sup> Corporations Act 2001 section 438A(b)(i)

<sup>386</sup> Corporations Act 2001 section 438A(b)(ii)

<sup>387</sup> Corporations Act 2001 section 438A(b)(iii)

<sup>388</sup> Anderson op cit (n359) 22.

<sup>389</sup> Corporations Act 2001 section 440B(1)

the administration.<sup>390</sup> The restrictions on enforcement do not apply where the administrator grants written consent or the court grants leave for such enforcement to proceed.<sup>391</sup> The stay of proceedings does not apply to criminal proceedings or prescribed proceedings.<sup>392</sup> There are further exceptions to the stay and these are to be found in Division Seven. The most salient of these are where the whole, or substantially the whole, of the property of the company is subject to a security interest and the secured party enforced the security interest<sup>393</sup> or where a secured party has a security interest in the perishable property of the company.<sup>394</sup> The exceptions to the moratorium under voluntary administration are a far cry from the limited exceptions provided for under business rescue. However, what is more poignant is the startling lopsidedness of the power dynamics exhibited between secured and unsecured creditors. Even at this stage it is manifestly clear that voluntary administration is a creditor-centric piece of legislation, but even more so, it is secured creditor-centric.

As is the case under business rescue, an administrator is precluded from disposing of property leased by the company or property belonging to the company over which a third party has a security interest. The administrator may dispose of this property if it is in the ordinary course of business or the secured party or lessor has consented in writing or with leave from the court.<sup>395</sup> The court may not grant such leave unless it is satisfied that provision has been made to adequately protect the interests of the lessor or secured party.<sup>396</sup>

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<sup>390</sup> Corporations Act 2001 section 440B(3)

<sup>391</sup> Corporations Act 2001 section 440B(2)

<sup>392</sup> Corporations Act 2001 section 440D(2)

<sup>393</sup> Corporations Act 2001 section 441A(1). The security interest must have been enforced before or during the 'decision period' which is a period of nine business days from the commencement of the voluntary administration.

<sup>394</sup> Corporations Act 2001 section 441C

<sup>395</sup> Corporations Act 2001 section 442C(1)-(2)

<sup>396</sup> Corporations Act 2001 section 442C(3)

## 6.6 EFFECT ON SHAREHOLDERS

The immediate effect that voluntary administration has on shareholders is that it precludes the transfer of shares unless it is with the written consent of the administrator.<sup>397</sup> The administrator may consent to the transfer with or without conditions.<sup>398</sup> The administrator may, however, only give such consent if they are satisfied that the transfer is in the best interests of the creditors as a whole.<sup>399</sup> Where the consent is refused, the transferor or the transferee or a creditor may make a court application for an order authorising the transfer,<sup>400</sup> which order the court may grant if it is satisfied that it is in the best interests of the creditors as a whole.<sup>401</sup> Where the consent is granted conditionally, the aforementioned parties may approach the court for an order setting aside any or all of the conditions<sup>402</sup> if it is in the best interest of the creditors as a whole.<sup>403</sup>

With regards to the alteration of the status of the company's shareholders, the Corporations Act states that this may not be done unless it is with consent of the administrator. Similarly, this consent must be written and may be given conditionally<sup>404</sup> or unconditionally.<sup>405</sup> In giving consent, the administrator must be satisfied that the alteration is in the best interests of the creditors as a whole.<sup>406</sup> Where the consent is refused or is given with conditions, a shareholder or creditor of the company may approach the court for an order authorising the alterations or setting aside any or all of the conditions.<sup>407</sup> The court may grant the order if it is satisfied that the alteration is in the best interests of the company's creditors,<sup>408</sup> or that the conditions imposed are not prejudicial to them.<sup>409</sup>

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<sup>397</sup> Corporations Act 2001 section 437F(1)

<sup>398</sup> Ibid

<sup>399</sup> Corporations Act 2001 section 437F(2)

<sup>400</sup> Corporations Act 2001 section 437F(3)

<sup>401</sup> Corporations Act 2001 section 437F(4)

<sup>402</sup> Corporations Act 2001 section 437F(5)

