Pre-insolvency procedures: a United Kingdom and South African Perspective

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Introduction

In light of the longstanding economic crisis the need for corporate rescue culture has been evolving in Europe and across the rest of the world. Great emphasis has been placed on rescue at an early stage and it appears that more and more rescue is attempted at a pre-insolvency stage, so as to enhance the likelihood of a successful reorganisation.[1] The aim of this paper is to consider the pre-insolvency procedures available in the United Kingdom and South Africa. In particular the paper provides an overview of the CVA procedure and the Schemes of Arrangement in the United Kingdom as well as the Business Rescue and the Compromise procedures in South Africa. In conclusion, the paper aims to provide an overview of the approach taken in both jurisdictions towards less formal restructurings by 'key players' in insolvency, such as insolvency practitioners and secured creditors as well as the courts.

The advantages of early-stage intervention

Although various formal and informal steps may be taken in order to give effect to a successful rescue, it is submitted that a traumatised company will often benefit from intervention before it gets to the stage of actual insolvency. In fact, it has been noted that most rescues are achieved through informal or less formal rescue, that is, rescue without recourse to the formal insolvency proceedings.[2] Less formal, pre-insolvency rescue

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[1] See S Frisby, "Report to the Insolvency Service: Insolvency Outcomes" (Insolvency Service, London June 2006).

[2] Ibid.

mechanisms have a variety of advantages for the ailing company. From a director's and also a shareholder's perspective, engaging in less formal rescue is preferable as it prevents any adverse publicity in relation to the company's financial troubles and hence protects its goodwill and reputation.[3] It could be argued that, by pursuing less formal rescue, the company can effectively avoid the stigma which is attached to corporate failure and that the realisable value of its assets can be protected.[4] Moreover, one could argue that less formal rescue is not as costly as formal insolvency proceedings, since the involvement of the court is very limited. In addition, since there is little court involvement in pre-insolvency rescue, one could argue that the process is more flexible.

Furthermore, as opposed to completely informal reorganisation,[5] a semi-formal reorganisation under the Company Voluntary Arrangement in the United Kingdom could prove more effective, as far as consent is concerned, since an approval in excess of 75% in value would suffice. Arguably the fact that there is no need to obtain the consent of all the creditors under a CVA avoids the flaws and challenges of informal rescue[6], as obtaining consent from dissenting creditors could prove to be a time-consuming and expensive course of action.[7] In the South African context it also worth noting that regardless of who initiates

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[3] V Finch, Corporate Insolvency Law: Perspectives and Principles, (2nd ed. Cambridge, 2009) at p. 278.

[4] Ibid, at p.p251-252.

[5] Where a reorganisation process is of a contractual nature, hence there is great reliance on a consensus being achieved with the creditors.

[6] J Payne, "Debt restructuring in English law: lessons from the United States and the need for reform" (2014) 130 LQR 282-305, at p. 287

[7] It could be said that a formal procedure, such as the Company Voluntary Arrangement in the United Kingdom, could prove more effective, as far as consent is concerned, since an approval in excess of 75% in value would

the rescue proceedings, the business rescue will only continue if the creditors accepts the business rescue plan. Of course there is no need for a unanimous vote of acceptance and the Companies Act 71 of 2008 therefore provides that the plan will be accepted if it was supported by the holders of more than 75% of the creditors' voting interest,[8] and the votes in support of the plan included at least 50% of the independent creditors' voting interest that were voted.[9] The South African business rescue proceedings thus also bind a dissenting minority.

It could be argued that early intervention is a key for successful corporate rescue. Accordingly, the insolvency law regimes of both the United Kingdom and South Africa make provision for early intervention proceedings. These proceedings are being increasingly used before the technical moment of insolvency and are "colonizing" the area formerly occupied by formal insolvency procedures. For instance, in the United Kingdom procedures are in place, which are designed to encourage an early stage intervention by the existing management, such as the Scheme of Arrangement, which is one of the oldest rescue devices in the world and the CVA procedure, which was introduced following the recommendations of the Cork Report.[10] In South Africa directors are also encouraged to initiate business rescue proceedings as soon as possible; in order to assist the board of directors from allegations of

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suffice. A Part 26, Companies Act 2006 scheme of arrangement could also be used for solvent entities, which would have the same effect.

[8] Companies Act 71 of 2008, section 152(2) (a).

[9] Ibid, section 152(2) (b). An independent creditor is described in section 128(1) (g) as a person who is a creditor of the company, including an employee of the company who is a creditor in terms of section 144(2) and who is not related to the company, a director or the practitioner.

[10] The Report of the Insolvency Law Review Committee, Insolvency Law and Practice, Cmnd 858 (1982, HMSO, London).

abuse of process the Act widened the definition of 'financial distress' by introducing a six month time period. The new mixed management displacement model in South Africa also encourages directors to initiate proceedings sooner.[11]

Pre-insolvency proceedings in the United Kingdom

<u>The development of a corporate rescue culture in the United Kingdom</u>

A financially ailing company may have resort to a range of mechanisms in the United Kingdom, such as for instance, informal workouts, a Company Voluntary Arrangement, a Scheme of Arrangement or administration. Arguably, the presence of such a wide range of reorganisation proceedings demonstrates the significance attached to business recovery in this jurisdiction. However, it was not until relatively recently that the United Kingdom established its sophisticated corporate rescue culture.

