Overview of the South African Business Rescue Process

By **KARABO MOTSHWANE**

Chapter 6 of the Companies Act, Act 71 of 2008 ("**New Act**") introduced business rescue to the South African legal system.

New Act

"Business Rescue": proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for:

1. **A temporary supervision** of the company, and of the management of its affairs, business and property;
2. **A temporary moratorium** on the rights of claimants against the company or in respect of the property in its possession; and
3. **Rescue Plan:** 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 maximizes the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company.[1]

Accordingly the business rescue proceeding is not only possible in circumstances were there are prospects of rescuing the business, but can also be commenced if there would be a better return for the creditors or shareholders through the proceeding than there would be with an immediate liquidation of the company.

Financial Distress

The test for financial distress under the New Act is a six month forward looking test:

Impending Commercial Insolvency	Impending Factual Insolvency
It appears to be reasonably unlikely that the company will be able to pay all of its debts as they become due and payable within the immediately ensuing six months.	It appears to be reasonably likely that the company will become insolvent (i.e., its liabilities exceed its assets) within the immediately ensuing six months.

Commencement of Business Rescue

Voluntary Business Rescue. A company or close corporation can be placed in business rescue voluntarily by the board of directors adopting and filing a resolution to commence business rescue proceedings and to place the company under the supervision of a business rescue practitioner.[2]

Thereafter, a number of forms and documents would need to be submitted to the companies' office for filing. There are strict time periods that the company must adhere to, once it files its resolution to commence business rescue proceedings.

Compulsory Business Rescue. A formal application can also be made to court by affected persons (creditors, employees, shareholders) to place a company in business rescue. Once the company is placed under business rescue, the order of the court must be provided to all affected persons notifying them of the commencement of business rescue. A voluntary business rescue application cannot be filed if a compulsory business rescue application has been initiated or if liquidation proceedings have already been initiated by or against the company.

A voluntary business rescue commences when the requisite documents are filed with the companies office. A compulsory business rescue, arising following an application made to court, commences once the papers have been lodged with the court.

Duration of Business Rescue

In accordance with the provisions of the New Act, business rescue proceedings are designed to last for a period of 3 months from start to finish. However, in practice, business rescue proceedings are extended from time to time with the support of the majority of creditors and can take anything from 6 months to 3 years, depending on the complexities of the business.

Certain factors may necessitate the continuation of business rescue beyond the 3 month period. These factors include but are not limited to:

— the business rescue practitioner attempting to procure a purchaser for the business or assets;

— the need to obtain regulatory approvals in respect of a plan that has been adopted with the requisite support; and

— the fulfillment of any conditions precedent, following the adoption of a plan, or even a general lack of co-operation from creditors or shareholders.

Extent of Court Involvement in the Business Rescue

Compulsory business rescue applications require the involvement of the courts to a limited degree, whilst voluntary procedures do not. A compulsory business rescue is initiated following an order of the court. Unless there is general litigation pertaining to a business that has been placed under business rescue, other than the initiation of a compulsory business rescue, the court should have no further involvement in the matter.

Management of the Company Whilst in Business Rescue

During business rescue proceedings, the business rescue practitioner has full management control of the company. The directors, though not exonerated from their duties and responsibilities (and corresponding liabilities) are answerable to the business rescue practitioner. Any action taken by a director whilst the company or corporation is in business rescue will require the approval of the business rescue practitioner. If such approval is lacking, the action so taken will be void.

Filing of Claims

In practice, business rescue practitioners compile their own claim forms for the submission of creditors' claims. In other instances, creditors and their legal advisors prepare the necessary claim forms. There is no specific time period within which a business rescue practitioner may receive claims. Typically though, claims are submitted at the first meeting of creditors and can be received up until such time as the business rescue plan is published by the practitioner, for the consideration of all affected persons. The practitioner may, however, determine a date by which all claims must be submitted. In some instances, and following a consideration of the books and accounts of the company, practitioners take into account the position of all creditors, whether or not they prove their claims, when preparing the business rescue plan.

Funding of the Company Whilst in Business Rescue

During business rescue, the company may obtain post-commencement financing which is either new money provided to the company following the commencement of business rescue or services rendered by employees or suppliers of the company for the duration of the business rescue. Post-commencement financings will rank senior to the claims of unsecured creditors, but pari passu secured creditors. Post-commencement lenders may also obtain collateral for their financing, but only over unsecured assets of the company in distress.

Effect of Business rescue on Employees

Employees continue to be employed by the company on the same terms and conditions, unless different terms are agreed upon between the employees and the company or unless changes occur in the ordinary course of attrition. Any retrenchments contemplated by the business rescue practitioner will be subject to South African labour legislation.

