

Some Initial Thoughts on the Development of a Modern and Effective Business Rescue Model for South Africa (Part 2)*

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6 Main Characteristics/Elements of a Successful and Workable Business Rescue Model for Consideration in the South African Context

As can be seen from the excerpts from the *UNCITRAL Guide* referred to in par 4 above, there appear to be a number of common characteristics that underlie a successful and workable business rescue model. Although the mechanics of these characteristics appear to differ in form and substance in each jurisdiction, there is nonetheless a certain commonality that applies to their application. Where appropriate, potential problems that may be experienced with these characteristics in the South African context, will also be discussed.

In addition, under the discussion of each of these elements a number of options, suggestions and considerations will be included.

6.1 Institutional Framework

It is perhaps appropriate to commence a discussion of a new business rescue model by determining the institutional framework within which it is proposed to operate. This point was touched on in par 4.3, where it was pointed out that it has to be decided who will exercise control over business rescue proceedings.

It is submitted that there are two important aspects to the supervision of a new business rescue model. Firstly, who will decide whether the business rescue model will apply, and secondly, who will exercise overall supervision as regards the actual business rescue process.

6.1.1 Determining Entry to the Business Rescue Provisions

6.1.1.1 Introduction

The main decision that needs to be made here is whether a new business rescue model will be reliant on court proceedings, or whether it will be

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possible to implement the provisions without recourse to the courts. It has already been pointed out that one of the reasons for the failure of judicial management is its reliance on court proceedings. It is therefore submitted that reliance on court proceedings for a new business rescue model could create the following potential problems:

- Cost factor – court proceedings are invariably expensive, and in the South African context, where most businesses are small to medium business enterprises, it would defeat the object of the exercise if the expense involved is too high to ensure the participation of the businesses one is seeking to save. South Africa needs a cost effective business rescue model that can be applied as inexpensively as possible.
- Time factor – court proceedings are not only expensive, but can also very often be subject to delays and postponements. Invariably speed will be one of the most important factors that can save a viable business, and unnecessary delays could defeat the very purpose of the business rescue provisions.
- Expertise – while no one will dispute the efficacy of our High Courts and the quality of the judges appointed to the judiciary, it is debatable whether the bench has the necessary expertise in order to make business-orientated decisions such as those that may be required when implementing business rescue provisions.

Conversely, if there is no court involvement the whole business rescue model may be open to abuse by a number of the participants. In addition, creditors and other interested parties, for example employees, may need to seek protection or assistance from the courts if their interests are being eroded by the implementation of the business rescue provisions.

It will probably also be necessary to introduce a system whereby a distinction is made between applications for business rescue by the debtor, and the possibility of an application being brought by one or more of the creditors. In the case where the debtor itself wishes to make use of the business rescue provisions, it seems appropriate that it should be able to do so without first having to approach the court. The debtor is fully aware of its own financial situation, and would be the best judge of when use needs to be made of the relevant business rescue provisions.¹³⁴

However, the same cannot be said about a creditor who may wish to implement the business rescue provisions. Most creditors will probably only have scant information regarding the true financial affairs of the debtor, and this information may not be sufficient to bring a successful application for the implementation of the business rescue provisions. For this reason it would be appropriate that any person, other than the debtor

¹³⁴ It is submitted that an insolvent trading provision will be instrumental in encouraging debtors who are in financial strife to seek assistance in terms of the business rescue provisions. It is preferable that the debtor seeks assistance at an early stage in order to make the success of a business rescue more likely.

itself, who wishes to implement the business rescue provisions should do so by means of an application to court. This will also place the debtor in a position to resist such an application, thereby nullifying any abuse of proceedings by third parties.

Although most creditors would probably follow the liquidation route where pending or actual insolvency is suspected, it is conceivable that there will be certain classes of creditors, such as the employees of the debtor, who may wish to have the business rescue proceedings implemented in order to protect their livelihood.

In the United States,¹³⁵ for example, both voluntary and involuntary business rescue proceedings (the so-called Chapter 11 procedure) are implemented by means of the filing of a petition, but this is merely a formality and is normally not subject to judicial consideration.¹³⁶ The courts can, of course, be approached in order to obtain relief, whether it be from the automatic stay or otherwise. In Australia business rescue proceedings are commenced by the debtor or the liquidator appointing an administrator. In the United Kingdom there are various options available in order to save businesses in distress.¹³⁷ However, in the United Kingdom the procedure closest to the American Chapter 11 procedure and the Australian voluntary administration procedure, is the administration order. The administration order is a court-driven procedure, and the court may only grant such an order if one of four objectives can be attained.¹³⁸

6.1.1.2 Application for Business Rescue by the Debtor

As stated above, it is submitted that a new business rescue model should provide for the implementation of the relevant provisions by the debtor without the debtor having to make an application to court. A commencement proceeding, such as the appointment of a business administrator or the filing of an application, should be sufficient in order to commence the proceeding by the debtor.

In order to protect creditors and employees from possible abuse of business rescue proceedings by the debtor, it is submitted that this low entry level to the proceedings should be balanced by providing for opposition thereto by parties who allege potential prejudice or abuse. It is stated as follows by the *UNCITRAL Guide*:¹³⁹

'125. It might be suggested that a relaxation of the commencement standard could invite abuse of insolvency proceedings... Whether such improper use could arise is a question of how the elements of the reorganization procedure are designed, including the

¹³⁵ All references to the United States Bankruptcy Code are references to Title 11 of the United States Code (11 USC, 1978).

¹³⁶ See John Ayer & Michael Bernstein *Bankruptcy in Practice* (American Bankruptcy Institute 2002) par 6.2 at 127.

¹³⁷ These are receiverships, administration orders and company arrangements.

¹³⁸ See Alice Belcher *Corporate Rescue* (1997) at 14-5, 151-5; and Vanessa Finch *Corporate Insolvency Law* (2002) Ch 9.

¹³⁹ A/CN.9/WG.V/WP.70 (Parts I and II). Both documents may be accessed at www.globulinsolvency.com/insol/intinsolvencies/uncitral.html.

commencement standard, requirements for preparation of the reorganization plan, debtor control of the business after commencement and sanctions for improper use of the process ... [I]t may be desirable that the insolvency law focuses upon discouraging improper use rather than making commencement more difficult to the potential detriment of all eligible applicants.¹⁴⁰

6.1.1.3 Application for Business Rescue by Parties Other Than the Debtor

In order to protect debtors from frivolous or malicious applications for the implementation of business rescue proceedings, I believe that such parties should be obliged to approach the court in order to do so. In addition, it would perhaps be a good idea to set a substantive standard that needs to be met in order to obtain relief in the form of a business rescue. This is the case in the United Kingdom where the court must be satisfied that the granting of an administration order is likely to achieve one of four specified purposes, such as a successful business rescue, an arrangement between the debtor and its creditors, or the more advantageous realisation of the debtor's assets than would be the case in liquidation.¹⁴¹

Considering the revised situation in South Africa regarding employees and the labour legislation that protects them, it would perhaps be appropriate that they be entitled to approach the court for relief where the debtor is experiencing financial difficulties, and the debtor itself has not implemented the business rescue provisions. In light of the fact that employers are already obliged to consult with employees when financial difficulties are being experienced,¹⁴² this would tie in quite appropriately with existing legislation.

6.1.1.4 Implementation of Business Rescue Provisions by the Court

The final possibility that needs to be addressed here, is the court's implementation of the business rescue provisions in cases where applications for liquidation are brought. This does not necessarily entail the court deciding of its own accord that a business rescue rather than a liquidation should be implemented, but rather that any one of the participants, including the debtor itself, may intervene in order to request the implementation of the business rescue provisions instead of the granting of a liquidation order. It is submitted that this possibility should be built into the system by linking the business rescue provisions to the liquidation provisions, and by making an order for the implementation of the business rescue proceedings one of the alternative orders that the court can make when considering an application for liquidation.

¹⁴⁰ See UNCITRAL *Guide* op cit note 6 in par 125.

¹⁴¹ See Belcher op cit note 138 at 14.

¹⁴² See s 197B of the Labour Relations Act 66 of 1995.

6.1.2 Overall Supervision of the Business Rescue Provisions

Considering the current institutional framework in terms of which insolvencies are conducted in South Africa, it seems appropriate that the Master of the High Court should perform overall supervision of business rescues. This is due to the fact that business rescue is an integral part of insolvency law, and the Master already supervises the administration of insolvent estates. The Master's role will be purely administrative in nature, and will not entail a great deal of new work (although it may entail the amendment of a few in-house structures and procedures).

However, there is one aspect regarding the Master's current supervision that will need to be excluded or limited, namely the making of appointments. It is suggested that the Master should not be involved in the appointment of business administrators. This aspect is discussed in more detail below.

6.2 Core Provisions of a New Business Rescue Model

Under this heading the core elements of a new business rescue model for South Africa will be addressed. The ensuing discussion should not be seen to be precipitating the content of what should be in a new business rescue model, but rather as points of departure that can stimulate debate.

6.2.1 Commencing the Business Rescue Procedure

6.2.1.1 Introduction

Although the commencement of a business rescue procedure has been partially discussed under par 6.1 (institutional framework) above, the discussion here will concentrate on the mechanics of who may commence the procedure, and how. There are mainly three aspects that need consideration here. Firstly, in what manner and in which circumstances a debtor may enter the business rescue procedure. Secondly, in what manner and in which circumstances persons other than the debtor itself may bring about the implementation of the business rescue procedure, and thirdly, in what circumstances the court may implement the business rescue provisions.