<sup>403</sup> Corporations Act 2001 section 437F(6)

<sup>404</sup> Corporations Act 2001 section 437F(8)(b)(ii)

<sup>405</sup> Corporations Act 2001 section 437F(8)(a)(ii)

<sup>406</sup> Corporations Act 2001 section 437F(9)

<sup>407</sup> Corporations Act 2001 section 437F(11) + (13)

<sup>408</sup> Corporations Act 2001 section 437F(12)

<sup>409</sup> Corporations Act 2001 section 437F(14)

## 6.7 EFFECT ON EMPLOYEES

The appointment of an administrator does not result in the automatic termination of employment contracts.<sup>410</sup> There is, however, no obligation to retain employees, except only in exceptional circumstances.<sup>411</sup> The administrator has the statutory power to dismiss employees and the pursuit of wrongful dismissal proceedings under those circumstances could require the leave of the court.<sup>412</sup> In the event that the administrator retains the employees, they will be personally liable for paying their post-appointment wages and entitlements.<sup>413</sup> This liability does not extend to pre-appointment wages and entitlements and any sum paid under these circumstances is recoverable out of the company assets as a priority debt.<sup>414</sup>

## 6.8 DECISION-MAKING

The administrator must convene a second meeting of creditors in order for the latter to decide the company's future.<sup>415</sup> The convening period for the meeting is generally 20 business days from the commencement of the administration.<sup>416</sup> Where the day after the administration begins is in December, or is less than 25 business days before Good Friday, the convening period will be 25 business days beginning on that day or the next business day if the day in question is not a business day.<sup>417</sup> The meeting must be held within five business days before or within five business days after the end of the convening period.<sup>418</sup> The court may extend the convening period upon application.<sup>419</sup> Where the application is made after the convening period has lapsed, the court may only grant an extension if it is satisfied that it will be in the best interests of the creditors.<sup>420</sup>

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<sup>410</sup> M Gronow 'Insolvent corporate groups and their employees: The case for further reform' (2003) 21 *C&SLJ* 189. 193

<sup>411</sup> *Ibid*

<sup>412</sup> *Ibid*

<sup>413</sup> Corporations Act 2001 section 443A

<sup>414</sup> Gronow *op cit* (n410) 193

<sup>415</sup> Corporations Act 2001 section 439B(1)

<sup>416</sup> Corporations Act 2001 section 439B(5)(b)

<sup>417</sup> Corporations Act 2001 section 439A(5)(a)

<sup>418</sup> Corporations Act 2001 section 439A(2)

<sup>419</sup> Corporations Act 2001 section 439A(6)

<sup>420</sup> Corporations Act 2001 section 439A(7)

The administrator convenes the meeting by giving written notice to as many of the company's creditors as reasonably practicable.<sup>421</sup> The administrator must also cause a notice setting out the prescribed information about the meeting to be published in the prescribed manner.<sup>422</sup> This must be done at least five business days before the meeting.<sup>423</sup> The aforementioned must be accompanied by a copy of a report by the administrator on the state of the company<sup>424</sup> as well as a statement setting out the administrator's opinion on whether it would be in the creditors' interests to either execute the deed, end the administration or wind up the company.<sup>425</sup> The administrator must also provide reasons for holding the aforementioned opinions as well as any other additional information known to them which will enable the creditors to make an informed decision.<sup>426</sup> If a deed of company arrangement is proposed, a statement setting out the details of the proposed deed must also be appended.<sup>427</sup>

Once convened, the meeting may be adjourned from time to time, but the period of adjournment, or the total periods of adjournment, may not exceed 45 business days.<sup>428</sup> At this meeting the creditors may either decide that the company execute the deed of company arrangement specified in the resolution, that the administration should end or that the company be wound up.<sup>429</sup> With regards to the creditors' meeting, Anderson notes the pragmatic approach taken to the voting in that there is a division of the votes into class and number but there is no division based upon priority as is the case under business rescue.<sup>430</sup> A further stark contrast is that the resolution is passed by a simple majority in number and value.<sup>431</sup> Where there is a split between the two groups, the administrator has a casting vote which, if used, is subject to a right of appeal.<sup>432</sup>