Prior to the enactment of the Insolvency Act 1986 (IA 86), there were only two formal possible procedures designed to keep 'alive' a traumatised business, the administrative receivership procedure or a scheme of arrangement. Nonetheless, the application of these to procedures was not without problems, as the administrative receivership procedure was conditional upon the exercise of the right of a floating charge holder to appoint an administrative receiver; in addition, the use of a scheme of arrangement as a corporate rescue

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[11] Companies Act 71 of 2008: section 137(2) (a)-(c) and 140 (1) (a). Under Business Rescue the company's management is displaced by an independent third party known as the Business Rescue Practitioner. Even though the management is displaced the directors are not removed from office and stay on in order to assist the Practitioner in his duties, this is done under the supervision of the practitioner.

tool was limited, primarily because the procedure was too ‘procedurally cumbersome and failed to safeguard sufficient and effective protection for the company.[12]

In 1985 by means of a text, later re-enacted as the IA 86,[13] two additional procedures were introduced as alternative means for corporate rescue, namely the administration procedure and the company voluntary arrangement (‘CVA’). The innovative reforms introduced by the IA 86, originally had their roots in the 1982 report of the Cork Committee,[14] which recognised the need to strengthen the United Kingdom’s corporate rescue regime. The Cork Report stated that a ‘good, modern system of insolvency law should provide a means for preserving viable commercial enterprises capable of making a useful contribution to the economic life of the country’.[15] However, it should be noted that, although the CVA appeared to be a promising ‘debtor in possession’ reorganisation tool, it was not fully embraced by practitioners.

However, the Enterprise Act 2002 together with the Insolvency Act 2000 contributed significantly to the development of a corporate rescue culture in the United Kingdom. The Insolvency Act 2000 introduced key reforms to the CVA procedure, so that the CVA now constitutes an important part of the current trend in shifting the ethos of the United Kingdom’s insolvency law towards effective corporate rescue.

[12] R Parry, “United Kingdom: Administrative Receiverships and Administrations” in Gromek Broc, K., and Parry, R., *Corporate Rescue in Europe: An overview of Recent Developments from Selected Countries in Europe* (Kluwer Law International, 2004) at p. 265.

[13] The Insolvency Act 1985 was consolidated as the Insolvency Act 1986.

[14] Report of the Review Committee on Insolvency Law and Practice, (Cmnd. 8558, 1982) (‘Cork Report’).

[15] V Finch, note 3 above, at p. 246.

An overview of the CVA procedure

The CVA was designed primarily with the aim of promoting corporate rescue. The objective of the CVA is to facilitate the rehabilitation of a financially troubled company by enabling it to reach a contractual compromise with its creditors. The CVA may be used as a stand-alone procedure or it may be combined with another procedure, such as administration. In other words, the procedure may be initiated either by the company's directors or by an administrator. Although the CVA may be effectively used as an exit route from administration, strictly speaking, it is not a formal insolvency procedure, as it is not necessary for the company to be insolvent or show that it is unable to pay its debts in order to enter into a CVA.

Where the CVA is initiated as a freestanding procedure, the existing management of a company is able to take early action by drafting a re-organisation proposal and presenting it to the company's creditors. The directors[16] are also entrusted with the implementation of the proposal under the supervision of a licenced insolvency practitioner, known as the "nominee" prior to approval of the proposal and as the "supervisor" after approval.[17]

The formation of the proposal is a key stage of the reorganisation process. The directors form the proposal[18] which inter alia, states the reasons why the company's directors believe that a CVA is desirable; the company's assets and their value; details of assets charged in favor of creditors; the nature and the amount of the company's liabilities; the duration of the CVA; the

[16] It should be noted that although the CVA is described largely as a 'Debtor in Possession' regime, in practice the directors heavily rely on the insolvency practitioner to both draft and execute the proposal.

[17] It is important to note that the insolvency practitioner must remain independent from the outset and throughout the implementation of the CVA process. See Statement of Insolvency Practice 3, para 3.2.

[18] Insolvency Act 1986, s 1(1).

dates of distributions to creditors; the identity and the remuneration of the insolvency practitioner of the proposed nominee/supervisor.[19]

The steps that directors must take in forming and implementing a CVA proposal depend on whether or not the protection of a moratorium is sought.[20] Arguably, one of the most significant reforms the CVA has been subject to is the introduction of provisions enabling a moratorium to be obtained while the CVA is being proposed.[21] However, notwithstanding the introduction of a reformed CVA, it could be said that the impact of the procedure has been limited. An obvious contributing factor to the limited use of the CVA could arguably be the fact that a moratorium is only available to “small companies”.[22] However, since large companies can still benefit from a moratorium (if one is necessary) by simply entering into administration proceedings, the lack of it under the CVA has not been identified as a major flaw by insolvency practitioners. In addition, it could be argued that the use of the CVA has been relatively limited, due to the fact that the procedure has been overshadowed by the streamlined administration procedure.[23]

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[19] See Insolvency Rules 1986, r.1.3. (1) - (8).