In deciding these issues there may be some policy decisions that need to be taken, especially where persons other than the debtor desire the implementation of the business rescue procedure.

6.2.1.2 Commencement of the Business Rescue Proceeding by the Debtor

As stated above, it is suggested that South Africa should elect an option for business rescue that will allow a debtor to enter business rescue proceedings without having to approach the court. The process must be as inexpensive and as swift as possible in order to ensure the best possible

prospect of the procedure succeeding. The Australian model appears to work extremely well where their voluntary administration procedure commences as soon as the debtor appoints an administrator. Apart from the nominated administrator accepting the nomination to act as such, there are hardly any formalities that have to be complied with. The effect of such an appointment is immediate, and results in the swift implementation of the voluntary administration procedure.

In the South African context such a simple and swift procedure may be open to abuse by debtors, especially considering that the commencement of a business rescue proceeding will result in an automatic stay. It is probably a given that checks and balances will have to be built into this procedure in order to prevent abuse. The most effective manner in which this could probably be achieved is to provide for opposition (by means of formal court proceedings) to the commencement of the business rescue proceedings by parties who allege prejudice. This method has two distinct advantages. The first being the cost involved in such an application will prevent frivolous or vexatious opposition proceedings and secondly, the courts will ensure that there is a definite prospect of prejudice before preventing the business rescue proceeding from continuing.

If it is accepted that the debtor itself should be able to enter the business rescue proceeding without recourse to the courts, there are a number of other issues that will need to be decided, namely:

- How is the proceeding commenced? Is it commenced by the filing of some sort of notice or application, will it commence by the passing of a resolution by the debtor or its management, or will it merely commence by the appointment of an administrator by the debtor?
- Which organ of the debtor should be authorised to commence the proceedings? For example, in the case of a company should the directors or the shareholders (or both) take the decision?
- Should provision be made for third parties to oppose the implementation of the business rescue provisions? If so, how should this be provided for and on what grounds?

However, if it is decided that the business rescue model should be a court-driven process, a commencement standard will have to be decided upon.

6.2.1.3 Commencement of the Business Rescue Proceeding by Persons Other than the Debtor Itself

It would appear that most jurisdictions only allow for a system of business rescue where the debtor itself can commence the proceedings.¹⁴³ There are, however, some jurisdictions that also allow creditors to

¹⁴³ See UNCITRAL *Guide* op cit note 6 in pars 126-31.

commence such a proceeding.¹⁴⁴ In the South African context the question needs to be asked whether or not creditors should be allowed to commence the business rescue proceeding in appropriate circumstances.¹⁴⁵

One of the options available is that provision can be made for creditors to intervene in liquidation proceedings and attempt to ensure the implementation of the business rescue provisions at that time. This can be achieved with the assistance of the court in a controlled environment, which will protect the interests of all the participants. Another option is to allow creditors to implement the business rescue provisions by way of an application to court (in the absence of liquidation proceedings) where clearly stated commencement standards have been set. The United Kingdom's commencement standard may be helpful in this regard.¹⁴⁶

Although it is not intended to discuss this aspect in any detail here, the question may be asked as to whether the time has not come in South Africa to treat employees as a special category of creditor in insolvency proceedings. Few will argue that employees are not merely creditors in the general sense of the word. They are an integral part of any business, and the human element that accompanies their presence in any business requires that they should be treated differently, especially in cases where they are about to lose their livelihood as a result of the insolvency of the business by whom they are employed. The many recent changes to South Africa's labour laws¹⁴⁷ reflect the importance that has been attached to employee rights generally, and the resultant protection of their interests. In this vein it is perhaps appropriate to ask whether the employees, as a group of persons integral to the business by whom they are employed, should not be given special rights when designing a new business rescue model.

By way of suggestion only, employees could be accorded the right to initiate a business rescue proceeding or to intervene in liquidation proceedings and request the implementation of the business rescue provisions instead. Another possibility is that the employees' express permission be obtained prior to the debtor itself being allowed to initiate a business rescue proceeding. To a large extent employees already have similar rights regarding liquidation due to the fact that they must be consulted whenever a debtor is experiencing financial difficulties.¹⁴⁸

¹⁴⁴ *Ibid.*

¹⁴⁵ An important point made by the UNCITRAL *Guide* op cit note 6 in par 126 is that one of the objectives of a business rescue proceeding is to enhance the value of assets upon insolvency and thereby increase the return to creditors. For this reason it is 'desirable that the ability to apply not be given exclusively to the debtor'.

¹⁴⁶ See Belcher op cit note 138 at 14.

¹⁴⁷ For a critical discussion of the recent amendments to the Labour Relations Act and the Insolvency Act, see André Boraine & BPS van Eck 'The New Insolvency and Labour Legislative Package: How Successful was the Integration?' (2003) 24 *Industrial LJ* at 1840.

¹⁴⁸ See s 197B of the Labour Relations Act.

- When deciding these issues, the following aspects will require attention:
- Should creditors in the general sense of the word be allowed to initiate business rescue proceedings, or should this be limited to employees?
 - If creditors and/or employees are to be allowed to commence business rescue proceedings of their own accord, how is such a proceeding commenced? Should creditors only be allowed to initiate such a process as intervening proceedings in an application for liquidation, or should they be allowed to approach the court of their own accord for the implementation of the proceedings?
 - Should creditors be required to provide security for costs (of both the application and the business rescue procedure) where they have initiated such a proceeding?
 - If creditors are to be allowed to initiate the proceeding, what commencement standards should be set before the court may grant the order?
 - If employees are to be accorded special rights in regard to the commencement of, and intervention in, business rescue proceedings, how will these rights be accommodated?

6.2.1.4 Commencement of the Business Rescue Proceeding by the Court when Considering an Application for Liquidation

It has already been stated that it is desirable to create a link between the liquidation provisions and the business rescue procedure. However, the question that needs to be asked is whether the court may order the implementation of the business rescue provisions of its own accord, or should it only be allowed to do so upon the request of a participant, such as the debtor or a creditor? In addition, where the court does receive such a request, or where it does so of its own accord, what criteria (if any) should be set before the business rescue proceeding can be set in motion?

Apart from the question as to whether a conversion from liquidation to business rescue should be built into the system, the question can also be asked as to whether the converse situation should apply, namely whether there should be a conversion provision from business rescue to liquidation. Very often it may be clear that the business rescue provisions will not or cannot achieve its objective. In such a case there should be a mechanism whereby the liquidation provisions can be implemented and the business rescue proceedings set aside.

Although it is preferable that business rescue proceedings be instituted as early as possible, it is also conceivable that there will be businesses that can be saved at the time the debtor is already insolvent. In addition, if one considers that one of the aims of a business rescue model is to enhance the value of the assets in order to ensure a more significant payment to the general body of creditors, then it makes sense for the courts to be able to order the implementation of the business rescue provisions where this can in fact be achieved. This will especially be the case when a specific

business can be sold as a going concern, thereby also ensuring the continuance of the existing employment contracts.¹⁴⁹

Conversely, it must be borne in mind that there are specific provisions that have been built into the insolvency and labour laws to ensure that a liquidator can achieve the same result within the liquidation process. One should be mindful of applying business rescue provisions when the same or similar objective can be achieved with the use of existing liquidation legislation.¹⁵⁰

Consequently, the following questions need to be addressed when deciding these issues, namely:

- Should a link to business rescue be built into the liquidation provisions, allowing for a conversion from liquidation to business rescue?
- Conversely, should business rescue proceedings contain a link in order to convert business rescue to liquidation proceedings?
- When the conversion provisions from liquidation to business rescue and vice versa are applied, what criteria should be laid down before the court may do so?
- If the courts are to be allowed to initiate a business rescue of their own accord, what criteria should be set before it is able to do so?

6.2.2 Automatic Stay (Moratorium)

While this is without question one of the main characteristics of a business rescue model, there are still various questions that need to be posed in this regard. Most jurisdictions appear to provide for a moratorium in one form or another, although the scope of the stay and the length of time for which it operates appears to differ from jurisdiction to jurisdiction. The *UNCITRAL Guide* highlights the importance of a stay by making the following statement:

¹⁴⁹ In reorganization proceedings, the application of a stay facilitates the continued operation of the business and allows the debtor a breathing space to organize its affairs, time for preparation and approval of a reorganization plan and for other steps such as shedding unprofitable activities and onerous contracts, where appropriate ... Given the goals of reorganization, the impact of the stay is greater and therefore more crucial than in liquidation and can provide an important incentive to encourage debtors to initiate reorganization proceedings.¹⁵¹

However, the *UNCITRAL Guide* also points out that the commencement of business rescue proceedings and the imposition of a stay give notice to all those that do business with the debtor that the future of the business is uncertain.¹⁵² This, in turn, creates 'a crisis of confidence and uncertainty as to how the insolvency proceedings will impact upon suppliers, customers and employees of the debtor's business'.¹⁵³

¹⁴⁹ See s 38 of the Insolvency Act 24 of 1936.

¹⁵⁰ It is submitted that the cost and time factor will play a role here. Converting liquidation to business rescue when the same result can be achieved under the liquidation provisions seems to be superfluous. All that will be achieved in such a case is additional costs and further time wasted.

¹⁵¹ *UNCITRAL Guide* op cit note 6 in par 179.

