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THE STAKEHOLDER INTEREST BATTLE IN BUSINESS RESCUE AND POST-COMMENCEMENT FINANCE

by

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ABSTRACT

Nearly 6 years following the introduction of the 'new' business rescue proceedings under Chapter 6 of the Companies Act 71 of 2008, the time is ripe for thorough reflection on this legislation and its implementation from a stakeholder interest perspective.

Analysis of the behaviour driven by Chapter 6 brings forth valuable insights with regards to the conflicting interests of secured pre-commencement creditors, business rescue practitioners as well as post-commencement financiers and the impact thereof on the provision of post-commencement finance. The ranking of claims in business rescue upon conversion to liquidation proceedings must be clarified with specific regard for the impact on the business rescue practitioner's position as opposed to the rights of secured creditors.

It is pertinent that section 135, which is a key provision in Chapter 6, lacks drafting finesse in its current form and does not provide sufficient and express clarity regarding the definition and ranking of post-commencement finance during business rescue or in the event of a subsequent liquidation.

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THE STAKEHOLDER INTEREST BATTLE IN BUSINESS RESCUE AND POST-COMMENCEMENT FINANCE

1. *Introduction*

1.1 The Challenge for Post Commencement Finance

Since its inception, Chapter 6 of the Companies Act 71 of 2008,[1] which deals with business rescue has been the subject of much debate. Chapter 6 replaces the concept of 'judicial management,'[2] as regulated by Chapter XV the Companies Act 61 of 1973, with 'business rescue' which represents a major shift from a creditor-friendly regime to a regime which favours a wider stakeholder base.

There is an increasing view by academics and legal practitioners that the South African business rescue regime in its current form has largely been unsuccessful. Despite the extensive conceptual research involving post-commencement finance, the lack of actual available post-commencement finance in the market is being regarded as one of the top five reasons for the failure of business rescues. [3]

It is often the actual or foreseeable lack of cash-flow that qualifies a business as financially 'distressed' and drives stakeholders to eventually put a business into business rescue.[4] This often occurs too late and has by such point in time dramatically reduced any chance of rescuing the business. Research has indicated that it is increasingly important for a business to obtain turnaround finance or formal post-commencement finance at the onset of financial distress - as the access to such finance is directly linked to the probability of success.[5]

The question that is often overlooked in this regard is the potential role and impact of respective stakeholders in the quest for post-commencement finance. There is much to be said for 'shy capital' which finds itself easily driven away when confidence is lacking. In spite of the respective business opportunity and risk-related returns linked to post-commencement finance, stakeholders either inspire or reduce confidence with financiers.

Following extensive research and engagement across a broad and inclusive stakeholder base, Du Preez denotes that there are eleven central reasons why financiers are disinterested in providing post-commencement finance.[6] These are:

1. The impact of the profile as well as the actions of the business rescue practitioner.[7]

[1] Companies Act 71 of 2008, hereafter 'the Act'.

[2] S 427 – 440 of the Companies Act of 1973.

[3] Pretorius and du Preez "Constraints on decision making regarding post-commencement finance in business rescue" 2013 *SAJESBM* 169, 170.

[4] S 128(1)(f) states that a company is 'financially distressed' when it is reasonably likely that it would not be able to pay its debts as they become due within the immediately ensuing 6 months or is likely to become insolvent in the ensuing 6 month period.

[5] Pretorius and du Preez (n3) 169; Reineck *A Private Equity Structure to Facilitate the Effective Post-Commencement Financing of Business Rescue* (2015 dissertation UCT) 19.

[6] Du Preez *The Status of Post-Commencement Finance for Business Rescue in South Africa* (2012 Thesis, Gordon Institute of Business Science, University of Pretoria) 105.

[7] The conduct of business rescue practitioners is currently unregulated and has resulted in a decreased level of trust from other stakeholders, which includes banks and other financiers.

2. Business rescue filings are done for the wrong purpose and too late.[8]
3. The business rescue culture and the related perceptions of business rescue in South Africa is negative.
4. There is perceived uncertainty and concern regarding the priority ranking of post-commencement finance.[9]
5. Regulations such as Basel have caused Banks to become conservative and risk-averse.
6. A financier faces the risk of losing funds provided.
7. An actual or perceived lack of cooperation by banks during Business Rescue proceedings.
8. Distressed businesses do not (but should) involve and engage Financiers prior to filing for business rescue.
9. The nature of the relationship between financiers, the business rescue practitioner and management is often strained.
10. The lack of available security. [10]
11. Financiers are often pessimistic and do not support the proposed business rescue plan.