[20] Where directors intend to apply for a moratorium the procedure which must be followed is stated in s.2 IA 1986, supplemented by the Insolvency Rules 1986, Part 1 Chapter 2. Where a moratorium is not required, the procedure is outlined in IA 1986 Schedule A1.

[21] R Parry, Corporate Rescue (Sweet & Maxwell, 2008), at p.136, para. 10-09.

[22] See s.382 (3) of the Companies Act 2006, which states that a company qualifies as small in relation to a subsequent financial year, if it satisfies at least two of the following ‘qualifying conditions’: a) its turnover does not exceed £6.5 million; b) its balance sheet total is not more than £3.26 million; c) it has no more than 50 employees.

[23] R Parry, note 21 above, at p. 136, para. 10-09.

The role of the nominee

The nominee has a very important role to serve, as he must establish whether or not the company is able to implement a CVA proposal. Accordingly, the nominee must present a report to the court stating whether in his opinion meetings of the company and its creditors should consider the proposal.[24] In order to be able to assess the company's suitability and to prepare his report, the nominee must receive a copy of the proposal from the directors,[25] a statement of the company's affairs,[26] as well as any other information he requires.[27]

The nominee shall summon meetings of the company and its creditors[28] in order to either approve (with or without modifications)[29] or reject the proposed CVA. After the conclusion of either meeting the chairman of the meeting shall report the result of the meeting to the court, and, immediately after reporting to the court, shall give notice of the result of the meeting to such persons as may be prescribed.[30]

With regard to the approval of the proposal, it is important to note that as opposed to a scheme of arrangement, the CVA treats all creditors as one single class. [31] All creditors who

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[24] S. 2 (2) of the Insolvency Act 1986,.

[25] S. 2(3) of the Insolvency Act 1986; Insolvency Rules 1986 r.1.4. (1), (2).

[26] Insolvency Rules 1986 r.1.5.

[27] Insolvency Rules 1986 r.1.6.

[28] Sch. A1 Insolvency Act 1986, para.29.

[29] Sch. A1 Insolvency Act 1986, para.31.

[30] Sch. A1 Insolvency Act 1986, para. 30(3).

[31] See I Fletcher, "UK Corporate Rescue Culture: Recent Developments- Changes To Administrative Receivership, Administration and Company Voluntary Arrangements- The Insolvency Act 2000, The White Paper and The Enterprise Act 2002" (2004)5 EBOR 119-151, at p.127.

receive notice of a creditors' meeting can vote on a CVA[32] draft. In order for the CVA to become effective, it needs to be approved by the requisite majority at the meeting.[33] The CVA is treated as a statutory contract[34], which bounds every person who was eligible to vote at the meeting regardless of whether they were present or not and whether they voted in favour or not of the proposed arrangement.[35] Upon approval of the CVA, the nominee becomes the supervisor.[36]

An important disadvantage of the CVA procedure is its vulnerability to claims of unfair prejudice to the interest of a creditor or member under the approved CVA. In addition the CVA is vulnerable to challenge on grounds of material irregularities. Such claims may be initiated by any person, who would be eligible to vote at the meeting, or any person who would have been entitled to vote had they had notice of the meeting. In any case no challenge can be made after a period of 28 days (a) beginning with the first day on which the Chairman's report required has been made to the court; or (b) in the case of a person who was not given notice of the creditors' meeting, after the end of the period of 28 days beginning with the day on which he became aware that the meeting had taken place.[37]

Schemes of arrangement:

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[32] Persons who are not entitled to vote at the meeting, ae not bound by the CVA. See s.5(2) of the Insolvency Act 1986.

[33] Insolvency Rules 1986 r.1.19: more than three quarters in value of the creditors voting on the resolution must vote in favour of the arrangement.

[34] *Johnson* v *Davies* [1999] Ch.117, 129H-130A.

[35] Sch. A 1 of the Insolvency Act 1986, s.37.

[36] Sch. A 1 of the Insolvency Act 1986, s.39 (2).

[37] Sch. A 1 of the Insolvency Act 1986, s.38 (3).

A scheme of arrangement is one of the oldest restructuring procedures available in the United Kingdom.[38] However, strictly speaking a scheme is not an exclusive corporate rescue instrument, as it was primarily designed to be used by solvent companies. Accordingly, as the scheme is a creature of company law[39], when compared to CVAs, it is not as stigmatised. Similarly to the CVA, a scheme enables a financially ailing company to reach a compromise with its creditors. However, in contrast to the CVA, the popularity of the scheme, as a rescue device has been steadily rising over the last few decades[40] and practitioners have favoured the use of schemes in a number of high profile debt restructuring cases.[41]

The scheme is a compromise between the company and its creditors, or between the company and its members. Similarly to the CVA, the company's directors remain in office and are responsible for the drafting and the execution of the restructuring plan. The process of implementing a scheme involves three distinct stages: a) formulation of the proposal and an application to the court; b) a creditors' meeting for approval of the scheme; and c) a 'sanction hearing' by the court.

