



# BUSINESS RESCUE

Etienne Swanepoel

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### Introduction

Liquidation or winding up, compromise with creditors and business rescue are mechanisms available to financially ailing companies in South Africa. The focus of this Chapter is the business rescue process given the mechanism is relatively new to South African law. We nonetheless include a brief overview of the alternate avenues available to companies in financial distress.

### Liquidation proceedings

In terms of South African law, liquidation means the process of dealing with or administering a company's affairs prior to its dissolution. This takes place by ascertaining and realising its assets and applying these firstly in the payment of creditors of the company according to a statutory order of preference and then by distributing the residue (if any) among the shareholders of the company according to these preferences.

One of the key principles of liquidation is the institution of a *concursum creditorum*, upon entering into liquidation, in which the rights of the general body of creditors prevail over the rights of any individual creditor. The claim of each creditor must be dealt with as it existed at the time of entering into liquidation and no transaction can thereafter be entered into with regard to the assets of the company by a single creditor to the prejudice of the general body of creditors.

The objective of the *concursum creditorum* is to ensure that what remains of the insolvent's assets are divided amongst its creditors, such that each creditor receives the same proportion of what is owing to him. To achieve this objective, the Insolvency Act 24 of 1936 provides for an insolvent company to be divested of its assets and for the assets to be legally vested in the liquidator as soon as he or she is appointed. Such divestiture deprives the insolvent company of ownership and control of its property.

### Compromise with creditors

The board of a company or its liquidator, in the event of it being wound up, that is not necessarily in financial distress and that is not yet in business rescue, may propose a compromise regarding any financial obligations between the company and all of any class of creditors.

The proposed compromise must be set out in a proposal (the proposal) and sent to all known creditors giving all information necessary to enable a creditor to make an informed decision whether to accept or reject the proposal.

The proposal must be accepted by a majority of creditors in number and holding at least 75% in value of claims who are present and voting at a meeting to consider the proposal. A proposal only becomes binding if approved by the court.

## Business Rescue

### Introduction

The Companies Act 71 of 2008 (the Act) introduced a business rescue process based on Chapter 11 of the US Bankruptcy Code, Bankruptcy Reform Act 1978, aimed at facilitating the corporate rescue and rehabilitation of companies that are financially distressed. Previously, the Companies Act 61 of 1973 provided for judicial management, a regime which proved unpopular and was little used.

Business rescue broadly involves the temporary supervision of the company and of the management of its affairs, business and property, and a temporary moratorium on the rights of claimants against the company or against property in the company's possession while a plan to rescue the company is approved and implemented.

## Purpose

The objective of business rescue is the development and implementation, if approved, of a plan to rescue a financially distressed company. The primary purpose of business rescue is the restructuring of the ailing company's affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis. To the extent it is not possible to give effect to the primary purpose the secondary purpose is to ensure a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company.

A financially distressed company is a company that 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 a company that appears to be reasonably likely to become insolvent within the immediately ensuing six months.

## Commencement

Business rescue proceedings can commence by:

- a resolution of the board of directors of the company (ie voluntary business rescue); or
- an affected person may apply to a court at any time for an order placing the company under supervision and commencing business rescue proceedings (ie court ordered business rescue).

An affected person is defined as a shareholder or creditor of the company, a registered trade union representing employees of the company, and non-unionised employees or their representatives.

## Effects and consequences

The primary effects of entering business rescue is the moratorium on legal proceedings against the company and the power of the practitioner to suspend, for the duration of the business rescue proceedings, entirely, partially or conditionally any contract to which the company is party (with employment contracts as one exception).

## Business rescue practitioner

A business rescue practitioner is appointed in both voluntary and court ordered business rescue. A business rescue practitioner must be a member in good standing of a legal, accounting or business management profession that is accredited by the Commission; be licensed as such by the Commission; have integrity, impartiality and objectivity; be eligible to act as a director in terms of the Act and not be on probation; be independent; and meet any minimum qualifications the Minister may specify. The practitioner can be removed by court order.

The primary powers and duties of the business rescue practitioner is to exercise full management control of the company in place of the directors and develop a business rescue plan and implement it if and when it is adopted.

## Business rescue plan

The practitioner is required to consult with creditors of the company, other affected persons, directors and management and then prepare the business rescue plan for consideration and adoption at a creditors' meeting (and where shareholder rights are affected by the business rescue plan, also with shareholders at a shareholders' meeting).

The business rescue plan must be published within 25 business days after the practitioner's appointment or within such longer period approved by the court or a majority of creditors.

After publication of the business rescue plan, the practitioner must call a meeting of affected persons to consider the business rescue plan and its reasonable prospects, invite discussion, and conduct voting on any amendment in terms of creditors' instructions and call for a vote for the preliminary approval of the business rescue plan by:

- more than 75% in value of all creditors' voting rights that voted; and
- by at least 50% in value of the voting rights of independent creditors (including employee creditors but excluding creditors who are related or interrelated to the company, for example, holding or subsidiary companies).

If the business rescue plan is approved and if it does not alter any shareholder rights, then it becomes final. An approved business rescue plan is binding on all creditors and shareholders whether or not they were present, they voted for or against or they have proved their claims. If a business rescue plan alters shareholder rights, the shareholders must also vote to approve the plan.

Once the business rescue plan is approved, the company under the direction of the practitioner must take all reasonable steps to satisfy any conditions to which the business rescue plan may be subject, and must implement the business rescue plan.

### **Debts and claims**

A business rescue plan may provide that any discharge of the whole or any part of a debt under the business rescue plan is binding on the creditor if the discharge is “acceded to” by the creditor and the creditor will then lose the right to enforce the relevant debt (or part of it).

### **Post-commencement finance**

The Act allows the company in business rescue proceedings to raise “post-commencement finance”, that is, to borrow funds and secure those borrowings using any unsecured assets of the company. The claims of employees for unpaid remuneration and expenses during the business rescue proceedings are also treated as post-commencement finance.

### **Conclusion**

It is evident from the growing case law that South African courts are not tolerating frivolous and abusive business rescue applications brought merely to postpone inevitable liquidation. In this regard, the requirements for business rescue applications and the standard of evidence that must be met by applicants has been at the forefront of the developing case law.

The success of each business rescue process rests largely on the qualification and experience of the practitioner conducting the rescue. It is important that the distressed company commences business rescue proceedings sooner rather than later, as this will increase the likelihood that it has sufficient funding to meet its ongoing expenses pending the approval of the business rescue plan. This will, in turn, enhance its ability to obtain the financing necessary to enable it to continue in business after the business rescue plan has commenced.