It is noteworthy that 6 of these items are also what Du Preez calls ‘prerequisites for success’ of post-commencement finance in the business rescue regime.[11] A clear deduction from the above is that there is a definitive conflict between stakeholder interests in the broader business rescue stakeholder base. The most notable antagonistic conflict is found between the respective interests and objectives of secured creditors prior to business rescue, including banks, and post-commencement financiers as well as business rescue practitioners.

This dissertation seeks to provide improved clarity and insight into the stakeholder interest battle in post-commencement finance and business rescue. Additional consideration will be given to how Chapter 6 of the Act provides partial regulation in some instances of stakeholder conflict and how Chapter 6 could inadvertently be driving additional negative behaviour in this context.[12]

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1.2 The need for post-commencement finance in business rescue

The United Nations Commission on International Trade Law (UNCITRAL) Legislative Guide on Insolvency Law stresses the importance of determining the need for post-commencement finance as early as possible in the ‘reorganisation’ process to enable the debtor company to continue its operations while a business rescue plan is being prepared.[13] The word “critical” is

[8] The business rescue process has been abused in certain instances by shareholders and other stakeholders who choose to take advantage of the Sec 133 moratorium to allow for additional time to strip the business before the formal rescue process commences and they lose effective control to deal with company assets as they choose. Filing may further occur too late when there is nothing of substance left to save in the business.

[9] Pretorius and du Preez (n3) 170. Inconsistency in local legal precedent regarding the preferential nature of PCF as per the Act has caused PFC financiers to be cautious. Chapter 11 of the Bankruptcy Code of 1978 (USA) attributes similar preferential status to turnaround finance in an attempt to stimulate the provision of such finance.

[10] It is often the case that by the time a business is classified as ‘distressed’ in terms of the Act, it is already over-leveraged and unable to raise PCF as no further security remains for the PCF financier.

[11] Du Preez (*Status of Post-Commencement Finance* n 6) 37, 94.

[12] S 153 (1) deals with an ‘inappropriate’ vote by creditors rejecting a Business Rescue plan which may be viable for purposes of potential self-interest.

[13] UNCITRAL Legislative Guide to Insolvency Law 113 par 94 https://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pdf (28/08/2017).

expressly used. The legislative guide not only stresses the importance of post-commencement finance to keep operations running, but includes any costs associated with maintaining the value of assets during the rescue process. The document aptly states:

"To ensure the continuity of the business where this is the object of the proceedings, it is highly desirable that a determination on the need for new finance be made at an early stage, in some cases even in the period between the time the application is made and commencement of proceedings. The availability of new finance will also be important in reorganization proceedings between commencement of the proceedings and approval of the plan…"[14]

In order for a company to be placed into or remain in business rescue, both section 129(1)(b) and 131(4)(a) require there to be a 'reasonable prospect' that the company can be rescued.[15] This is the primary objective of the Chapter 6 regime. The Act does however not elaborate on the meaning of 'reasonable prospect' nor does it endeavour to provide any guidance on the elements to be considered in this test.[16]

This has left the task of providing such guidance largely to our courts, particularly in terms of section 131(4) where the application to place a company into business rescue is brought before the court for approval by an 'affected person'[17] as defined in the Act.

In *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd*,[18] the court per Eloff J, applied a stringent test providing a list of factors establishing 'reasonable prospect'. It can be widely interpreted that a material factor in the test relates to the requirement and availability of post-commencement finance along with other necessary resources such as raw materials and human capital.[19]

"…If the company will be reliant on loan capital and other facilities, one would expect to be given come concrete indication of the extent thereof and the basis or terms upon which it will be available".[20]

The Supreme Court of Appeal seemingly disagreed with the guidance provided in *Southern Palace Investments. In Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Khyalami) (Pty) Ltd*,[21] the court focussed on the 'reasonability test' which is more vague with a less stringent base. On a more practical note, Henochsberg provides additional factors, as applied by practitioners and boards, which do not include the factors in *Southern Palace Investments* – two of which notably include the existence and availability of unencumbered assets of the company and the availability of post-commencement finance.[22]

[14] UNCITRAL (n 13) 114 par 95. Reference to "the plan" being a restructuring plan or in South African context, a business rescue plan.
[15] S 129 refers to a voluntary process whereby a Board passes a resolution to file for business rescue on behalf of the company. Sec 131 is where an 'affected person' as defined in Sec 128(1)(a) brings an application for business rescue before a court.
[16] Turnaround Management Association of South Africa (TMA) (*Practice Note Number 9)* 2016 3.
[17] S 128(1)(a) defines an 'affected person' as a shareholder, creditor, employee trade union representative or non-unionized employee or his respective representative.
[18] *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd* 2012 2 SA 423 (WCC) par 21.
[19] *Southern Palace* (n 18) par 24.3.
[20] *Southern Palace* (n 18) par 24.2.
[21] *Oakdene Square Properties (Pty) Ltd v Farm Bothasfontein (Khyalami) (Pty) Ltd* 2013 4 SA 539 (SCA) 16 par 29.
[22] See TMA (n16); *Henochsberg on the Companies Act 71 of 2008* 468.