As part of stage one, the board directors shall form the restructuring plan,[42] which is then proposed on behalf of the company to its members and creditors. Once a

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[38] It dates back to the Joint Stock Companies (Arrangement) Act 1870.

[39] The statutory regime relating to schemes is set out in Part 26 of the Companies Act 2006.

[40] R Parry, note 21 above, at p. 233. See Also V Finch, note 3 above, at p. 486, where it is argued that the revived popularity of schemes of arrangement may be due to the courts 'constructive attitude, to facilitate the implementation of schemes by means of assessing junior creditors' 'real economic interests'.

[41] Such as Crest Nicholson plc, McCarthy & Stone plc, Wind Hellas Telecommunications SA and European Directories Group.

[42] Although the appointment of a qualified insolvency practitioner is not necessary, typically directors seek the advice of restructuring experts at this early stage.

compromise/arrangement has been proposed, the company by sending preliminary circulars[43] shall inform its creditors or members about the objectives of the scheme as well as the relevant meetings (if more than one) the company aims to call. The company must also select the classes in which the creditors or members affected by the scheme should be placed and accordingly notify them. The division of classes depends on how similar[44] the rights of the members of each class are. However, it is not necessary that their rights are exactly the same.[45] Finally, stage one involves an application being made to the court, which will have to decide whether or not to make a "meetings order".[46]

Stage two involves a meeting of creditors or members who will decide whether to approve the scheme. However, it is required that, prior to the meeting, sufficient information must be circulated so as to enable the creditors to reach an informed decision.[47] As mentioned above the approval of a scheme of arrangement involves a complex voting structure under which, for voting purposes, creditors are divided into classes and it is required that a reorganization arrangement be approved by a majority vote of all classes of creditors.[48]

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[43] However, compliance with this requirement may be waived by the court in exceptional cases. See for instance *Marconi Corp Plc v Marconi Plc* [2003] EWHC 663.

[44] The interests of creditors in each class should not be so dissimilar so as to make it impossible for them to consult together with a view to their common interest. See *Sovereign Life Assurance Co v Dodd* [1982] 2 QB 573, 583; and *Re BTR Plc* [1999] 2 BCLC 575.

[45] *Re Osiris Insurance Ltd* [1999] 2 BCLC 182.

[46] At the meetings hearing the court will consider whether or not the company has appropriately identified the classes, which will have to consider the scheme. See *Re Hawk Insurance Co Ltd* [2002] BCC 300.

[47] See s. 897 of the Companies Act 2006.

[48] See s. 899 of the Companies Act 2006, which states: If a majority in number representing 75% in value of the creditors or class of creditors or members or class of members (as the case may be), present and voting either in person or by proxy at the meeting summoned under section 896, agree a compromise or arrangement, the court

In comparing the complex approval process of a scheme to the much simpler process of a CVA, it could be argued that restructuring by means of a CVA should be preferable. Nevertheless, the simplicity aspect of the CVA is outweighed by the fact that, once an arrangement becomes binding under the scheme, it binds all creditors (including dissenting creditors), whereas an agreement reached under the CVA is only binding upon creditors who were eligible to vote, or who would have been eligible to vote, if they had notice of a creditors' meeting. In addition, it is important to note that, under a scheme of arrangement, it is not necessary to consult any class of creditors who have no real economic interest in the company, hence their votes on the scheme may be disregarded.[49] This is a significant advantage of a scheme as it provides greater finality than a CVA, which is vulnerable to challenges on grounds on unfair prejudice.[50]

Stage three involves a "sanction hearing", where the court will consider whether or not to sanction the scheme.[51] Once the scheme has obtained the required level of approval, it must be sanctioned by the court and the court's order takes effect once a copy of it is delivered to the Registrar of Companies.[52] It should be noted that the sanctioning of the scheme is not a simple rubber-stamping exercise. Instead, the court may not sanction a scheme even where it

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may, on an application under this section, sanction the compromise or arrangement. However, see also Charles Maunder, 'Bondholder Schemes of Arrangement: Playing the Numbers Game' (2003)16(10) Insolv. Int. 73-77, 76, where it is argued that if the majority in number requirement was removed, schemes of arrangement would be more flexible and attractive restructuring tools.

[49] See *Re Tea Corp*. [1904] 1 Ch. 12. See also *Re My Travel Group Plc* [2004] EWHC 2741; [2005] 1 WLR 2365, where the basis of valuation of entitlements caused some contention. See also R Parry, note 22 above, p. 236; and V Finch, note 3 above, at p.486.

[50] R Parry, note 21 above, at p. 233.

[51] Ibid, at p. 236.

[52] Companies Act s.899 (1) & (4)

has received the approval of creditors, [53] as it must be satisfied that the classes were fairly represented by the parties who attended the meeting,[54] and that the terms of the scheme are fair.[55] In addition, the court has discretion to refuse to sanction a scheme, unless it is convinced that all the procedural requirements have been complied with.[56] It is argued that the requirement that a scheme of arrangement has to be approved by the court is a significant advantage of the procedure, because, once the arrangement has been court-approved, it cannot be challenged by the company's creditors or its members. It could be argued that this might be one of the primary reasons why such schemes seem to be more popular than the CVA, as a CVA may be challenged on the grounds of unfair prejudice.[57]

Pre-insolvency proceedings in South Africa

A very large premium has been placed on retaining jobs and businesses in South Africa,[58] and as an emerging market economy an efficient rescue system is of the utmost importance. South Africa's Companies Act 71 of 2008 heralded a new era of corporate rescue for financially distressed corporations by replacing the largely unsuccessful Judicial

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[53] Jennifer Payne, "Debt restructuring in English law: lessons from the United States and the need for reform (2014) L.Q.R 130(Apr) 282-305, at p.292.