¹⁵² *Ibid.*

¹⁵³ *Ibid.*

6.2.2.4 Duration of the Application of the Moratorium

6.2.2.4.1 Unsecured Creditors

It would appear that the insolvency laws of most countries provide for the moratorium to apply to unsecured creditors for the full duration of both liquidation and business rescue proceedings.¹⁶³ It would further appear sufficient to apply the stay to unsecured creditors until such time as the business rescue plan has been approved and has become effective.¹⁶⁴

6.2.2.4.2 Secured Creditors

The length of time that a stay should apply to secured creditors within a business rescue model appears to be more problematic.¹⁶⁵ At the very least it would appear that the stay should apply to secured creditors for a sufficient length of time in order to ensure that the business rescue can be conducted in an orderly fashion without any of the assets becoming separated before the business rescue plan can be finalised.¹⁶⁶

For the following reasons it may be a good idea to limit the period of time during which a moratorium will be effective as regards secured creditors:¹⁶⁷

- to avoid delays in proposing a business rescue plan;
- to encourage a speedy resolution of the business rescue proceedings;
- a fixed period provides certainty and predictability regarding the period of time that secured creditors will have to endure the limitation of their rights.

The problem of determining a fixed period of time during which the moratorium will apply, is that the length of time specified may not be long enough to bring about a business rescue plan.¹⁶⁸ The manner in which this can be addressed is to provide for a specific period of time that can be lengthened by the court when the circumstances warrant it.¹⁶⁹ The alternative is not to specify the length of the stay, but to state in which circumstances relief may be obtained from the moratorium by secured creditors.¹⁷⁰

It is suggested that a South African business rescue model should provide for a specified time limit, with the possibility of extending it should the circumstances warrant such an extension. Any extensions of

¹⁶³ UNCITRAL *Guide* op cit note 6 in par 201.

¹⁶⁴ *Ibid.*

¹⁶⁵ *Idem* in par 203.

¹⁶⁶ *Ibid.*

¹⁶⁷ *Ibid.*

¹⁶⁸ *Ibid.*

¹⁶⁹ *Ibid.* However, see also par 205 where it is stated that there should be a limitation on the length and number of extensions that may be acceded to.

¹⁷⁰ *Ibid.*

the stay should be approved by the court, which will also provide secured creditors with an opportunity to oppose an extension in order to protect their interests. It is submitted that in this manner all the parties concerned will be obliged to work at bringing about a speedy and effective business rescue plan.

6.2.2.5 Protection of Secured Creditors Under a Moratorium

A moratorium on the enforcement of a secured creditor's rights may have a prejudicial effect on such a creditor, and it is for this reason that one needs to examine how any such prejudice can be limited or eliminated.¹⁷¹ There are various manners in which this can be done, although a complete discussion falls outside the aim of this article.¹⁷² At this stage it would, however, seem appropriate to at least determine whether secured creditors will enjoy some sort of protection should the moratorium continue for an extended length of time. Examples of how secured creditors' interests can be protected are:

- A limitation of the duration of the moratorium;
- Provisions allowing for the moratorium to be lifted;
- Measures ensuring that the value of encumbered assets are protected against diminution (whether it be as a result of the use of the asset or as a result of the application of the moratorium);
- By consulting with secured creditors on the use and sale of the encumbered assets;
- By the payment of interest as far as the proceeds of the asset allow;
- By taking over the asset where the asset is worth less than the secured claim.

It is submitted that secured creditors should be included in the initial moratorium created as a result of the commencement of the business rescue proceeding, but that provisions providing relief should be included to protect secured creditors should there be an extension of the moratorium.

6.2.3 Use and Disposal of Assets¹⁷³

It is a general principle that the insolvency laws should not unduly interfere with the ownership rights of third parties or the rights of secured creditors.¹⁷⁴ However, in certain circumstances, especially in the case of business rescues, it may be necessary to apply these assets in order to achieve the desired objective.¹⁷⁵

¹⁷¹ *Idem* in par 206.

¹⁷² The various manners in which this can be done are discussed at some length in the UNCITRAL *Guide* op cit note 6 in pars 207-15.

¹⁷³ *Idem* in pars 220-4.

¹⁷⁴ *Idem* in par 220.

¹⁷⁵ *Ibid.*

When dealing with a business rescue situation, it will be necessary to provide that the business administrator has the right to freely use and dispose of certain assets if one wants to achieve the required objective.¹⁷⁶ For this reason the *UNCITRAL Guide* suggests that a distinction should be made between the use and sale of assets in 'the normal course of business' and where they are used or disposed of in other circumstances.¹⁷⁷ For example, if a liquidator wishes to sell assets in terms of the current winding-up provisions of the Companies Act, he or she may need to first obtain prior authorisation from either the creditors or the Master.

Having to obtain prior authorisation in a business rescue situation may hamper the business administrator in the performance of his or her functions. For this reason it would probably be necessary to clearly define when the business administrator will not be required to obtain prior approval. If the conduct of the business administrator is within the boundaries of the normal course of business, he or she should not be required to obtain prior approval, but should be allowed to make decision in the interests of continuing the business operations of the debtor. However, if the use and sale of assets falls outside the parameters of business rescue, then prior approval should be a requirement.

6.2.4 Post-Commencement Finance

6.2.4.1 Introduction

Post-commencement finance is potentially one of the most important, and most problematic, aspects of a successful business rescue model. It has already been stated that the mere commencement of a business rescue proceeding will affect the creditworthiness of the debtor, and hence will also create a lot of uncertainty regarding third parties' dealings with that debtor.

However, the continued operation of a debtor's business after the commencement of a business rescue proceeding is critical to the success of the proceeding itself.¹⁷⁸ In order to continue trading the debtor will have to have access to funds in order to enable it to continue to pay for its operating expenses, including any costs that may be incurred in maintaining the value of assets.¹⁷⁹

A distinction needs to be drawn between the cash flow that will be needed in order to continue trading up until the time a plan is proposed, on the one hand, and the cash flow that will be generated in terms of the proposed plan, on the other hand.¹⁸⁰ It is submitted that the business rescue provisions for South Africa should only address the access to post-commencement financing for the first-mentioned period, namely the time

¹⁷⁶ *Ibid.*

¹⁷⁷ *Idem* in par 221.

¹⁷⁸ *Idem* in par 240.

¹⁷⁹ *Ibid.*

¹⁸⁰ *Idem* in par 241.

leading up to the proposal and acceptance of a plan. The arrangements regarding financing after the implementation of a plan, should be left to the content of the plan itself.¹⁸¹ For this reason this article will not address post-plan financing in any detail, and will concentrate on the provision of funding during the initial period of the business rescue proceedings.

The UNCITRAL *Guide* mentions the following as possibilities regarding the provision of post-commencement finance:¹⁸²

- There may be sufficient liquid assets, in the form of cash or other assets that can be converted to cash to fund the continuation of business operations;
- Funding out of the debtor's existing cash flow through operation of the moratorium and the cessation of payments on pre-commencement liabilities;
- Financing by third parties in the form of trade credit extended to the debtor by vendors of goods and services, or loans and other forms of finance extended by lenders;
- Providing security for new loans with existing assets that have equity over and above the claims that are secured by them, or over unencumbered assets;
- Provision of finance by family members or group companies; and
- Borrowing by the business administrator in his or her own name.

It should be clear that all the above examples have their limitations.¹⁸³

Very few creditors would be keen to lend money to the debtor on an unsecured basis where the debtor is already subject to a business rescue proceeding. There may also be no unencumbered assets left in the estate, or the encumbered assets may not have sufficient equity with which to secure further credit. The problems associated with personal liability would also discourage most business administrators from incurring debt in their own name.¹⁸⁴ All these limitations have to be borne in mind when considering the thorny issue of post-commencement finance.

6.2.4.2 Sources of Post-Commencement Finance

Post-commencement finance could be provided by existing (pre-business rescue) lenders and vendors, or it could be provided by new lenders and vendors.¹⁸⁵ Although these lenders would be motivated to lend for different reasons, both would only be prepared to do so if they are to be accorded special treatment under the business rescue provisions.¹⁸⁶

¹⁸¹ Ibid.

¹⁸² Idem in pars 240-4.

¹⁸³ Ibid.

¹⁸⁴ Ibid.

¹⁸⁵ Idem in par 245.

¹⁸⁶ Ibid.

6.2.4.3 Attracting Post-Commencement Finance – Providing Security or Preference

According to the UNCITRAL *Guide* a number of different approaches can be taken in order to attract post-commencement financing.¹⁸⁷ The different options are briefly set out below.

6.2.4.3.1 Granting Security

This option can only be used where there are unencumbered assets in the estate that are capable of being used for this purpose. It is also possible to apply assets that are already encumbered and where there is sufficient equity in the property to accord further security to another creditor. The UNCITRAL *Guide* points out that very often the only assets that will be able to be applied in the provision of new security are assets that have been recovered under the provisions dealing with impeachable transactions ('avoidance proceedings').¹⁸⁸

6.2.4.3.2 Establishing a Priority (Preference)

The only other workable alternative appears to be the establishment of a priority over the existing assets of the debtor in order to secure the necessary financing.¹⁸⁹ There are different levels at which such a preference can be created in favour of the new lender. For example, the loan could be secured by providing the lender with a priority over the unencumbered assets, in which case the lender will be paid before the unsecured creditors, but not before secured creditors. It would therefore qualify as an administration expense and be paid ahead of the claims of the unsecured creditors.¹⁹⁰

Another example is where the new financing is paid as a type of 'super preference', in which case the lender will be paid in preference to all the creditors in the estate, including the secured creditors.¹⁹¹ In cases such as this the legislative provisions usually require prior court approval, as the existing rights of secured creditors will be affected.¹⁹²

Under the current judicial management provisions of the Companies Act, it is possible for the creditors, at a meeting convened for such purpose, to consent to post judicial management liabilities to be paid in preference to their own claims.¹⁹³ This allows the judicial manager to incur new debts and which can then be paid in preference to the pre-judicial management claims. Something similar needs to be designed for a new business rescue model, but the authorisation procedure needs to be

¹⁸⁷ *Idem* in pars 246-50.