This supports the commonly held view in the business rescue fraternity that the lack of readily available post-commencement finance is a major cause, if not "the" cause, for business rescue failure.[23]

It is therefore prudent to deduce that both practically as well as theoretically, the availability of post-commencement finance, in whichever form, should be regarded as a material factor when making the 'reasonable prospect' determination. In most instances, attempting a rescue without the real possibility of raising post-commencement finance would be like running an engine without oil. It may puff on for a while – but eventually it will land up as scrap-metal.

2. The Concept of Post-Commencement Finance

Governments and policymakers around the world have great ambitions and even better intentions with regards to the development and implementation of corporate rescue regimes. A flourishing economy is dependent on successful enterprises which are capable of creating and maintaining jobs thereby contributing to social development within an economy.[24] The primary intention is to prevent the enterprise from becoming distressed in the first place and further to provide support for the enterprise which is already in distress so that it may recover and avoid total demise. Section 128(1)(f) states that a company is 'financially distressed' when it is reasonably likely that it would not be able to pay its debts as they become due within the immediately ensuing 6 months or is likely to become insolvent in the ensuing 6-month period.

In an attempt to avert liquidation by filing for business rescue, a degree of support is needed from broader as well as directly related commercial stakeholders such as 'trade creditors' in the form of additional finance, trade credit or postponement and compromise of claims.[25] But once a business reveals its distressed status to stakeholders and the trade environment, it often becomes even more difficult to gain such support as creditors must firstly protect their own interests and avoid becoming financially distressed themselves. Once a company has reached the stage where it has filed for business rescue, it is most probable that traditional funding and increased credit have not materialized and that post-commencement finance is the only viable option to remain trading while the 'reasonable prospect' determination is made and business rescue plan is devised.[26]

The Act does not contain a comprehensive definition of post-commencement finance. Section 135(1) and (2) of the Act makes provision for the advancement of post commencement finance to a company in business rescue, whereas subsection (3) sets out the preferential order of claims during the business rescue process. This section has not been optimally drafted and has left the definition and interpretation of what constitutes post-commencement finance open to uncertainty and misinterpretation.[27] This is problematic and must be clarified in order to provide post-commencement financiers the assurance that their claims will enjoy preferential

[23] South Africa restructuring survey results 2017 'Seeing through the fog' 21 https://www2.deloitte.com/content/dam/Deloitte/za/Documents/Corp-Fin/za_Restructuring_Survey_2017.pdf (05/09/2017).

[24] Du Preez (*Status of Post-Commencement Finance* n 6) 2.

[25] Pretorius and Du Preez (n 3) 170.

[26] In practice, it is not uncommon to find that a company has been put into business rescue due to panic and the need for immediate protection from creditors. In such instances, the consideration of whether there is a remote prospect of rescuing the company has not been properly investigated. The BRP takes the lead in such determination as the stakeholders may lack the commercial insight.

[27] Du Preez (n 6) 77.

status. Section 135 in its present form seemingly confuses the definition of post-commencement finance and the ranking of claims within the business rescue process.

Section 135(2) states that "the company may obtain financing other than as contemplated in subsection (1)". There is no expansion or clarity as to what these other forms of "financing" could be. It is presumed that all claims that arise during business rescue are included and not only transactions which would commonly be regarded as "financing" such as trading credit and loans.[28] The section further states that "such financing may be secured" by remaining unencumbered assets.[29] This is a controversial point as it is most probable that at the point of filing for business rescue, there would be no unencumbered assets available.

The section does not make it expressly clear whether the term includes all post-commencement "claims" which could be an extension of pre-commencement claims under the operation of contract (therefore potentially not voluntary) or "claims" arising from creditors who agree to extend new credit on a voluntary basis. [30]

It is only logical that post-commencement finance would constitute any provision of credit for the rendering of goods or services, including the services of employees or other loans or credit facilities.[31] The accepted view is that post-commencement finance does not only take the form of 'cash finance' provided to a distressed company, but includes the continued provision of goods and services by pre-commencement creditors in lieu of payment at a later stage on agreed terms. Therefore, creditors should take cognisance of the fact that continued supply on credit to a company in business rescue constitutes post-commencement finance and it is advisable that such arrangements be formalised in writing with the practitioner.[32]

Another issue which has not yet been clarified by legal precedent is the view that there are various post-commencement finance phases.[33] What is the risk for a lender who advances "post-commencement finance" in the period after filing (for business rescue) but prior to the adoption and approval of the business rescue plan? The perception is that this is high risk assistance as it is unclear what the status of the assistance would be in the event that the plan is successively not approved. Does the assistance constitute post-commencement finance and will the lender be repaid?