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<sup>421</sup> Corporations Act 2001 section 439A(3)(a)

<sup>422</sup> Corporations Act 2001 section 439A(3)(b)

<sup>423</sup> Ibid

<sup>424</sup> Corporations Act 2001 section 439A(4)(a)

<sup>425</sup> Corporations Act 2001 section 439A(4)(b)

<sup>426</sup> Ibid

<sup>427</sup> Corporations Act 2001 section 439A(4)(c)

<sup>428</sup> Corporations Act 2001 section 439B(2)

<sup>429</sup> Corporations Act 2001 section 439C

<sup>430</sup> Anderson op cit (n359) 30.

<sup>431</sup> Ibid

<sup>432</sup> Ibid

### 6.8.1 *Employee entitlements*

The Corporations Act provides that each deed should contain a provision protecting the entitlements of eligible creditor employees to the extent that the priority of payment ought to be at least equal to that which prevails in the event of the company being liquidated.<sup>433</sup> This requirement can be dispensed with at a meeting of eligible employee creditors or via the medium of a court order approving the non-inclusion of the provision.<sup>434</sup> The aforementioned meeting must be convened by the administrator at least five business days before the meeting to decide the company's future.<sup>435</sup> Notice of this meeting must be sent to as many of the employee creditors as practicably possible and must be accompanied by a statement setting out inter alia whether the inclusion of the provision would result in a better outcome for eligible employee creditors than would an immediate winding up of the company.<sup>436</sup> An administrator, eligible employee creditor or interested party may approach the court for an order approving the non-inclusion of the provision.<sup>437</sup> It should be noted that this is the only instance in the whole procedure where employees are specifically mentioned and catered for.

## 6.9 *CONSEQUENCES OF DEED*

First and foremost, the adoption of the deed of company arrangement results in the termination of the moratorium.<sup>438</sup> This is where the power dynamics alluded to earlier become most pronounced. In addition to binding the shareholders and the directors, the deed binds all creditors of the company in relation to debts which arose on or before the date on which its adoption is approved.<sup>439</sup> This, however, does not preclude a secured creditor from realising their security interest to the extent provided for in the deed, where they voted in favour of its adoption.<sup>440</sup> This is not an unfettered right as the court may limit it if it is satisfied that dealing with

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<sup>433</sup> Corporations Act 2001 section 444DA(1)

<sup>434</sup> Corporations Act 2001 section 444DA(2)

<sup>435</sup> Corporations Act 2001 section 444DA(3)

<sup>436</sup> Corporations Act 2001 section 444DA(4)

<sup>437</sup> Corporations Act 2001 section 444DA(6)

<sup>438</sup> Anderson op cit (n359)25

<sup>439</sup> Corporations Act 2001 section 444D(1)

<sup>440</sup> Corporations Act 2001 section 444D(2)

the security interest would have a material adverse effect on achieving the objects of the deed.<sup>441</sup> Be that as it may, this is a far cry from the provisions of the Companies Act which states that the business rescue plan binds all creditors regardless of whether or not they voted in favour of it.<sup>442</sup> Where a transfer of shares is envisaged, this may not be done unless it is with the consent of the owner of the shares or with the leave of the court.<sup>443</sup> The court may not grant such leave if it would unfairly prejudice the interests of the shareholders.<sup>444</sup> The release of the company from its debts will be to the extent provided for in the deed and will only bind those creditors who are bound by the deed.<sup>445</sup>

## **6.10 TERMINATION AND VARIATION OF DEED**

The creditors may pass a resolution to vary the deed at a meeting convened by the administrator at the request of creditors holding not less than 10% of the value of all claims against the company.<sup>446</sup> Notice of the meeting must be sent to as many creditors as practicably possible at least five business days before the meeting.<sup>447</sup> Where the deed is varied, a creditor of the company may approach the court for an order cancelling the variation.<sup>448</sup> Where there has been a breach of the deed, the creditors may pass a resolution terminating it provided that the breach has not been rectified at the time of adopting the resolution.<sup>449</sup> The creditors may also, at this stage, resolve that the company be wound up.<sup>450</sup> The deed may also be terminated by the court upon application by a creditor, the company, the Australian Securities and Investments Commission, or any other interested person.<sup>451</sup> In addition to the above, the deed will generally terminate

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<sup>441</sup> Corporations Act 2001 section 444D(3)

<sup>442</sup> Companies Act 2001 section 152(4)

<sup>443</sup> Corporations Act 2001 section 444GA(1).