[54] R Parry, note 21 above, at p. 238.

[55] Ibid, at p. 239-247.

[56] *Alabama, New Orleans, Texas and Pacific Junction Rly Co* [1891] 1 Ch. 213, 245.

[57] R Parry note 22 above, at p. 233.

[58] D Burdette, "Some initial thoughts on the Development of a Modern and Effective Business Rescue Model for South Africa (Part 1)" (2004) SA Merc LJ 16: 241- 263, at p 241.

Management Procedure.[59] Chapter 6 of the Act dealing with Business Rescue and Compromises also replaces the section on compromises and arrangements contained in the previous Companies Act of 1973.[60] Thus the Act currently provides for two Pre-insolvency proceedings: the Business Rescue procedure and the Compromise with creditors.

Both the mechanisms contained in Chapter 6 provide a debtor in financial distress with access to corporate reorganisation in order to try and circumvent insolvency. The Business Rescue provisions can be regarded as a more traditional type of procedure that can be likened to the Administration procedure under the English Enterprise Act.[61] Under Business Rescue the company's management is displaced by an independent third party known as the Business Rescue Practitioner. Even though the management is displaced the directors are not removed from office and stay on in order to assist the Practitioner in his duties, this is done under the supervision of the practitioner.[62] The Compromise provisions provide for an alternative option with less involvement from the court and practitioners, in this sense it is reminiscent of the US Chapter 11 debtor-in-possession in that the debtor is able to stay in control of its affairs although it is a simpler provision than the Chapter 11 procedure.[63] This mechanism provides for a more flexible framework and can even be utilised by companies that are not experiencing financial distress.

[59] Ibid. See also E Snyman-van Deventer and L Jacobs, "Corporate Rescue: The South African Business Rescue Plan Examined" (2014) NIBLeJ 103-115, at p 103.

[60] Companies Act 61 of 1973.

[61] H Klopper and R Bradstreet, "Averting Liquidations with Business Rescue: does a section 155 Compromise Place the bar too high?" (2014) Stell LR 549- 565, at p. 550.

[62] S. 137(2) (a)-(c) and 140 (1)(a) of the Companies Act 71 of 2008.

[63] See note 61 above at p. 553.

Although the new corporate rescue procedures in South Africa are more informal than under the previous Act, the procedures that are currently available to distressed companies are still more formal than informal in nature since it is highly regulated by legislation. Informal creditor workouts are rarely heard of nor are they documented.[64] The Chapter 6 mechanisms are less formal since the involvement of the courts have been limited whilst the involvement of other stakeholders have been broadened. A discussion on the development of a rescue culture as well as an overview of the two reorganisation options will now follow.

The development of a rescue culture in South Africa

South Africa is still struggling with a liquidation culture despite the fact that South Africa now has modern rescue provisions to aid failing debtors. The process of moving towards a rescue culture is happening very slowly. This liquidation culture emanates from South Africa's prevailing creditor-friendly approach to insolvency matters.[65] It is, however, of importance to mention that even though the shift is happening at a very slow pace, it is indeed happening. In recent years, since the inception of the Companies Act of 2008, there has been more emphasis on the protection of the interests of all the relevant stakeholders. It has even been stated by the court that Business Rescue is to be preferred to the liquidation of the company and that the old mind-set of the creditor being almost entitled to a winding-up order as of a right was inappropriate.[66] One of the biggest hurdles to overcome in creating a rescue

[64]N Harvey, *Turnaround Management and Corporate Renewal. A South African Perspective,* (Johannesburg *ed.* 2011) at p. 134.

[65] See D Burdette, note 58 above, at p. 244; *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd* 2012(2) SA 423 (WCC); *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Kyalami) (Pty) Ltd* 2012(3) SA 273 (GSJ): 276. "By law the creditor of an ailing company had a right *ex debito justitiae* (as of right) to liquidate the company."

[66] *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd* 2012 2 SA 423 (WCC)

culture in South Africa is the larger creditors, e.g. the Banks who are to a large degree very reluctant to participate in, or even support the rescue proceedings because of the aforementioned reasoning. And although creditors still play an overwhelming role in the outcome of reorganisation procedures,[67] there seems to be a shift to a more inclusive approach to the rescue of a company albeit at a very slow pace.