According to Du Preez, this is not sufficiently clear and although the Act surely does not envisage such an adverse result, this remains the perception amongst financiers and funders.[34]

Should there be procedural non-compliance regarding the appointment of the practitioner or notice to affected persons in a voluntary section 129 filing, the business rescue could lapse with retrospective effect.[35] This could leave funders who provided funding on the assumption that the business was in business rescue, without the priority status enjoyed by post-commencement financiers as the company was not legally in business rescue.[36]

[28] Van der Linde in Faber, Vermunt, Kilborn and Richter *Commencement of Insolvency Proceedings (*2012) 546.
[29] S 135(2)(a).
[30] Van der Linde in Baer and O'Flynn *Financing Company Group Restructurings* (2015) 441.
[31] Smuts "Affected Persons in Business Rescue" Part 4 2016 https://brexchange.co.za/affected-persons-business-rescue-part-4-shareholders/ (29/08/2017).
[32] Smuts "Affected Persons in Business Rescue" Part 2 2017 https://brexchange.co.za/affected-persons-business-rescue-part-2-creditors-continued/ (02/09/2017).
[33] Du Preez (n6) 90-91.
[34] Du Preez (n33) above.
[35] S 129(5)(a).
[36] Refer to the discussion on 'substantial compliance' below with reference to the *Madodza* case (n 137) and the *Advanced Technologies* case at (n 135).

The period immediately following the filing for business rescue is crucial and the need for post-commencement finance is often the greatest at this stage of the process to enable short term trade obligations to be met in the form of working capital requirements, restructuring costs and the restoration of the company balance sheet to a state of solvency.[37] It is improbable that any unencumbered assets remain at this stage to secure such post-commencement finance which further highlights the need to clarify the remaining questions regarding post-commencement finance for funders.

A distressed business commonly has three options to consider in driving the business back to financial health: (1) debt restructuring; (2) asset sale; or (3) a capital injection from an external source such as a financier or investor.[38] These are private reorganisation mechanisms and if applied early enough, can prevent the potentially costly process of entering business rescue or eventual liquidation.

Interestingly, only option three would qualify as post-commencement finance if it should occur within the ambit of business rescue. This leaves the question of whether the restructuring of debt, which may have a cost for the creditor in the medium to long term, should not also be expressly included in the definition of post-commencement finance when embarked upon within the rescue process. The immediate effect on the debtor company would be improved cash flow and liquidity.

2.1 Traditional forms of post-commencement finance

2.1.1 Shareholder funding

It seems that shareholders do not consider, and in some instances are not aware, that they could enjoy the payment priority afforded to post-commencement financiers in section 135 if they provide funding after the business rescue filing.[39] This lack of insight and understanding could leave the shareholder out of pocket and at the back of the creditor queue. They have every right to be involved in the business rescue process as they have a very real interest in the eventual outcome of the process which could see their shares regain some of the value that may have been lost.[40] Traditionally the view of stakeholders has been that it is the creditor who has the most to lose.[41]

The perception amongst practitioners and wider stakeholders in the business rescue fraternity is that existing banks remain the most likely originators of distressed funding with existing shareholders being regarded as the second most likely source.[42]

A further consideration is that the conversion of any shareholder loans into further equity may improve the solvency position on the balance sheet, but would not assist with much needed additional liquidity. Providing additional cash funding in the form of equity would have the greatest effect in facilitating the rescue process, but leave the shareholder with even greater

[37] Du Preez (n 6) 6.

[38] Senbet and Wang "Corporate Financial Distress and Bankruptcy: A Survey" 2012 10 https://www.rhsmith.umd.edu/files/Documents/Centers/CFP/FinancialDistressSurveySenbetWang.pdf (31/07/2017).

[39] See Smuts (n 31).

[40] Loubser "The Role of Shareholders during Corporate Rescue Proceedings: Always On the Outside Looking In?" 2008 20 SA Merc LJ 372.

[41] See Loubser (n 40) 373.

[42] South Africa restructuring survey (n 23) 3.

exposure. This could however provide the confidence that a third party funder requires to participate and provide additional post-commencement finance alongside the shareholder.[43]

2.1.2 Financial institutions and lenders

Although it does not occur often enough in practice, it would make sense for pre-insolvency lenders such as financial institutions such as banks and even trade creditors, who have an existing relationship with the distressed company, to provide additional funding or trade credit.[44] This could have the effect of improving their chances of recovering existing claims or provide a prime opportunity to benefit from higher risk-related lending rates. Such a decision should, however, be carefully considered as no lender wishes to throw good money after bad.