¹⁸⁸ *Idem* in par 247.

¹⁸⁹ *Idem* in pars 248-50.

¹⁹⁰ *Ibid.*

¹⁹¹ *Ibid.*

¹⁹² *Ibid.*

¹⁹³ Section 435 of the Companies Act.

spelled out very clearly. The level of authorisation required by the business administrator is dealt with in par 6.2.4.4 below.

6.2.4.4 Authorisation for Post-Commencement Finance

A hierarchical approach is probably needed when it comes to the authorisation of a business administrator to obtain post-commencement funding.¹⁹⁴ For example, if unsecured assets, or secured assets with sufficient equity to provide additional security, are applied in obtaining the necessary finance, the business administrator should be allowed to do so without prior approval if the funding is required for transactions in the normal course of business. Where the post-commencement funding will be treated as an administrative preference or priority over unsecured creditors claims, some form of authorisation should be required, for example by the creditors or the court.¹⁹⁵ Where the amount is relatively small, creditor authorisation could be sufficient, while court authorisation could be required when the amount exceeds a specified threshold.¹⁹⁶ Where the funding affects the rights of existing secured creditors, court authorisation should be obtained in order to secure the funding.¹⁹⁷

6.2.5 Treatment of Contracts¹⁹⁸

The treatment of a topic as wide as this is not realistic in an article of this nature. However, there are some important aspects regarding contracts that will have a major impact on business rescue proceedings.

Generally it is submitted that the same rules regarding contracts in insolvency should apply to business rescue proceedings. This will enable the business administrator to maintain contracts that are beneficial to the continued business operations of the debtor, and to shed contracts that are not. While this is stated as a general rule, one should be cautious of the abuse that could emanate from such a practice, for example, a debtor entering a business rescue procedure in order to rid itself of onerous contracts that it no longer wishes to maintain.

One specific type of contract that will need specific consideration in a business rescue procedure, is the employment contract¹⁹⁹ between the debtor and its employees.²⁰⁰ Frequently business rescue procedures provide for the downsizing of the workforce in order to ensure the availability of additional cash flow. In addition, non-core or non-profitable segments of the debtor's business may be sold off in order to

¹⁹⁴ UNCITRAL *Guide* op cit note 6 at par 251.

¹⁹⁵ *Ibid.*

¹⁹⁶ *Ibid.*

¹⁹⁷ *Ibid.*

¹⁹⁸ See, generally, UNCITRAL *Guide* op cit note 6 in pars 254-94.

¹⁹⁹ *Idem* in par 291.

²⁰⁰ This excludes contracts of employment regarding the management of a debtor, such as directors, which are dealt with below.

ensure the debtor's survival. This may entail a loss of jobs and the resultant termination of the contracts of employment.

However, in South Africa this may not be easily possible due to the stringent labour laws that apply by virtue of the Labour Relations Act. Recent amendments to this Act and the Insolvency Act reiterate the government's commitment to saving jobs and the protection of employees where the debtor experiences financial difficulties. In light of the recent amendments to s 38 of the Insolvency Act, it is submitted that the same rules should apply to a new business rescue procedure. Put differently, a business rescue procedure should also trigger the suspension of the contracts of employment, and not bring about their termination. The advantage this holds for the employee is that his or her contract of employment is not terminated, and passes to the new employer in cases where the business is sold as a going concern.²⁰¹ To further protect the employee, it will probably be necessary to build in provisions to ensure that a business rescue plan takes cognisance of the Labour Relations Act and the resultant retention of employment contracts. If this is not done an abuse of the business rescue procedure is a distinct possibility where, for example, the plan makes provision for the retrenchment of employees or the immediate termination of such contracts of employment.

By only suspending the contracts and not terminating them, there is also a benefit for the business administrator. Although the employees are not required to perform any work, and are therefore not paid, this gives the business administrator some flexibility regarding the availability of funds that would normally be used to pay the employees' salaries. It also means that the business administrator can selectively re-employ, on an ad hoc basis, some or all of the employees that are needed to continue the business operations of the debtor. The added benefit here is that the employees already know the business and are properly trained to perform the specific functions required in order to keep the business operative.

It is further submitted that any business rescue plan that deals with the retention or retrenchment of employees, be made subject to the current provisions of the Labour Relations Act.²⁰² This may, however, necessitate the amendment of some of the provisions of the Labour Relations Act (as well as some of the provisions of the Insolvency Act) to tie in with a business rescue procedure.

6.2.6 *Impeachable Transactions*²⁰³

In many cases the receipt of funds generated as a result of having set aside impeachable transactions can ensure the continued existence of a debtor's business. For this reason it is submitted that a business

²⁰¹ In terms of s 197A of the Labour Relations Act.

²⁰² For example, retrenchments in terms of s 189 of the Labour Relations Act.

²⁰³ See further UNCITRAL *Guide* op cit note 6 in pars 295-348 where this aspect is dealt with in detail.

administrator should be able to implement provisions relating to impeachable transactions in a business rescue situation. This is currently the case under the judicial management provisions²⁰⁴ contained in the Companies Act, and should be retained under a new business rescue model.

6.2.7 Participation by the Debtor After the Commencement of a Business Rescue Proceeding²⁰⁵

Another important question that can arise in a business rescue situation, is to what extent the debtor should still be involved in the administration process once the business rescue proceeding has commenced. There are many facets to the involvement of the debtor after the commencement of a business rescue proceeding, a detailed discussion of most of which would fall outside the scope of the present article. However, there are basically two categories under which all these facets can be discussed, namely the involvement of the debtor in the continued operations of the business of the debtor, and the debtor's obligation to assist the business administrator in furnishing important information that would be needed for the implementation of a business rescue plan.

6.2.7.1 Involvement of the Debtor in the Business Operations After the Commencement of Business Rescue Proceedings

There are many jurisdictions where the existing management of a debtor is displaced by the person appointed to implement the business rescue. Even under South Africa's current judicial management provisions the management of a company is displaced by a judicial manager or provisional judicial manager once appointed.²⁰⁶

However, according to the *UNCITRAL Guide* there are a number of advantages if the existing management's involvement is continued after the commencement of the proceedings.²⁰⁷ For example, the management of the debtor will have an intimate knowledge of its business and the industry within which it operates.²⁰⁸ Such knowledge may assist the business administrator in performing his or her functions with a more immediate and complete understanding of the operation of the debtor's business activities.²⁰⁹ This knowledge may also assist in the proposal of a workable business rescue plan. By displacing the debtor in such circumstances it may lead to '[an elimination of] an incentive for entrepreneurial activity, risk-taking in general and for debtors to

²⁰⁴ Section 436 of the Companies Act.

²⁰⁵ See, generally, *UNCITRAL Guide* op cit note 6 in pars 361-93.

²⁰⁶ Section 428(2)(a) of the Companies Act.

²⁰⁷ *UNCITRAL Guide* op cit note 6 in pars 365-9.

²⁰⁸ *Ibid.*

²⁰⁹ *Ibid.*

commence reorganization procedures at an early stage'.²¹⁰ It may also undermine the likelihood of a workable business rescue plan.²¹¹

However, there are also some potential disadvantages to retaining the involvement of the management of a debtor once business rescue proceedings have commenced, for example:

- creditors may have a lack of confidence in the management of the debtor due to its financial woes; and
- allowing the management of the debtor to continue may exacerbate the breakdown of confidence and antagonise creditors further.

While there are certainly some advantages to retaining the services of the management of the debtor in some way, the commitment of the management to do so may depend on how the business rescue proceeding was commenced in the first place. For example, if the debtor itself applied for the implementation of the business rescue provisions, there will in all probability be a commitment from the management to assist in keeping the debtor out of liquidation. In such a case the management's assistance can be extremely helpful, if not indispensable. However, if the debtor has been forced into a business rescue by some other party such as the employees or a creditor, then the management may be antagonistic towards all the parties concerned. In such a case the assistance of the management would probably not be forthcoming.

It is uncertain whether in South Africa this is an aspect that should be legislated to merely include or exclude the involvement of the management of the debtor in a business rescue situation. Perhaps the solution would be to displace the management of the debtor, but to include a provision where the business administrator, after consultation with the creditors and the employees, has a choice to retain the involvement (to whatever extent) of the existing management. In this way the management can be excluded where their involvement would be to the detriment of the business rescue, and retained where it could be to its benefit. Another option would be to provide for the retention of the management on a consultative basis only, and where they would have no say in the day-to-day running of the business.