Business Rescue

According to section 7 of the Act one of the main purposes thereof is to provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders.[68] The Act provides for proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for: the temporary supervision of the company, and of the management of its affairs, business and property; a temporary moratorium on the rights of claimants against the company or in respect of property in its possession; and the development and implementation, if approved, of a plan to rescue the company.[69]

The first topic to discuss in this regard pertains to the concept of imminent insolvency in a South African context. When will a company be regarded as being in financial distress? It is a well-known fact that time is of the essence in corporate reorganisations. Section 128 of the Act states that a company will be deemed to be financially distressed if it appears to be reasonably unlikely that the company will be able to pay all of its debts as they become due

[67] A Loubser, "The Role of Shareholders during Corporate Rescue Proceedings: Always On the Outside Looking In?" (2008) SA Merc LJ. 20: 372-390, at p. 379.

[68] S.7 (k) of the Companies Act 71 of 2008.

[69] Ibid, s.128 (1) (b) (i)-(iii).

and payable within the immediately ensuing six months,[70] or if it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months[71] The adding of the six month time period was to encourage the early commencement of Business Rescue which in turn maximises the chance of a successful rescue. The formulation of the concept of financial distress in the Act also refers to commercial and factual insolvency at a future date implying that Business Rescue should not be utilised by companies that are already insolvent. South African courts agree with this and have at numerous occasions denied applications for the initiation of Business rescue where the companies are insolvent and not in financial distress.[72]

The initiation of the procedure can happen either voluntarily by way of a company resolution or by application to the High Court by an affected person. An affected person is defined in the Act as a shareholder or creditor of the company, any registered trade union representing employees of the company and any employees of the company not represented by a trade union.[73]

[70] Ibid, s. 128(1)(f)(i). Referring to the so called cash flow test for insolvency.

[71] Ibid, s. 128(1)(f)(ii). Referring to the so called balance sheet test for insolvency.

[72] *Gormley v West City Precinct Properties (Pty) Ltd* (Unreported case). “It must either be unlikely that the debts can be repaid within 6 months or that the company will go insolvent within the ensuing 6 months. In this case the company is presently insolvent and cannot pay its debts unless a moratorium of 3-5 years is granted. The facts of this matter does not bring West City’s financial situation within the definition of ‘financially distressed’”. See also *Wellman v Marcelle Props* 193 2012 JDR 0408 GSJ: 12. “In my view, Business Rescue proceedings are not for the terminally ill close corporation.”. *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd* 2012 2 SA 423 (WCC). *African Banking Corporation of Botswana v Kariba Furniture Manufacturers* (228/2014) [2015] ZASCA 69. “Suffice it to say that the company was clearly hopelessly insolvent and effectively dormant in that it had not traded for years and had no business contacts in place.”

[73] S. 128(1) (a) (i)-(iii) of the Companies Act 71 of 2008.

The commencement standard that applies depends on the party that initiates the rescue process, providing for different requirements for when the debtor initiates to when an affected person applies to court for an order placing the company under Business Rescue. This is a positive development, [74] as it also allows for different evidential burdens taking the circumstances and information position of the different role players into account. The new requirements for initiating Business Rescue are seen as an improvement to the requirements under the previous Companies Act of 1973. Some believe that the evidential burden imposed by the previous Act was unrealistic, outdated and excessive, and resulted in rescuable companies being denied a lifeline. Others argue that the courts wrongly interpreted judicial management as an extraordinary remedy, only to be granted in exceptional circumstances.[75]

Under the Business Rescue model a company may voluntarily initiate rescue proceedings and place the company under supervision, by taking a resolution, if the board has reasonable grounds to firstly, believe that the company is financially distressed and secondly, that there appears to be a reasonable prospect of rescuing the company.[76] An affected person, on the other hand, may apply to court to make an order placing the company under supervision and commencing business rescue proceedings, if the court is satisfied that the company is financially distressed; the company has failed to make an employment-related payment arising from a regulatory or contractual obligation or if it is otherwise just and equitable to do so for financial reasons, and there is a reasonable prospect for rescuing the company.[77] The court's involvement has therefor been limited at the commencement of the proceedings. The

[74] Under the 1973 Companies Act only one set of requirements was applicable regardless of who was initiating the rescue procedure.

[75] See D Burdette note 58 above, at pp.248 - 249.

[76] S. 129 (1) of the Companies Act 71 of 2008.

[77] S. 131(4) (a) (i)-(iii) of the Companies Act 71 of 2008.

debtor is fully aware of its own financial situation, and would be the most appropriate judge to decide when to make use of rescue provisions.[78] A rescue mechanism that relies heavily on the involvement of the court is expensive and therefor contradictory to the aim of helping the company in dire financial straits.

The most problematic requirement for South African courts to date has been the need for a reasonable prospect of rescue to exist.[79] This is mainly due to the fact that the meaning of “successful rescue” is a contentious issue and will depend on the viewpoint from which it is regarded and also because there is no way in which to determine the viability of the debtor company. According to the Act a successful rescue could include returning the company to solvency or alternatively bringing about a better return for the company’s creditors and shareholders than would result from the immediate liquidation of the company.[80]

After the commencement of the proceedings, the appointment of the Business Rescue Practitioner should take place. If the company initiates the proceedings the Practitioner will be appointed by the board of the company.[81] If, however, the procedure is initiated by an affected person the applicant to court would nominate a practitioner and the court will appoint an interim Practitioner, subject to the ratification by the creditors.[82] The Practitioner is a key role player in the rescue procedure and the duty to rescue the company falls on his

[78] D Burdette, “Some initial thoughts on the Development of a Modern and Effective Business Rescue Model for South Africa (Part 2)” (2004) SA Merc LJ 16: 409-447, p 410.