It is interesting that section 128(1)(a) does not allow for the inclusion of a pure financial post-commencement financier as an 'affected person' at any point in time. This is in contrast to the protection that other affected persons such as shareholders, secured and unsecured pre-business rescue creditors have. This implies strongly that the post-commencement financier cannot apply for the removal of the business rescue practitioner under section 139(2) which reads:

> "Upon request of an affected person, or on its own motion, the court may remove a practitioner from office on any of the following grounds:
>
> (a) incompetence or failure to perform the duties of a business rescue practitioner of the particular company;
> (b) failure to exercise the proper degree of care in the performance of the practitioner's functions;
> (c) engaging in illegal acts or conduct;
> (d) if the practitioner no longer satisfies the requirements set out in section 138(1);
> (e) conflict of interest or lack of independence; or
> (f) the practitioner is incapacitated and unable to perform the functions of that office, and is unlikely to regain that capacity within a reasonable time."

Due to the extensive powers and authority granted to a practitioner during the business rescue process, it would only be sensible to include a post-commencement financier as an affected person from the day he provides post-commencement finance which would allow him the protection afforded under section 139(2).

A significant challenge experienced by financial institutions and other lenders is the availability of any remaining security for post-commencement finance. In the majority of instances, a company would have increased its debt base to the greatest extent possible, exhausted any institutional funding and be stuck with an over-leveraged balance sheet. The red-tape and robust process-driven business models of most lenders in this class would simply not allow for further financial assistance or post-commencement finance even with an accompanying preferential claim status. The reliability and credibility on available financial statements or accounts is often low and may not put the lender in a position where he can make an informed decision.

[43] Van der Linde in Baer and O'Flynn (n 30) 427.
[44] UNCITRAL (n 13) 115 at 99.

2.1.3 Strategic investors and distressed funds

Strategic investors may include competitors or operating entities in related industries searching for a 'bolt-on' or opportunity to vertically or horizontally integrate their supply chain to unlock synergies and additional value in their own stable. An asset in distress could be acquired (by means of subscription or sale of shares) for a good price due to the urgency involved and the bargaining power of an acquirer is increased.[45]

The transaction may involve acquiring the distressed entity and recapitalising it with fresh cash reserves thereby allowing for the restoration of the balance sheet to solvency and potentially negotiating a compromise with creditors to improve operational liquidity. Such a recapitalisation in business rescue would be regarded as post-commencement finance and carry preferential ranking in terms of section 135 of the Act. This could result in a fair return for creditors.

South Africa does not have a true formal distressed funding sector compared to the far more mature industry in Europe and the United States. Distressed funds typically have a fairly more liberal approach and process to extending post-commencement finance than traditional institutional lenders such as banks. A distressed fund would typically apply a risk related interest rate making their funding generally expensive. Restrictive covenants on management and the business is the norm. Every matter under consideration is different and may require different assessment criteria.

Development funding institutions such as the National Empowerment Fund (NEF), Public Investment Corporation (PIC) and Development Bank of Southern Africa (DBSA) do make loans available and are willing to take up mezzanine capital positions in distressed companies. Their mandate in such instances is focussed largely around the facilitation of black economic transformation and job preservation.[46]

Strategic investors are driven by the creation of value and the unlocking of synergies within their structures by assimilating the distressed business or its operations thereby benefiting the wider stakeholder base, including employees and management. Such value may initially not be financial in nature and emerge over time, whereas distressed funds are driven largely by short-term financial returns which may be to the detriment of other creditors who stand behind them in the queue from a post-commencement finance perspective.

A consideration which is to be noted is that a strategic acquisition could be achieved in parallel to the approved business rescue plan. The underlying risk remains that should the acquisition be made for a price which is regarded as 'insufficient value' or 'not for fair value' the business rescue practitioner may be challenged by other affected persons via a court process which could result in the transaction being regarded as void.[47] The common law remedy, actio Pauliana, could be used for fraudulent transfer transactions which were made to the detriment of creditors.[48]

A combination of debt and equity from a post-commencement financier could be used whereby a controlling stake in the company is taken at nominal value with further capital being injected

[45] Senbet and Wang (n 38) 11.
[46] Van der Linde in Baer and O'Flynn (n 30) 427.
[47] Senbet and Wang (n 38) 12.
[48] Van der Linde in Baer and O'Flynn (n 30) 429.

for operational purposes in the form of debt.[49] In such instance the Shareholders Agreement and Memorandum of Incorporation would be drafted in favour and protection of the interests of the post-commencement financier. Conditions such as the change of management could be made at the outset of the process,[50] but would have to comply with South African labour legislation. Research in the American debtor-in-possession (DIP) environment have further indicated that approximately 70% of CEO's are replaced within 2 years of entering the Chapter 11 process.[51] The deduction is that DIP lenders enforce control and additional governance in the debtor firm in the form of a change in management.[52]