Similarly, directors retain their positions. The business rescue practitioner is however empowered to remove from office any person who forms part of the management of the company.

Effect of Business Rescue on Contracts

Generally speaking, contracts concluded with the company (unless they contain an event of default clause, which usually includes the occurrence of business rescue proceedings), prior to the commencement of business rescue, remain extant. The business rescue practitioner may suspend (entirely, partially or conditionally), any agreement to which the company is party, however, the other party to the contract may assert a claim for damages against the company. If the business rescue practitioner wishes to cancel a contract, he or she may only do so unilaterally with the sanction of the court.

Effect of Business Rescue on Shareholders

There can be no alteration to the classification or status of a company's issued securities unless this is done (A) in the ordinary course of business, (B) by way of an order of court or (C) in pursuance of the provisions of the business rescue plan. Further, shareholders retain their shareholding in the company, notwithstanding the commencement of business rescue proceedings.

Generally, shareholders are affected by the business rescue process, as investors would generally require some equity in the business. Such instances result in the shareholders' shares being diluted.

Effect of Business Rescue on Creditors

The historic position and claims of creditors are crystallized as of the date of the commencement of business rescue proceedings. Creditors are entitled to submit claims to the business rescue practitioner, but all legal proceedings against the company are subject to a stay, so creditors may not enforce any claims against the company.

The commencement of business rescue proceedings gives rise to the operation of a general moratorium on the rights of creditors to enforce their claims against a company or in respect of property belonging to the company or lawfully in its possession. A creditor may also not continue with enforcement action against a company (i.e., execution of a writ). In certain instances, proceedings may be brought against a company with the written consent of the business rescue practitioner or with the leave of the court. If a claim is subject to a time limit, the claim will not prescribe during the period in which the company is in business rescue. Prescription terms will be suspended.

However, leave of the court or the practitioner's consent is not required if the litigation is about the business rescue itself. For example, one can approach the court directly if the litigation is about the removal of the practitioner in accordance with section 139 of the New Act.

Voidable Transactions

The business rescue provisions in the New Act do not deal specifically with voidable transactions. Instead, they place an obligation on the business rescue practitioner to investigate any voidable transaction, though these are not specified. However, any action taken by a creditor without the approval of the business rescue practitioner will be void.

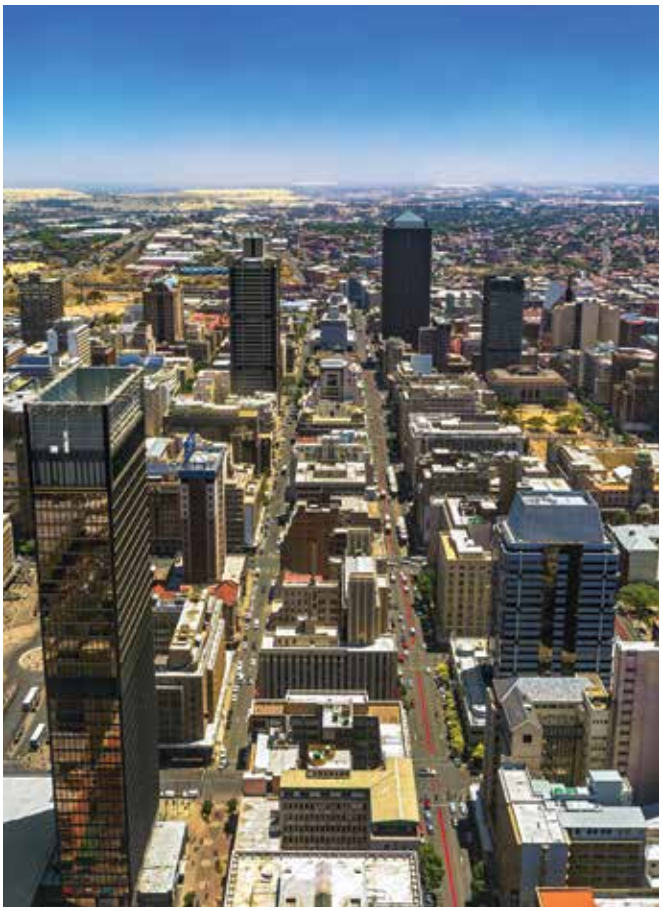
The Business Rescue Plan

The business rescue process culminates in the preparation of a business rescue plan by the business rescue practitioner. The business rescue practitioner will consult with all affected persons, creditors and the management of the company when preparing the plan. Broadly speaking the plan will set out details relating to the background of the company, any proposal made for the rescue or rehabilitation of the company and any assumptions or conditions upon which the plan is based. The plan will also include how the assets, liabilities, contracts and employees will be treated following the adoption of the plan.