[79] M Pretorius, “Companies and Intellectual Property Commission (CIPC) Status Quo Report” (2015) at p. 5.

[80] S. 128(1) (b) (iii) of the Companies Act 71 of 2008.

[81] S. 129(3) (b) of the Companies Act 71 of 2008.

[82] S. 131 (5) of the Companies Act 71 of 2008.

shoulders. It is for this reason that the Practitioner should be suitably qualified and experienced in order to perform all that is expected of him.

According to the 2008 Companies Act a Practitioner should be a member of the law, accounting or business management profession.[83] The regulations to the act furthermore stipulate that a practitioner should have experience in "business turnaround practice".[84] The 2008 Act places more emphasis on the experience of the business rescue practitioner than its predecessor. Practitioners are therefore divided into three categories: senior practitioners, experienced practitioners and junior practitioners. For large and state-owned companies only senior practitioners may be appointed. For medium companies senior and experienced practitioners may be appointed, but not junior practitioners; etcetera.[85] This clearly indicates that the legislature wanted to make sure that only the most experienced practitioners are appointed in the larger and more difficult rescue situations in order to optimise the chances of a successful rescue of the company. Apart from being suitably qualified and experienced, the Practitioner also needs to be of good character and integrity,[86] and be independent and objective.[87] The duties of the Practitioner include taking control of the management of the debtor company, undertaking an investigation into the financial affairs of the company and the drafting and implementation, if approved, of a business rescue plan. In order to assist the Practitioner in performing these duties, the Act affords him with a wide array of powers

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[83] S. 138 (1) (a) Companies Act 71 of 2008.

[84] Regulation 127, Regulations to the Companies Act 71 of 2008.

[85] Regulation 127 (2) (c) (i)-(iii), Regulations to the Companies Act 71 of 2008.

[86] Regulation 126(4) (a), Regulations to the Companies Act 71 of 2008.

[87] S. 138 (1) (e) of the Companies Act 71 of 2008.

including the power to obtain post-commencement financing and suspending certain contracts or parts thereof[88].

The drafting, acceptance and implementation of a business rescue plan are among the most important aspects of a modern rescue model.[89] The business rescue plan is one of the greatest improvements in respect of the South African rescue model. By having to propose, accept and implement a business rescue plan, the restructuring of the debtor could occur much sooner, with the added benefit that certainty with regard to the outcome of the rescue is created for all parties concerned.[90] The business rescue plan will be considered at a meeting of affected persons and voted upon by the company's creditors. The shareholders will only be allowed to vote if the plan alters the rights attached to their shares. At this meeting, the Rescue Practitioner must present the proposed rescue plan to the creditors and shareholders to afford them the opportunity to consider it.[91] The practitioner must also use this opportunity to inform the meeting of whether he still believes that there is a reasonable prospect of the company being rescued.[92] The creditors and shareholders may then discuss and raise arguments about the plan, as well as cast any vote on a motion regarding the amendment of the plan or the adjournment of the meeting to afford the practitioner time to revise the plan based on their recommendations.[93] When a vote is called, the proposed business rescue plan

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[88] Ss. 135-136 of the Companies Act 71 of 2008.

[89] P Kloppers, "Judicial Management - A Corporate Rescue Mechanism in Need of Reform?" (1999) 10 Stell LR 417 - 435, at p. 427. See also E Snyman-van Deventer and L Jacobs, "Corporate Rescue: The South African Business Rescue Plan Examined" (2014) NIBLeJ 103-115, at p 103.

[90] D Burdette, note 78 above, at p. 438.

[91] S. 152 (1) (a) of the Companies Act 71 of 2008.

[92]S. 152 (1) (b) of the Companies Act 71 of 2008.

[93] S. 152 (1) (c), (d) (i) - (ii) of the Companies Act 71 of 2008.

will be approved if the plan received support from the holders of more than 75% of the creditors' voting interests that were voted,[94] and if the votes in support of the proposed plan included at least 50% of the independent creditors' voting interests, if any, that were voted.[95] A business rescue plan approved in the abovementioned ways is binding on the company, each of the creditors of the company, and each holder of company securities, whether or not that person was present at the meeting or voted in favour of the plan.[96] This means that the vote will also bind the minority of dissenting creditors.

Another important aspect to consider regarding Business Rescue pertains to the automatic "stay" or moratorium that becomes effective upon commencement of the proceedings. The moratorium on claims from creditors provides the debtor company with some breathing room in order to try and facilitate the rescue procedure.[97] For the duration of the Business Rescue proceedings, no legal proceeding against the company, or in relation to any of the company property, may be commenced or proceeded with in any forum, except with the written consent of the practitioner or with leave of the court and in accordance with any terms the court deems suitable.[98]

The termination of the Business Rescue proceedings can happen in a number of ways. In terms of section 132 the proceedings will come to an end if the court sets aside the company's resolution to place the company under rescue,[99] or if the court has converted the

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[94] S. 152 (2) (a) of the Companies Act 71 of 2008.