6.2.7.2 Involvement of the Debtor in Furnishing Information²¹²

It is clear that there should be an obligation on the management of the debtor to provide complete and detailed information regarding the business activities of the debtor. Without such information it is unlikely that any form of business rescue plan would be capable of implementation. For this reason suitable provisions will have to be designed in order to obtain the information from the existing management of the debtor. The actual information that is required can be set out in a form which the

²¹⁰ *Ibid.*

²¹¹ *Ibid.*

²¹² *Idem* in pars 383-6.

management of the debtor would be obliged to complete. Suitable sanctions can be built into the provisions where full and frank disclosure has not been made.

In addition, the existing provisions relating to interrogations (inquiries) as currently set out in ss 414 to 418 of the Companies, could be made applicable in order to obtain such information should it not be forthcoming. This is currently the situation under the judicial management provisions of the Companies Act.²¹³

6.2.8 The Business Administrator/'Turnaround Manager'²¹⁴

6.2.8.1 Introduction

For ease of reference the insolvency representative²¹⁵ is referred to as a 'business administrator'. By business administrator is meant the person that will displace the management of the debtor and conduct the business rescue proceedings on behalf of all the parties involved.

This aspect of a new business rescue model for South Africa will probably be the most difficult to implement. It is safe to state that South Africa does not generally have a business rescue culture, and therefore there may be very few people who have the necessary expertise to genuinely call themselves 'turnaround managers', 'company doctors', or any other name by which such specialists go.²¹⁶ To exacerbate the problem, South Africa does not have a formally regulated insolvency profession. Although it would appear that this aspect is at long last being addressed by both government and the insolvency profession, it will be of little value when deciding who should be entrusted with the task of being appointed to implement a new business rescue model.

In countries such as Australia and the United Kingdom insolvency practitioners, who appear to consist mainly of accountants, are appointed as business administrators. However, in the United States of America it is mainly lawyers that are appointed to implement the Chapter 11 cases. One is tempted to state that in the South African context only accountants should be appointed to conduct business rescue proceedings. However, this would be unfair to the many attorneys and some liquidators that are quite capable of handling a business rescue proceeding, not to mention other experts that ply their trade outside the confines of the legal and accounting professions. Perhaps the answer lies in rather laying down certain minimum criteria regarding qualifica-

²¹³ See s 439(2) of the Companies Act.

²¹⁴ For a complete discussion of this important aspect in the UNCITRAL *Guide* op cit note 6, in pars 394-433.

²¹⁵ The UNCITRAL *Guide* op cit note 6 uses the term 'insolvency representative' to denote the insolvency representative or practitioner in both liquidation and business rescue proceedings.

²¹⁶ It needs to be stated that there are in fact private organisations in South Africa that are extremely active in the 'turnaround' business. However, these companies and the specialists employed by them are not active in the insolvency or liquidation industry. They operate outside the insolvency regime and are mostly active in the sphere of informal creditor workouts.

tions and/or appropriate experience when making such appointments, than looking at one specific sector, professional or otherwise.

Currently there is an initiative by the Department of Justice and Constitutional Development to create a separate panel of 'turnaround experts'. The task team that was requested to submit a report in this regard, recommended that an association of some sort should be established that could develop the criteria for appointments to this panel. Unfortunately it would appear that the criteria will be coupled to the practical experience of individuals within their own chosen profession, for example, an attorney who has practiced for his or her own account for at least five years. With respect, such an approach can never be beneficial for a new turnaround or business rescue industry in South Africa. The fact that an attorney, for example, has practiced for his or her own account for a period of five years does not qualify them as a business rescue expert. It is submitted that the criteria should rather be based on experience, qualifications and expertise within the sphere of *business*.²¹⁷

It has also been suggested in some quarters that the persons that qualify for appointment as business rescue administrators should not also be allowed to be appointed as liquidators in insolvent estates. While it makes sense not to allow the same person from being appointed as both business administrator and liquidator in the same estate, it is difficult to justify the exclusion of liquidators, for example, from being allowed to act also as business administrators. These potentially problematic aspects need to be approached with sensitivity and care, and it is suggested that proper research be conducted into the suitability of all persons that are to enter the business rescue profession.

6.2.8.2 What Qualities Are Required of a Business Administrator?

The *UNCITRAL Guide* is quite helpful in pointing out the necessity of appointing suitably qualified persons to conduct the work of a business administrator. In par 394 of the *UNCITRAL Guide*, it is stated that 'it is essential that the insolvency representative be appropriately qualified and possess the knowledge, experience and personal qualities that will ensure not only the effective and efficient conduct of the proceedings, but also that there is confidence in the insolvency system'.²¹⁸ In par 396 of the *UNCITRAL Guide* the following important statement is also made:

'396. In determining the qualifications required for appointment as an insolvency representative, it is desirable that a balance be achieved between stringent requirements that lead to the appointment of a highly qualified person but which may significantly

²¹⁷ See par 6.2.8.2 below where this aspect is discussed at length.

²¹⁸ *UNCITRAL Guide* op cit note 6 in par 394. If current media coverage of the insolvency profession is anything to go by, it is clear that the current insolvency system does not inspire confidence. For this reason the system in terms of which business rescue proceedings will be conducted needs to be thoroughly planned and implemented.

restrict the pool of professionals considered to be appropriately qualified and add to the costs of the proceedings, and requirements that are too low to guarantee the quality of the service required. Where there is a lack of appropriately qualified professionals, the role given to the court in appointment and supervision of the insolvency representative may be an important factor in achieving the required balance.'

The aspects which are discussed in pars 6.2.8.2.1 to 6.2.8.2.8 regarding the appointment of business administrators, and which are relevant in the South African context, have been gleaned from the *UNCITRAL Guide*.²¹⁹

6.2.8.2.1 Knowledge and Experience²²⁰

According to the *UNCITRAL Guide* '[t]he complexity of many insolvency proceedings makes it highly desirable that the insolvency representative be appropriately qualified with knowledge of the law (not only insolvency law, but also the relevant commercial, finance and business law), as well as adequate experience in commercial and financial matters, including accounting'.²²¹

It seems appropriate that business administrators should possess the requisite skills in order to carry out their functions in a business rescue environment. However, it must also be borne in mind that persons who do not, for example, have the requisite legal skills may employ an attorney to assist them in the carrying out of their duties. Similarly, an attorney without the requisite commercial or accounting skills could employ an accountant to assist in the performance of his or her functions.

However, as a point of departure it seems clear that prospective business administrators should at least meet some or other minimum criteria regarding professional qualifications. In addition to these minimum qualifications (see par 6.2.8.2.2 below) a prospective business administrator should demonstrate that he or she possesses sufficient practical experience in order to be appointed to such a responsible position.

6.2.8.2.2 Appropriate Qualifications²²²

By qualifications are meant not only professional qualifications and examinations, but also the requirements set by licensing authorities, specialised training courses and certification examinations, requirements for certain levels of experience in relevant areas (for example finance, commerce, accounting and law), and continuing professional education to ensure awareness of current developments in the applicable areas of law and practice.²²³

A combination of all the above is to be preferred, and should be set as a prerequisite before entry to this profession is allowed. It has already been

²¹⁹ *Idem* in pars 398-406.

²²⁰ *Idem* in par 398.

²²¹ *Ibid.*

²²² *Idem* in par 399.

²²³ *Ibid.*

stated that a professional organisation catering for business rescue should be established as soon as possible, and be given statutory recognition. The statutory recognition of such persons could be included in the provisions for a new business rescue model that will eventually be developed and implemented.

6.2.8.2.3 Personal Qualities²²⁴

The UNCITRAL *Guide* refers to personal qualities such as integrity, impartiality, and good management skills.²²⁵ Since these are qualities that are already required under South Africa's current insolvency laws, they will not be expanded on in this article.

6.2.8.2.4 Conflicts of Interest²²⁶

This is a well-known requirement under current South African law, and is contained in the affidavit of non-interest that has to be lodged by all incumbent trustees and liquidators. Consequently this requirement will not be discussed here.

6.2.8.2.5 Selection and Appointment²²⁷

It is submitted that in the South African context the selection and appointment of business administrators should be dealt with separately. It is fair to state that there have been numerous problems with the current appointment criteria (regarding trustees and liquidators) applied by the Master of the High Court. The situation has become so contaminated that the whole appointment process currently lacks credibility.

As far as selection procedures are concerned, it is submitted that an independent professional association should be established that can introduce procedures for the selection of persons that can act as business administrators. The selection criteria must be spelt out clearly, and the procedures for the selection of candidates must be as transparent as possible. It is submitted that the actual appointment procedure (of persons that qualify and have been selected to fill the post of business administrator) should be a creditor²²⁸ or court-driven²²⁹ process, and that the Master should have no say as to who is appointed (although the Master will have to issue the letters of appointment as such). Whether a court- or creditor-driven process will be applied will ultimately depend on the manner in which a business rescue proceeding will be commenced under a new South African model.

²²⁴ *Idem* in par 400.

²²⁵ *Ibid.*

²²⁶ *Idem* in pars 401-2.

²²⁷ *Idem* in pars 403-6.

²²⁸ *Idem* in par 406.

²²⁹ *Idem* in par 404.

6.2.8.2.6 Remuneration²³⁰

The remuneration payable to trustees and liquidators under current South African insolvency law has been a bone of contention for decades, especially in very large estates where there are assets worth many millions of rands. The reason for this is that the current system of remuneration is calculated as a percentage of the sale price of estate assets (a commission-based system) according to a predetermined tariff guide.