Voting on the Plan

The business rescue practitioner must convene and preside over a meeting of the creditors within 10 business days of the publication of the plan[3]. At this meeting, the plan must be introduced, the employees' representatives must be afforded and opportunity to address all persons at the meeting and a discussion is held on the proposed plan. The practitioner will then procure a vote for the approval of the plan.

A plan will be accepted with the favorable vote of at least 75% of the aggregate recognized claims, of which at least 50% must be third party creditors (i.e. not intercompany claims). If the plan affects the rights of shareholders or securities holders, a separate vote of the shareholders or securities holders affected is procured. A simple majority vote is required for a plan to be supported by shareholders and/or securities holders. If a plan is rejected, affected persons or the practitioner himself can take steps to implement the plan (i.e., apply to court to disregard the vote on a plan or procure a vote from creditors to draft a revised plan) failing which the plan will be held to have been rejected.



In applying to court, the party so applying to court, would essentially be requesting the court to set aside the vote of the creditors or the shareholders as being inappropriate.

Cram Down on Creditors

Once the business rescue plan has been approved, it is binding on all creditors whether or not the creditors were present at the meeting, voted in favor or against the plan or abstained from voting.

The business rescue practitioner must file a notice of substantial implementation of the plan with the companies' office once the plan has been substantially implemented.

Also, if a business rescue plan that is approved by creditors and shareholders, if need be, compromises the claims of creditors, such creditors are not entitled to enforce the remainder of their claims against the company unless the business rescue plan provides otherwise. In such an instance, the company will continue to trade with a "clean bill of health".

Effect on Suretyships

If the company that is in business rescue gave a surety or guarantee to a third party, such party cannot enforce such surety or guarantee against the company in business rescue as a result of the operation of the moratorium. Such a party would need to submit a claim in the business rescue proceedings. However, if a third party stood surety for, or guaranteed the obligations of, the company in business rescue, such third party could be liable for the remainder of the debt that the company is not able to pay, unless the principal claim is discharged. If the principal claim is discharged, the suretyship claim will fall away but the guarantee, provided it is drafted as an independent guarantee, will remain extant.

Termination of business rescue

Business rescue proceedings end when:

— the court sets aside the resolution or order that began the business rescue proceedings or when the court converts business rescue proceedings into liquidation proceedings;

— the business rescue practitioner files a notice of termination of business rescue proceedings with CIPC; and

— business rescue plan has been proposed and rejected and no affected person has acted to extend the proceedings in any manner contemplated by the New Act or a business rescue plan has been adopted and the business rescue practitioner has subsequently filed a notice of substantial implementation of the plan.

Status of the Company after the Business Rescue

If a business rescue plan is adopted and implemented in accordance with its terms, the company will continue to trade and will graduate from business rescue. If a plan is rejected, and steps are not taken to implement a revised plan, the practitioner will need to make application to court to place the company in liquidation. A similar result may ensue if the conditions precedent to a plan are not fulfilled.

Conclusion

The business rescue process in its initial stages was abused by companies which went into business rescue without prospects of being rescued. These are companies which were candidates for liquidation.

The courts have however passed judgments giving guidance to the use and implementation of the business rescue provisions. That has allowed some stability and a reduction of unsuccessful business rescue proceedings. There has been an increase of successful business rescue cases, including those of On digital Media Proprietary Limited t/a Top TV, South Gold Mine Proprietary Limited, Optimum Coal Mine Proprietary Limited and Meltz Proprietary Limited.

The business rescue process is a great tool in insuring that business salvaged and the employment rate minimised. It is also an opportunity for investors looking at acquiring business at discounted rates. ■

1. As defined in Section 128(1)(b) of the New Act.
2. Section 138 (1) (b) of the New Act provides that a person may be appointed as a business rescue practitioner of a company, only if such person: (i) is a member in good standing of a legal, accounting or business management profession accredited by the Commission; (ii) has been licensed as such by the Commission; (iii) is not subject to an order of probation in terms of section 162 (7); (iv) would not be disqualified from acting as a director of a company; (v) does not have a relationship with the company such as would lead a reasonable and informed third party to conclude that the intergrity, impartiality or objectivity of that person is compromised by the relationship; and (vi) is not related to a person who has a relationship with the company.
3. Pursuant to Section 152 of the New Act.

▼ **Karabo Motshwane** has been a director at Werksmans Attorneys in Johannesburg, focusing on the Dispute Resolution practice since March 2014. His areas of specialisation include dispute resolution, insolvency, business rescue and restructuring. He is also knowledgeable in all areas of commercial litigation; including contractual disputes, corporate law and governance, shareholder and director disputes, arbitration, mediation and alternative dispute resolution. Karabo holds an LLB from the University of South Africa.