<sup>444</sup> Corporations Act 2001 section 444GA(3)

<sup>445</sup> Corporations Act 2001 section 444H

<sup>446</sup> Corporations Act 2001 section 445F(1)

<sup>447</sup> Corporations Act 2001 section 445F(2)

<sup>448</sup> Corporations Act 2001 section 445B

<sup>449</sup> Corporations Act 2001 section 445CA

<sup>450</sup> Corporations Act 2001 section 445E

<sup>451</sup> Corporations Act 2001 section 445D

upon filing of a notice by the administrator or when circumstances specified in the deed which result in termination occur.<sup>452</sup>

### 6.11 CONCLUSION

The voluntary administration provisions have undergone very little change since their enactment and thus it remains an overtly creditor-friendly procedure. The procedure does not have a dedicated section outlining the rights of employees. This is unlike the provisions of business rescue. As a result, employees often find themselves left in the lurch. The plight of employees was noted by both Anderson and Gronow, with the latter advocating for immediate reform, particularly in the context of group insolvencies.<sup>453</sup> When comparing the position of employees, one should not lose sight of the unique position occupied by trade unions in South Africa. One must be particularly cognisant of the political landscape where the Congress of South African Trade Unions is a member of the tripartite alliance along with the ruling African National Congress and the South African Communist Party. Trade unions are thus able to exert immense influence and this is evident from the business rescue provisions. The differences cannot, however, be exclusively ascribed to labour union influence. Anderson notes the differences between the treatment of employees under official management and under business rescue.<sup>454</sup>

He finds the protections afforded to employees under business rescue understandable, particularly considering the disadvantage experienced by employees in the decision-making process under official management.<sup>455</sup> What is pertinent, however, is that he does not ascribe this lack of protection to a fundamental difference in the underlying approach but rather to the differences in social structures and conditions that exist in each jurisdiction.<sup>456</sup> What is most startling is the extent to which shareholders have been excluded from the process. Anderson views the treatment of shareholders in this regards as a gap in the

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<sup>452</sup> Corporations Act 2001 section 445C

<sup>453</sup> Gronow op cit (n410). 206

<sup>454</sup> Anderson op cit (n362) 22

<sup>455</sup> Ibid

<sup>456</sup> Ibid

Australian procedure.<sup>457</sup> He opines that this treatment of shareholders is based on the perception that they cease to have an interest in the property of a company upon insolvency as it will be utilised to satisfy the claims of creditors.<sup>458</sup>

He however correctly notes the flaw of this perception in the context of corporate rescue legislation in that if a rescue is successful, the corporate entity will be restored to full health thus resulting in a continuing interest in the corporate entity by the shareholders.<sup>459</sup> It seems logical, therefore, that those shareholders should have more of a say in a process where they have such a vested interest in the outcome.

Despite the above, voluntary administration is a purpose built procedure which is premised, first and foremost, on expedience. This is evident in the relatively short time frame prescribed for the preparation of a deed as well as the simplistic approach taken to voting. Instead of providing for mechanisms to further increase the odds of a deed being adopted, the approach taken is to either adopt the deed or to wind up the company with as little of its already limited resources being utilised in what could turn out to be a pyrrhic victory.