In the *UNCITRAL Guide* it is stated that the 'remuneration should be commensurate with the qualifications of the insolvency representative and the tasks it is required to perform, and achieve a balance between risk and reward in order to attract appropriately qualified professionals'.²³¹ Internationally several methods are employed for calculating the remuneration, some of which are discussed in this paper under this heading. As far as the 'risk and reward' approach is concerned, it is submitted that there should be some sort of incentive for the business administrator to bring about a successful business rescue plan. In other words, it makes sense to adopt a method whereby the business administrator will be rewarded in cases where the business rescue is successful, either because a business rescue plan has been implemented, or because the business of the debtor has been sold as a going concern, thereby ensuring the debtor's continued participation in the country's economy and the retention of jobs for the employees.

Some of the international methods of calculating a business administrator's remuneration include²³² time-based systems, commission-based systems and involvement of creditors.

South Africa currently employs a commission-based system of remuneration (although the judicial management provisions allow for a time-based system that is taxed by the Master) where the trustee or liquidator becomes entitled to a fixed percentage of the proceeds of the various types of assets in that particular estate. The disadvantage of this system is the payment of very high fees in estates with large and valuable assets, while the work performed may not be commensurate with the remuneration. Conversely, in small estates the fees may also not be commensurate with the work performed. The advantage of this system, however, is that all the creditors will pay a proportionate portion of the remuneration, and unsecured creditors will not necessarily be burdened with the payment of the fees. The Master taxes the fee of trustees and liquidators, and can act as an important counter-balance where excessive fees are claimed in an estate.

Many people believe that a time-based system of remuneration is the better option. The advantage of this system is that the fee will normally be commensurate with the amount of work done, no matter how large the

²³⁰ *Idem* in pars 412-8.

²³¹ *Idem* in par 412.

²³² *Idem* in pars 413-5.

value of the debtor's estate. According to the *UNCITRAL Guide* one disadvantage of a time-based system of remuneration 'is that although it may encourage a very thorough administration, [it] may also operate in some cases as an incentive to maximise the time spent on administration without necessarily achieving a proportional return of value to the estate'.²³³

Whatever option is employed in the South African context, it is clear that there should be some mechanism whereby the business administrator's remuneration can be taxed. Since the Master currently performs this function in insolvent estates, it is perhaps appropriate that the Master also tax the fee of business administrators with the input and approval of the estate creditors.

6.2.8.2.7 Personal Liability²³⁴

It seems unnecessary to debate whether or not a business administrator should be required to provide security for the proper performance of his or her functions. The only question that needs to be posed is what form the security should take. Currently trustees and liquidators have to provide the Master with a bond of security for the full value of the estate assets in order to ensure the proper performance of their duties. This system appears to work quite well in practice, and should probably be continued under a business rescue model. It goes without saying that the cost involved in providing security will be paid as an administration expense from the assets of the debtor.

One additional question that may be raised in the business rescue context, is the extent to which a business administrator should be held personally liable, especially in cases where the business administrator continues with the business of the debtor that has become subject to the provisions of a business rescue procedure.

6.2.8.2.8 Duties and Functions of a Business Administrator²³⁵

A list of some twenty duties and functions are listed by the *UNCITRAL Guide* as the type of duties and functions that must be performed by the business administrator.²³⁶ These duties and functions are of a general nature and deal mainly with the taking charge of the estate, representing the debtor, continuing with the business of the debtor and conducting other tasks that are related to the proper functioning of the estate, providing information to all participants, etcetera. While it is not intended to discuss all these duties and functions here, it goes without saying that these duties will form part and parcel of any new business rescue model that is introduced in South Africa.

²³³ *Idem* in par 413.

²³⁴ *Idem* in pars 419-24.

²³⁵ *Idem* in pars 408-10.

²³⁶ *Idem* in par 408.

6.2.8.3 Conclusion

If a new business rescue model is successfully implemented in South Africa, it will bring about a whole new profession of business administration. For this reason it is important that all the issues enumerated above be given considerable thought before such a system is implemented. If a new business rescue model is to have even a modicum of credibility, it is essential that the persons appointed are professional, accountable and effective.

6.2.9 Creditors' Participation in the Business Rescue Procedure²³⁷

6.2.9.1 Introduction

There are various levels of creditor participation in business rescue proceedings internationally.²³⁸ The level of participation by creditors in the proceedings depend mainly on the design of the overall insolvency laws of a particular country.²³⁹ Generally speaking, the involvement of creditors in the process is justified by the fact that they are the main stakeholders should the business rescue succeed or fail.²⁴⁰ Creditors can also act as a safeguard against abuse by the business administrator, especially if the business administrator is required to consult creditors on a regular basis and before major decisions in regard to the affairs of the debtor are taken.

There are too many detailed aspects to creditor participation to include in this article. However, it is necessary to at least discuss the approach that can be adopted to ensure maximum creditor involvement in a new business rescue model. It is generally accepted that in South Africa creditors tend to be apathetic in their participation in insolvency proceedings. The argument by creditors is probably that there is not much to be gained by attending creditor meetings, as the trustee or liquidator will in any event have to sell the assets and distribute the proceeds in terms of the provisions of the insolvency laws. However, in a business rescue environment the creditors stand to gain (and lose) a lot more, and it is submitted that it is therefore necessary to ensure more effective creditor participation under a new business rescue procedure.

6.2.9.2 The Role of Secured Creditors²⁴¹

At this stage already it needs to be determined what the role of secured creditors will be in a business rescue procedure. Apart from the secured creditor's interest in its security, and any act by the business administrator that will affect such security, secured creditors will

²³⁷ See generally UNCITRAL *Guide* op cit note in pars 434-75.

²³⁸ Idem in pars 436-7.

²³⁹ Ibid.

²⁴⁰ Idem in par 434.

²⁴¹ Idem in par 444.

normally not have an interest in the administration of the estate generally where the security is sufficient to cover the claim of such creditor.²⁴² However, to the extent that a secured creditor's claim is not covered by its security it does have an interest in the general administration of the estate and the eventual outcome of the business rescue procedure. For this reason it is suggested that a secured creditor's participation in the business rescue proceedings should generally be limited to the extent to which they are unsecured.

There are existing provisions in current insolvency legislation that recognise this limitation on secured creditors' participation,²⁴³ and it is submitted that these provisions should be extended to business rescue proceedings.

6.2.9.3 Functions to be Performed by Creditors²⁴⁴

Due to the fact that South Africa has a pro-creditor insolvency system, creditors will to a large extent determine how and by whom the insolvency process will be conducted. For example, the creditors elect a trustee or liquidator, they can give the trustee or liquidator instructions at meetings of creditors and they can vote in favour of the acceptance of a composition or compromise.

This approach should in all probability be carried over to a business rescue model, since it is ultimately the creditors who stand to lose should the rescue attempt fail. Working from this premise it may be accepted that the creditors will also exercise a large degree of control over the business rescue procedure. However, creditors will not have a say in all aspects of the administration of a business rescue, and for this reason the matters on which creditors will have a say will need to be clearly spelled out. For example, while creditors will have a say in regard to the content of the business rescue plan, they will not necessarily have a say over the day-to-day running of the business of the debtor by the business administrator.

The manner in which creditors usually participate in proceedings is to allow them to vote on the issues that need deciding. There are many aspects to voting at meetings, especially regarding the matters on which voting is required (for example, on whether new debt can be incurred, or voting for the acceptance of a business rescue plan). These aspects need to be clearly set out in the business rescue provisions.

6.2.9.4 Mechanisms to Facilitate Participation by Creditors²⁴⁵

There are various mechanisms used internationally in order to facilitate

²⁴² *Ibid.*

²⁴³ See, eg, s 52(5) of the Insolvency Act.

²⁴⁴ *Idem* in pars 445-50.

²⁴⁵ *Idem* in pars 439-41.

participation by creditors in the business rescue procedure. The two main methods appear to be meetings of creditors and creditor committees.²⁴⁶

6.2.9.4.1 Creditor Meetings²⁴⁷

Creditor meetings are well known in South Africa, since they are currently used in insolvency proceedings. Meetings are convened at key moments during the administration process, which ensures maximum creditor participation at a time when decisions need to be taken. A similar approach will probably need to be taken in a business rescue context, although the timing of these meetings will largely differ from the timing in the case of insolvency proceedings. The main object of the meetings will be to obtain instructions from the creditors in regard to decisions that need to be taken regarding the business rescue of the debtor.

One question that arises is what type of majority (of votes) will be needed at a business rescue meeting of creditors in order to implement a decision. For example, when a business rescue plan is submitted to a meeting of creditors, will the majority be a simple majority in number and value, or will the plan require a larger majority (say 75 percent) of the votes before it can be implemented? The various possibilities here need to be properly explored, as too large a majority may hamper the introduction of a successful business rescue plan. However, considering that all creditors will be bound by the business rescue plan, a marginal majority may not be an acceptable result either.

It is also preferable that the business rescue provisions clearly spell out the matters on which creditors must vote.²⁴⁸ Similarly, the voting requirements regarding each type of decision will need to be included in such provisions.²⁴⁹ It is submitted that only actions by the business administrator that will have a significant impact on the general body of creditors, will need to be voted on. Examples of these would include voting for the appointment of a business administrator, approval of a business rescue plan, approval of post-commencement finance and the sale of a substantial portion of the debtor's assets.²⁵⁰

When deciding how the insolvency meetings are to be convened and where they are to be held, reference will need to be made to the proposed manner in which creditor meetings will be held in terms of the proposed new Insolvency and Business Recovery Bill. This will promote uniformity and certainty regarding all procedures in terms of the new Bill.