2.2 Non-traditional post-commencement finance and post-commencement employees

Section 135(1) places the practitioner, followed by the post-commencement employees, at the front of the line and classifies unpaid services provided by such employees from the commencement phase as post-commencement finance.[53] This sections current drafting structure could have the effect that any other post-commencement finance provided be utilised to bankroll the practitioner fees and employee costs during the business rescue process further exacerbated by the extensive protection of employee rights under South African labour legislation which is not aligned with the Chapter 6 process.[54]

It should therefore be asked whether an appropriate balance is being managed between the interests of employees and creditors in the Chapter 6 regime.[55] Despite the noble intentions behind the protection of employees and their rights under international standards and bodies such as the International Labour Organisation (ILO) and European Union (EU), the effectiveness of a corporate rescue regime could be diluted and in fact threatened by the over-protection of employees.[56] A creditor may reach a point where it no longer sees a viable business to be rescued and pushes for liquidation in order to recover a greater share of its capital or assets. Should liquidation be initiated under the auspices of the Insolvency Act,[57] employees enjoy far less protection, with a capped claim preference , in comparison to a business rescue process which would still require conformation with the Labour Relations Act (LRA) and the Basic Conditions of Employment Act (BCEA) and places no express limitation on a claim, which further enjoys super priority status. This super priority status remains in place should the rescue fail and the company goes into liquidation, being only subject to liquidation costs.[58] It is herewith contended that the over-protection of employee rights at the potential cost of the creditors interests, would ultimately be to the detriment of the employee. Creditors or investors

[49] Levenstein *An appraisal of the new South African business rescue procedure* (2015 thesis University of Pretoria) 475; Becker and Levenstein *Opportunities arising from the new business rescue provisions of the South African Companies Act, 2008* https://www.werksmans.com/legal-briefs-view/opportunities-arising-new-business-rescue-provisions-south-african-companies-act-2008/ (02/10/2017).

[50] Senbet and Wang (n 38) 12.

[51] Chapter 11 of the American Bankruptcy Code is the equivalent of Chapter 6 in the South African Companies Act.

[52] Senbet and Wang (n 38) 39.

[53] S 135(1) of the Act.

[54] Joubert, van Eck and Burdette "Impact of Labour Law on South Africa's New Corporate Rescue Mechanism" 2011 International Journal of Comparative Labour Law and Industrial Relations 27 1 79.

[55] See (n 54) 65.

[56] (n 54) 65 above.

[57] Act 21 of 1936; (n 54) 80.

[58] S 135(4).

may be dissuaded from investing or acquiring a distressed company with the intention to restructure as the cost of retrenchment could severely dilute the attractive returns envisaged by saving the company.[59] However, should the fees of practitioners, the salaries of employees and claims of post-commencement financiers not be preferred in business rescue, and a subsequent liquidation, there would be little incentive to take appointments or support the business rescue process. The risk remains that their converted claims in a liquidation scenario will not be satisfied once secured creditors' claims are paid.

Section 131 makes it possible for affected persons, which includes employees, to apply to a court to place the company into business rescue should other affected persons have failed to do so.[60] So great is the regard for the employee that an employee representative must be given the opportunity to address the creditors meeting before the proposed business rescue plan is subjected to a creditors' vote.[61]

2.3 The lack of regulation of business rescue practitioners

The extensive authority granted to the business rescue practitioner (hereafter 'the practitioner') by section 40 of the Act in the form of administrative and advisory control of the enterprise under management makes it imperative to ensure that the individual appointed in such a capacity has the necessary qualifications, experience and competence needed to drive the turnaround of a business under administration. The absence of a capable practitioner could directly affect a potential funder's appetite to provide post-commencement finance.

Section 40 (1) (a) of the Act states that the practitioner –

> "…has full management control of the company in substitution for its board and pre-existing management…"

Cassim rightly states that the actual professional and practical experience of a practitioner is of greater importance than the personal attributes of integrity and impartiality.[62] To a great extent, the success or failure of a business rescue is dependent on the quality of the practitioner who, who following appointment, must immediately determine the 'reasonable prospect' of success after investigating the affairs of the company.[63]

It is therefore clear that the lack of formal regulation of the business rescue practitioner profession is a cause for great concern. Indeed, the practitioner could well be the weakest link in the entire business rescue process.[64] The role of the practitioner should not perceptionally be regarded as antagonistic in the instance of creditors whose funding, participation and support is required for a successful turnaround regime.[65]

[59] Joubert, van Eck and Burdette (n 54) 67.
[60] See s 131 of the Act.
[61] Joubert, van Eck and Burdette (n 54) 78.
[62] Cassim *Contemporary Company Law* (2012) 889.
[63] S 141 (1) of the Act.
[64] Hoosein *The Weakest Link: The Regulation of the Business Rescue Practitioner* (2014 dissertation UJ) 2.
[65] Bradstreet "The Leak in the Chapter 6 Lifeboat: Inadequate Regulation of Business Rescue Practitioners May Adversely Affect Lenders' Willingness and the Growth of the Economy" 2010 *SAMLJ* 198.