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<sup>457</sup> Anderson 'Seen But Not Heard? The Significance of Shareholders under Part 5.3A of the Corporations Act' *Insolvency Law Journal* (16) 2008 222. 225

<sup>458</sup> Ibid

<sup>459</sup> Ibid

# CHAPTER 7: CONCLUSIONS

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## 7.1 *CONCLUSIONS ON BUSINESS RESCUE*

This dissertation has looked at the rights of affected persons under business rescue and attempted to ascertain whether or not a balance has been struck between the various competing interests. It was pointed out that the striking of a balance does not connote equality, but rather that the rights afforded to each group of affected persons correlates with the interest they have in the outcome. The conclusion reached is that the legislature failed to strike an appropriate balance by marginalising shareholders and granting more rights to employees than is necessary. Further to that, it was concluded that creditors are sufficiently protected and have been given rights which are commensurate to the interest that they have. A few issues were highlighted in relation to creditors, however it was concluded that notwithstanding those, the legislature made appropriate policy decisions. There were reservations about the practicality of mechanisms such as the binding offer, even though the idea behind their existence is commendable. The conscious effort taken to provide protection to employees is commendable however, the extent to which it has been done requires review. As discussed in the conclusion in chapter 5, wholesale changes are not required and significant improvement can be achieved by taking away certain rights. Clarification, especially with regards to the issue surrounding the appointment of the practitioner, is required in order to remedy some of the palpable inconsistencies in the procedure.

## 7.2 *COMPARATIVE ANALYSIS*

A brief study of the Australian voluntary administration procedure was undertaken in order to compare the rights given to employees, creditors and shareholders. It

was found that that procedure is overtly creditor-centric and does not provide the same protections afforded to shareholders and employees under business rescue.

Further to that, a significant emphasis has been placed on secured creditors, which is not the case under business rescue. Similar concerns were raised with regards to the marginalisation of shareholders even though it is all the more pronounced under the voluntary administration. Indeed the issue of shareholders raises interesting philosophical and policy questions with regards to the stated objectives of business rescue and voluntary administration. The granting of extensive participation rights to creditors cannot be gainsaid. However, it brings to light the balance between the desire to preserve the company and the desire to secure a better return for both creditors and shareholders, particularly whether or not the former can be meaningfully pursued when creditors are placed in the driving seat of the process.<sup>460</sup> Fridman questions whether the continued existence of a company would be meaningfully pursued by creditors who have a greater incentive to maximise short term returns to satisfy their claims than to dissipate the value of any security they might have in the company by continuing business.<sup>461</sup> He eventually ascribes the high rate of administrations which end up in liquidations to this moral hazard (so to speak) and seems to suggest the need for some adjustment to voluntary administration by shifting control of the process to employees and shareholders.<sup>462</sup> He however acknowledges that certain safeguards have been put in place such as the empowering of the court to terminate any deed that may be oppressive.<sup>463</sup> He then goes on to sound a warning with regards to the pursuit of collective insolvency administration. He opines that though this may be a noble pursuit, it should not be pursued fruitlessly or inefficiently.<sup>464</sup>

The level of involvement of the various stakeholders is a delicate issue that requires the consideration of numerous policy factors, chief among those being the effect that a certain approach could have on the availability of credit and the terms upon which such credit is availed. More than anything, it will hinge on the

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<sup>460</sup> S Fridman 'Voluntary administration: Use and abuse' (2003) 2 *BLR* 331. 355

<sup>461</sup> *Ibid*

<sup>462</sup> *Ibid*

<sup>463</sup> Page 356

<sup>464</sup> *Ibid*

philosophy underling the respective procedure. For example, voluntary administration seems to strive to be as uncomplicated, inexpensive and flexible as possible and as a result there are fewer parties involved and if a deed of company arrangement is not adopted the company will seamlessly go into liquidation. Conversely, business rescue seems to be geared towards the adoption of a business rescue plan.<sup>465</sup> This is why we see the numerous mechanisms put in place in order to attempt to have a plan adopted as well as the somewhat inclusive approach evidenced by the fact that the employee's committee is entitled to address the meeting where the business rescue plan is being considered.<sup>466</sup>

All things considered, the business rescue provisions are a step in the right direction. They represent a belated yet welcome progression from the restrictive and inherently flawed judicial management. Despite the conclusions reached and the concerns raised, one should not be quick to throw the baby out with the bath water.

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<sup>465</sup> Anderson op cit (n359) 27

<sup>466</sup> Ibid

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