²⁴⁶ It is to be noted that some insolvency jurisdictions use a combination of the two.

²⁴⁷ *Idem* in pars 451-4.

²⁴⁸ *Idem* in pars 471-4.

²⁴⁹ *Ibid.*

²⁵⁰ *Ibid.*

6.2.9.4.2 Creditor Committees²⁵¹

There are a number of jurisdictions that make use of creditor committees to ensure creditor participation in the business rescue proceeding. There are definite advantages to the use of creditor committees in very large estates where there are large numbers of creditors. The appointment of a creditor committee to represent all creditors then streamlines the process and leads to a more efficient administration process. However, creditor committees can also be costly affairs as the representatives on the creditor committee may need to be remunerated for the duties they perform.

While there can be no general opposition to the use of creditor committees in practice, careful thought needs to go into whether or not they should be introduced under a South African business rescue model. Aspects such as representation, liability and the expense involved in forming and running such committees need to be carefully considered when deciding whether or not to implement such a system.²⁵²

6.2.10 The Business Rescue 'Plan'

6.2.10.1 Introduction

The design, acceptance and implementation of a business rescue plan is surely one of the most important aspects of a modern business rescue model. One of the drawbacks of judicial management is that the judicial manager is required to trade the ailing business out of trouble until all its creditors have been paid, and the business is once again a viable, solvent entity. By introducing the proposal, acceptance and implementation of a business rescue plan, the reorganisation of a debtor can be brought to finality a lot sooner, with the added advantage that it creates certainty for all the parties involved as to what the outcome of the business rescue will be once a plan has been accepted and implemented.

As regards the nature and form of a business rescue plan, the *UNCITRAL Guide* states the following as a point of departure:²⁵³

'483. The purpose of reorganization is to maximize the possible eventual return to creditors, providing a better result than if the debtor were to be liquidated and to preserve viable businesses as a means of preserving jobs for employees and trade for suppliers. With different constituents involved in the reorganization process, each may have different views of how the various objectives can best be achieved. Some creditors, such as major customers or suppliers, may prefer continued business with the debtor to rapid repayment of their debt. Some creditors may prefer an equity stake in the business, while others will not. Typically, therefore, there is a range of options from which to select in a given case and if an insolvency law adopts a prescriptive approach to the range of options available or to the choice to be made in a particular case, it is likely to be too constrictive

²⁵¹ *Idem* in pars 455-70.

²⁵² *Idem* in pars 455-70 for a detailed exposition on the advantages and disadvantages of this mechanism for creditor participation.

²⁵³ *Idem* in par 483.

... A non-intrusive approach that does not adopt ... limitations is likely to provide the flexibility sufficient to allow the most suitable of a range of possibilities to be chosen for a particular debtor.'

While it is submitted that the business rescue provisions should regulate as many of the aspects of a business rescue plan as possible, it will also be necessary that these be limited to procedural issues such as who may propose a plan, the voting on a plan, the implementation of a plan and how the plan will be given effect to. However, the *content of a plan* should be left as open-ended as possible to allow for just about anything to be achieved that is not in conflict with any of the other laws of the Republic.

There are a wide range of issues that can be discussed when it comes to a business rescue plan, all of which cannot be properly debated in the parameters of this article. There are, however, a number of core issues relating to the plan that need to be highlighted. These core issues are:

- the proposal of the business rescue plan;
- the plan itself;
- approval of the plan;
- steps to be taken where a proposed plan cannot be approved;
- binding dissenting classes of creditors ('cram-down' provisions);
- confirmation of the plan (if set as a requirement);
- effect of an approved plan;
- legal challenges to the plan;
- amendment of the plan after approval;
- implementation of the plan;
- where implementation of the plan fails; and
- conversion to liquidation.

The most important issues arising from these core elements of the plan are briefly discussed below. Finally, it should be mentioned that the instrument in terms of which a proposed business rescue plan will be implemented will also be of importance. For example, under the Australian system of voluntary administration the plan is implemented by means of a Deed of Company Arrangement. It is a document that embodies the business rescue plan and, once executed, regulates the rights and obligations of all the parties regarding that specific debtor. Once the Deed of Company Arrangement has been executed, the administration comes to an end and the company is henceforth regulated by such Deed. The form in which a business rescue plan in South Africa will be implemented, also needs to be given serious consideration.

6.2.10.2 The Proposal of the Business Rescue Plan²⁵⁴

There are two important issues that are relevant here, namely the timing of the business rescue plan (in other words at what stage of the proceedings a plan should be proposed), and the parties who are capable of proposing a plan.

6.2.10.2.1 Timing of the Business Rescue Plan

Some jurisdictions provide for a plan to be proposed at the time the application for business rescue is proposed, while others provide for the plan to be proposed only after the commencement of the business rescue proceeding. The submission of a plan at the time the application is made, or at the time the business rescue proceeding commences, may not be a realistic option if creditor and/or employee input on the plan is required. The post-commencement negotiation and proposal of a plan would probably be a more flexible approach where the input of all the parties affected can be obtained. It is submitted that such an approach would be less prescriptive, and for this reason it is to be preferred. However, checks and balances will have to be built into the system to avoid an abuse of proceedings where, for example, a debtor has merely commenced a business rescue procedure in order to obtain the automatic stay (with no intention of proposing a workable business rescue plan).

An additional aspect that needs consideration is the imposition of time limits for the proposal of a plan. According to the *UNCITRAL Guide* the imposition of time limits vary from 35 days to 120 days in the various jurisdictions. In this regard it is submitted that a flexible approach should be adopted in terms of which the plan can be proposed within as short a time as possible, but where the time can be extended in appropriate cases.

6.2.10.2.2 Parties Permitted to Propose a Plan

When it comes to the proposal of a business rescue plan, there are various approaches that could be adopted. For example the debtor, creditors, employees or the business administrator could all be authorised to propose a plan. Such an open-ended approach may however delay the process as each party tries to secure the implementation of their own proposals. It is submitted that an option where the business administrator proposes a plan, after consultation with all the stakeholders, would be a workable solution within the South African context.

6.2.10.3 The Business Rescue Plan²⁵⁵

There are basically two aspects that need to be discussed under this heading, namely the content of the plan and the information that should accompany the proposal of a plan.

²⁵⁴ Idem in pars 486-96.

²⁵⁵ Idem in pars 497-505.

6.2.10.3.1 Content of the Business Rescue Plan

It would be extremely difficult to draft legislative provisions that can cater for all eventualities under a business rescue plan. It is also submitted that such an approach would be too prescriptive, not allowing enough flexibility for a business administrator to propose a workable plan given the circumstances in that particular estate. In accordance with the suggestions made in the *UNCITRAL Guide*,²⁵⁶ it may be more acceptable to identify the minimum content of a plan which focuses on its key objectives and the procedures for its implementation. It should also clearly set out the impact it will have on the various parties which are subject to the plan.

6.2.10.3.2 Information that Must Accompany a Proposed Plan

In order to assist interested parties in making an informed decision as to the acceptability of a proposed plan, as much information as possible should be provided to them prior to the point at which they will be required to vote on the proposal. In this regard it is submitted that the legislative provisions should at least determine the minimum amount of information that must be provided, and that information must accompany the plan when it is submitted to the stakeholders for their consideration. Minimum information such as the following could be considered:

- full information regarding the financial position of the debtor (including asset and liability and cash flow statements);
- a comparison between what will be received by creditors under the plan and what could be expected to be received by them under liquidation;
- the basis upon which the debtor will be able to continue trading and subsequently be reorganised;
- the voting mechanisms that apply in approving the plan; and
- information showing that the plan is capable of implementation and that the debtor is able to meet its commitments under the plan.

It is suggested that this information should be set out in regulations that can be updated and/or amended regularly and swiftly, as and when the need arises.

6.2.10.4 Approval of the Business Rescue Plan²⁵⁷

6.2.10.4.1 Introduction

The issues surrounding the approval of a business rescue plan, especially one that will bind dissenting creditors, are complex and multi-faceted. The competing interests of the various stakeholders may

²⁵⁶ *Idem* in par 500.

²⁵⁷ *Idem* in pars 506-29.

necessitate a division of the various types of creditors into classes, for example, secured creditors, preferential creditors, unsecured creditors, the employees, shareholders and the like. It should be borne in mind that, as a general principle, creditors should only be bound by a plan if they have been given an opportunity to vote on the plan.²⁵⁸

The main purpose of dividing the claims into various categories, is to ensure that all creditors have been treated in a fair and equitable manner. The UNCITRAL *Guide* points out that this method also ensures that (statutory) preferential claims are treated in accordance with the preferences established under the insolvency laws.²⁵⁹ The downside to this method (of classifying claims) is that it can increase the complexity and costs of the business rescue proceeding, depending on how many categories are established.²⁶⁰

6.2.10.4.2 Procedures for Approval

It seems fair to state that before creditors can be expected to vote on a plan, they must be given sufficient time to study the content of the plan prior to a meeting (or meetings) being called to vote on the acceptance thereof. It is clear that a special meeting or meetings will have to be convened for voting on the plan to take place.