Appointing the correct practitioner for the right business rescue matter is imperative and the 'horses for courses'[66] approach could provide great comfort to post-commencement financiers.

Section 138(1)(e) contains the central requirement of practitioner independence from the company to allow for the objective and impartial application of his powers.

Hoosein makes the following pertinent observation: [67]

> "Independence of the applicant is essential to avoid a conflict of interest arising between the practitioner himself and the company or its creditors. The qualification purely dictates that the applicant be independent of the company; this should be amended to include independence from creditors. Relationships with creditors should also be prohibited, as it may hinder the practitioner's independence. The practitioner's independence from the creditors is just as important as his independence from the company."

The independence of the practitioner is imperative and would enable the practitioner to balance conflicting interests of the company, creditors, post-commencement financiers and other affected persons.[68]

3. The stakeholder base in business rescue matters

One of the main objectives of Chapter 6 is the restructuring of a distressed company's affairs in such a way that would result "in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company…."[69] This sentiment is invariably amplified by section 7(k) of the Act which states that one of the objectives of the Act itself is to provide for the rescue and recovery of distressed companies "in a manner that balances the rights and interests of all relevant stakeholders".

The shift from a substantially creditor-friendly rescue framework in the judicial management regime to the business rescue regime which is invariably favorable to the debtor along with various other stakeholders, gives rise to new challenges and behaviours which need to be addressed by our courts.[70] However, a balance must be struck between protecting the distressed business (debtor) and its stakeholders at the potential cost to the interest of creditors who could in the process be discouraged from contributing capital to over-protected business debtors. One would effectively serve the interests of all stakeholders by affording sufficient protection to creditors.

Secured creditors, most notably banks, are often accused of taking a narrow view in the instance of business rescue by being over-secured thereby not leaving sufficient security for potential post-commencement financiers. In addition, banking institutions incentivize their representatives based on capital recovered in the short term which often results in a vote against a potentially viable business rescue plan which could provide better returns to a larger stakeholder base in the medium to longer term.

[66] Cassim (n 62) 890.
[67] Hoosein (n 64) 10.
[68] Hoosein (n 64) 15.
[69] S 128(1)(b)(iii). Reference is also made to S 128 (a) which defines 'affected persons' and is aligned with the broader view of 'stakeholders,' being wider than just creditors and shareholders.
[70] See Bradstreet (n 65) 198.

Given that the ability to raise post-commencement finance is so closely linked to the success of business rescue, it is difficult to believe that the Act itself does not provide more extensive and express certainty regarding how post-commencement finance should be dealt with and, once granted, how it affects the ranking of pre-business rescue creditors who hold security.[71]

In the 2013 High Court judgment by Kgomo J, *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies & Engineering Company & Gainsford*,[72] the court set out a ranking for post-commencement finance which places (secured and unsecured) post-commencement finance claims above the claims of secured pre-commencement creditors. [73] This ranking was set out *obiter* and should therefore not be regarded as binding on other courts. Van der Linde and Calitz criticise this judgement as the distinction between encumbered assets and free residue is not considered which has the effect of prejudicing the rights of secured pre-commencement creditors.[74]

Redpath Mining South Africa (Pty) Ltd v Marsden,[75] which was also decided by Kgomo J, was decided on the same basis as *Merchant West*, and failed to correct or further clarify the position on ranking. Both these cases are in conflict with section 135(3) of the Act which does not refer to secured pre-commencement claims presumably because such claims are promptly repaid separately from the proceeds of respective security as set out in section 134(3).[76] Had it been the intention of the legislature that post-commencement employee claims have priority over secured pre-commencement claims, such should have been very expressly stated in the Act as the effect is severely prejudicial to creditor rights regarding their security.[77]

In the 2015 *Diener* Case,[78] the court a quo dealt with the status and preference of the remuneration of the business rescue practitioner in instances where business rescue proceedings were converted into liquidation proceedings. The case brought about the result that the practitioner steps to the back of the queue with concurrent creditors in the event that liquidation ensues and his fees have not been paid despite the preferential status of his claim conferred by section 135 and 143 of the Act.[79] This had led to the further antagonistic tendencies between practitioners, secured pre-commencement creditors and liquidators.