[95] S. 152 (2) (b) of the Companies Act 71 of 2008.

[96] S. 152 (4) of the Companies Act 71 of 2008.

[97] D Burdette, note 78 above, at p 417.

[98] S. 133(1) (a)-(b) of the Companies Act 71 of 2008.

[99] S. 132(2) (a) (i) of the Companies Act 71 of 2008.

proceedings to liquidation proceedings.[100] The Practitioner can also terminate the rescue by filing a notice of termination.[101] In the event that the business rescue plan is rejected, the proceedings will also come to an end.[102] The proceedings will also come to an end when the Practitioner files a notice of substantial implementation of the plan.[103]

The Compromise procedure

The alternative procedure provided for in the Act is the section 155 Compromise with creditors.[104] In the case of a compromise with creditors the debtor company will remain entirely in possession and no Practitioner will be appointed in order to assist the company. This type of procedure envisages some element of commercial give and take and accommodation on both sides. That is between the Company and its creditors.

The board of a company may propose an arrangement or a compromise of its financial obligations to all of its creditors, or to all of the members of any class of its creditors, by delivering a proposal to every creditor and the Commission. The company must therefore develop their own plan for “rescue”. The prescribed contents of the plan for a compromise are similar to those of the business rescue plan.[105] The proposal will then be voted upon by all the creditors or the class of creditors and will only be adopted if supported by a majority in number, representing at least 75% in value of the creditors or class, as the case may be.[106]

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[100] S. 132(2) (a) (ii) of the Companies Act 71 of 2008.

[101] S. 132 (2) (b) of the Companies Act 71 of 2008.

[102] S. 132 (2) (c) (i) of the Companies Act 71 of 2008.

[103] S. 132 (2) (c) (ii) of the Companies Act 71 of 2008.

[104] S. 155 of the Companies Act 71 of 2008.

[105] S. 155 (3) of the Companies Act 71 of 2008.

[106] S. 155(6) of the Companies Act 71 of 2008.

The section 155 Compromise or arrangement under the Companies Act of 2008 replaces the old section 311 procedure of the previous Act. Like the previous procedure, the section 155 Compromise also provides for the court to sanction a compromise that was reached between the company and the majority of its creditors.[107] The wording of the Act does, however, create uncertainty regarding the need for the court to sanction the proposal: "the company may apply to court for an order approving the proposal".[108] The wording creates the impression that it is up to the company to decide whether or not to approach the court for an order approving the proposal or not.[109] It does, however seem as though the purpose of the provision was for the company to guarantee that any dissenting creditors are in fact bound by the compromise. Where the creditors unanimously agree to the proposed plan no court sanction will be needed, since section 155(8)(c) provides that the order of court sanctioning a compromise is "final and binding" on all of the company's creditors or all of the members of the relevant class of creditors.[110]

The section 155 Compromise is therefore still heavily reliant on creditor involvement despite this procedure being primarily debtor driven. It also has certain drawbacks making the process one that is rarely used. The Compromise does not afford the debtor company or other stakeholders with the same protection, for example a moratorium against claims and proceedings against the company, as the Business Rescue Procedure does. The procedure could therefore be improved upon by incorporating some form of moratorium or stay (as is

[107] H Klopper and R Bradstreet, "Averting Liquidations with Business Rescue: does a section 155 Compromise Place the bar too high?" (2014) Stell LR 549- 565, at p. 553.

[108] S. 155 (7) (a) of the Companies Act 71 of 2008.

[109] H Klopper and R Bradstreet, note 107 above at pp. 553-554.

[110] S. 155(8) (c) of the Companies Act 71 of 2008.

afforded under Business Rescue). It could also be an expensive procedure if the debtor has to apply to court for an order sanctioning the proposal.

Conclusion

In the United Kingdom the first step towards the establishment of a corporate rescue culture was made following the Cork Committee's proposals by means of reforms, which led to the enactment of the Insolvency Act 1986. In addition, the Enterprise Act 2002 introduced revolutionary changes to the existing restructuring regime of the United Kingdom and importantly promoted a "second-chance culture" in a traditionally regarded "creditor-friendly" jurisdiction. Finally, it has been argued that the United Kingdom's current insolvency laws, in particular its restructuring and business rescue regime, are performing well in comparison with their international peers.

On the other hand, corporate rescue in South Africa still has a long way to go in creating a rescue system that is truly reflective of a robust rescue culture. This is despite the fact that public opinion suggests support for the Chapter 6 provisions, which are even regarded as employment-preservation mechanisms. The buy-in of the larger creditors continues to be of paramount importance in moving towards the "second chance culture" that already exists in the United Kingdom. South Africa has taken remarkable strides in transforming its corporate rescue sphere and the progress that it has made is laudable. In conclusion, it could be argued that although key differences exist between the two jurisdictions, South Africa, albeit still in its toddler steps in establishing an effective corporate rescue, could benefit from keeping a close eye on the UK corporate rescue procedures and even consider whether it would be appropriate to incorporate similar procedures in its rescue regime.