As far as the voting itself is concerned, provision will probably have to be made for creditors to vote in person, by proxy or electronically (for example, by e mail). Other issues that may arise when it comes to voting on the plan are:

- whether creditors will vote generally or in classes;
- the types of claims that will be recognised for the purposes of voting (for example only on the basis of admitted claims, or also on the basis of claims that have been provisionally admitted);
- whether secured creditors will be required to vote;
- whether (statutory) preferential claims will be considered in determining whether a majority has been obtained;
- which interested parties (other than creditors) will be allowed to vote on a plan (for example, employees, who will not necessarily be creditors of the debtor); and
- how creditors that abstain from voting, or those who do not participate in the process at all, will be treated (in other words, are they regarded as having voted against the plan, or are they left out of the voting equation?).

6.2.10.4.3 Requirements for Approval of the Proposed Plan

The majority required for the approval of a proposed plan will depend on whether creditors vote generally or within their various classes. For

²⁵⁸ *Idem* in par 506.

²⁵⁹ *Ibid.*

²⁶⁰ *Ibid.*

example, if there are three classes of creditors voting for the acceptance of a plan, the majority will then need to be determined within each class. It then has to be determined what type of majority is required from the three classes before the plan can be accepted.

The alternative is to provide that creditors vote generally, and the requisite majority in number of value carries the day. Most systems appear to work on a system of at least two-thirds or three-quarters in value, and at least half or two-thirds in number.

The current rules contained in South Africa's insolvency laws regarding voting may prove to be helpful when designing these new rules for the acceptance of a business rescue plan, for example, where secured creditors are only allowed to vote on the unsecured portion of their claims.

6.2.10.5 Steps to be Taken When the Plan Cannot be Approved²⁶¹

The provisions regarding the acceptance or not of a plan should be sufficiently flexible to allow for the terms of the plan to be modified during the voting process. In this way the meeting convened for the purposes of voting can be adjourned to enable further negotiation on the content of the plan. However, considering the abuse that can take place if unlimited adjournments are allowed, there should probably be a limitation on the number of times an adjournment can be allowed for modification of the plan.

Where the plan is not acceptable to the requisite majority of creditors, and no acceptable resolution by modification of the plan can be achieved, there should at least be some mechanism that can bring this process to a close. The two options in this regard appear to be a conversion from business rescue to liquidation, or a mere termination of the business rescue proceedings which places the debtor where it was prior to the business rescue proceedings having commenced. It is submitted that the mere threat of liquidation in the case of the non-acceptance of a business rescue plan may operate to encourage debtors to come up with one that is acceptable to all the parties.

6.2.10.6 Binding Dissenting Creditors ('Cram-Down')²⁶²

In order to ensure that a business rescue proposal is successfully implemented, it will probably be necessary to provide a mechanism whereby minority dissenting creditors can be bound by the business rescue plan. This is known in business rescue parlance as a 'cram-down' provision. This aspect will, of course, be affected by the majority that will be required in order to accept the proposed plan in the first place. From this it follows that safety features will have to be built into the provisions

²⁶¹ *Idem* in pars 530-1.

²⁶² *Idem* in par 532.

to allow dissenting creditors to protect their interests, and to ensure that their rights are not unfairly affected. How (and in what circumstances) a cram-down should be provided for, will be one of the more problematic aspects to consider when designing a new business rescue model.

6.2.10.7 Confirmation of the Plan²⁶³

One question that does arise is whether the plan that has been accepted in the requisite manner by creditors, needs to be confirmed by another authority (for example, the court) before it can be implemented. Such a procedure may prove to be costly and time consuming, and it is suggested that this should be avoided if at all possible. It is submitted that if the plan is contained in some form of deed of arrangement and has been properly executed by the debtor and the business administrator, it should be unnecessary to obtain alternative or additional confirmation of the plan.

In addition, a provision probably needs to be built in to the procedure to prevent any of the parties to the business rescue plan from bringing an application to liquidate the debtor as long as the terms of the plan are being adhered to. Also, provision will have to be made for procedures where the plan is not adhered to by either the business administrator or the debtor. One option would be to include provisions that allow for the plan to be modified after acceptance if it is found to be flawed as regards its practical implementation.

6.2.10.8 Implementation of the Plan²⁶⁴

A question that arises when dealing with the implementation of the business rescue plan, is whether this should be done by the business administrator that designed and proposed the plan, or whether it should be implemented by some other independent person? This will of course depend on whether the business rescue procedure comes to an end at the time the plan is accepted and executed, or whether the procedure only comes to an end once the business rescue plan has been fully implemented. If the business rescue procedure comes to an end once the plan has been accepted and set in motion, it may be a good idea that someone other than the business administrator oversees the process of implementation. In such a case the creditors could nominate someone to implement the plan, and provision for this could be made in the plan itself.

6.2.10.9 Other Issues of Importance

Although not discussed in any detail in this article, the following important questions will also have to receive the necessary attention when drafting the provisions relating to the business rescue plan:

²⁶³ Idem in par 533-9.

²⁶⁴ Idem in par 545.

- Will the plan have to be accepted by equity holders as well?
- How will challenges to the approval of a plan be dealt with?
- What happens when the implementation of a plan fails? and
- How should a conversion (if any) to liquidation be dealt with?

6.2.11 Treatment of Creditor Claims²⁶⁵

The treatment of creditor claims relates to two important aspects of a business rescue model, namely the voting by creditors on the acceptance of a plan and the distribution that will ultimately be made to the creditors. In this regard the following questions come to mind:

- What procedures will be followed for the submission, verification and admission or rejection of claims?
- Are all creditors allowed to submit claims, including those that have contingent and unliquidated claims?
- Will there be any claims that cannot be submitted in any circumstances (for example personal injury claims and foreign tax claims)?
- At what stage of the proceedings should claims be lodged?
- What happens when creditors fail to submit claims? and
- What procedures should be followed when claims are disputed?

These are but some of the issues that may arise when dealing with the admission of creditors' claims. As a point of departure it is suggested that the current insolvency procedures should, as far as is practically possible, at least apply to the submission, admission and rejection of claims, although the inclusion of creditors with contingent claims and unliquidated claims may need to be dealt with another way in a business rescue scenario.

6.2.12 Statutory Preferences (Priorities) and Distribution Rules²⁶⁶

Although statutory preferences and distribution rules relate more to liquidation than business rescue proceedings,²⁶⁷ one aspect of this topic that does deserve a mention here is the possible subordination of claims. It may become necessary to provide for the subordination of claims in the business rescue context, especially when the business administrator needs to obtain finance in order to continue running the business after the business rescue proceeding has commenced. In such a case it may be necessary to make provision for the subordination of claims in order to make sufficient funds available with which to pay the new lender. This is not a new concept in the South African context, as s 435 of the Companies Act makes provision for the subordination of claims for the purposes of judicial management.

²⁶⁵ Idem in pars 566-612 for a detailed discussion of this aspect.

²⁶⁶ Idem in pars 613-42.

²⁶⁷ It is accepted that the priority and ranking of claims in a business rescue context will be dealt with as part of the proposed business rescue plan.

6.2.13 Discharge of Debts and Claims²⁶⁸

In order to ensure that a debtor which has been subject to a business rescue regime has the best possible chance of succeeding, provision can be made for a formal discharge of claims and debts that existed prior to the time the business rescue procedure was commenced. The principle of a discharge may be of particular importance in ensuring that the provisions of the plan will be complied with by creditors who rejected the plan, or by those who did not participate in the process. A discharge therefore establishes 'unequivocally that the plan fully addresses the legal rights of creditors'.²⁶⁹

The only remaining issue here is at what stage the discharge will take effect. This could either be at the time the plan is approved (whether it be by the court or the creditors, or both) or at the time the plan has been fully implemented.

6.2.14 Conclusion of Proceedings

Although this topic was briefly referred to above, the question does arise as to when the business rescue proceeding comes to a conclusion. Some jurisdictions provide that the business rescue proceedings come to a close as soon as the plan has been approved (and confirmed, where necessary), while others provide that the proceedings only terminate where the liabilities have been discharged in accordance with the plan and the plan has otherwise been implemented in full.

7 Conclusion

In this article an attempt has been made at illustrating the many facets that need to be considered when developing a modern and effective business rescue model for South Africa. Assuming that a new business rescue model will eventually be introduced, it is clear that a lot of work and consultation will be needed before such a model can be implemented. There are many stakeholders in the insolvency industry, including creditors, employees, equity holders, directors of companies, members of close corporations, credit and consumer protection organisations, the insolvency profession, business administrators, the Masters of the High Court, the bench, the bar, the side-bar and various government departments. For this reason it is imperative that the development of a new business rescue model be undertaken with the requisite skill, care and consultation.

South Africa's insolvency laws largely comply with the international benchmarks laid down by the World Bank and the United Nations Commission on International Trade Law (UNCITRAL), with the

²⁶⁸ Idem in pars 665-6.

²⁶⁹ Idem in par 665.

notable exception of a modern and effective business rescue regime. By developing a modern and effective business rescue regime, it is submitted that South Africa will be removing another barrier to the attraction of foreign investment. In addition to this, the socio-economic reality in South Africa dictates that businesses should be saved where possible, not only for the benefit of the economy, but also for the benefit of the employees who stand to lose their livelihood as a result of the liquidation of the debtors that employ them.

One can but hope that the government departments that are responsible for the development and implementation of a new business rescue model will take the necessary steps to bring about this important change to South Africa's insolvency laws, something that should happen sooner rather than later.