The Supreme Court of Appeal in *Diener*,[80] has provided much needed clarity in this regard and supports the view that business rescue is not intended to dilute or interfere with the rights of secured creditors.[81]

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[71] Jones & Wellcome "The elephant in the room – post-commencement financing and whether pre-business rescue creditors' rights to their security are compromised" https://www.cliffedekkerhofmeyr.com/en/news/publications/2016/dispute/dispute-resolution-alert-20-july-the-elephant-in-the-room-post-commencement-financing-and-whether-pre-business-rescue-creditors-rights-to-their-security-are-compromised.html (19/08/2017).

[72] *Merchant West Working Capital Solutions (Proprietary) Limited v Advanced Technologies & Engineering Company (Proprietary) Limited & Gainsford* (Unreported, Case No 2013/12406) at 21.

[73] *Merchant West* case (n 72); Pretorius and du Preez (n 3) 171.

[74] Van der Linde and Calitz *National Report for South Africa* in Faber, Vermunt, Kilborn, Richter and Tirado *Ranking and Priority of Creditors* (2016) 463.

[75] *Redpath Mining South Africa (Pty) Ltd v Marsden No and Others* (18486/2013) [2013] ZAGPJHC 148 http://www.saflii.org/za/cases/ZAGPJHC/2013/148.html (03/07/2017).

[76] Van der Linde 'Company and Insolvency Law Update' (paper delivered at the Annual Banking Law Update in Johannesburg on 15 May 2014).

[77] Van der Linde and Calitz (n 74) 464 fn 205; (n 76 above).

[78]*Ludwig Wilhelm Diener NO vs Minister of Justice* case no 30123/2015 (SG) (unreported).

[79] *Diener* case (n 78) 23 at 60.

[80] *Diener NO v Minister of Justice and Others* 2018 All SA 317 (SCA).

[81] (n 80 above) 17 at 44.

Plasket AJA found that, following the conversion of business rescue proceedings into liquidation proceedings, section 135(4) provides the practitioner "a preference in respect of his or her remuneration to claim against the free residue after the costs of liquidation but before claims of employees for post-commencement wages, of those who have provided other post-commencement finance, whether those claims were secured or not, and of any other unsecured creditors."[82]

This judgement seemingly does not provide the same protection to secured pre-commencement creditors and secured post-commencement creditors.

It is reasonable to say that the previous lack of express guidance on how to apply insolvency legislation in conjunction with the ranking of claims in Chapter 6 of the Companies Act, specifically section 135 and section 143, contributed to the lack of support for business rescue and the provision of post-commencement finance by creditors. The status of secured pre-commencement creditors and post-commencement financiers must at all times be protected and assured, not only through statutory interpretation, but by consistent judicial interpretation and enforcement through precedent.[83]

Levenstein proposes that post-commencement finance "might be placed after the supervisors' fees and administration claims, but before secured creditors; or it might rank *pari passu* with all administration expenses."[84] What is clear is that post-commencement financiers need to have clarity on where post-commencement finance ranks with other claims and how it is 'converted' into a 'claim' when liquidation proceedings commence, as any perceived lack of clarity in this regard would prove to be a direct disincentive for providing funding to distressed companies.[85]

It is here that we must take a broader look at the stakeholder base surrounding a company – and more specifically, a company in business rescue, since interests in such instance are amplified by the necessity to succeed.

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3.1.1. Shareholders

As a direct result of corporate limited liability,[86] shareholders in a business rescue scenario stand to lose no more than their actual investment in the company. If, however, the business rescue is successful, the shareholder's gain is not limited in the same manner as would be the case for a creditor.

[82] *Diener* (n 80) 19 at 49.

[83] Levenstein *An appraisal of the new South African business rescue procedure* (n 48) 474.

[84] Levenstein *An appraisal of the new South African business rescue procedure* (n 48) 477.

[85] Levenstein *An appraisal of the new South African business rescue procedure* (n 48) 476.

[86] *Salomon v Salomon & Co Ltd* 1897 AC 22 (HL). The concept of 'limited liability' in corporate law delineates that shareholders in a private company are not liable for the liabilities of the company in normal circumstances. The principle becomes very important when a company is in distress as creditors would not be able to hold shareholders directly liable for company woes.

Of imperative importance for a business rescue practitioner, in any scenario, is to determine to which extent a shareholder has contributed to the demise of the company into a state of distress – and whether the resulting state is due to active or passive means.[87]

As one of several stakeholders, the shareholder essentially loses control of the company once in business rescue and it would be in his interest for the business rescue to succeed – preferably in a way where his interests are not materially diluted. Depending on the eventual outcome, the way post-commencement finance is structured could see a shareholder retain his share interests fully, or see his interests diluted to an insignificant pittance.

This brings us to the convergence and potential conflict between the interests of three major stakeholders: the shareholder, practitioner and post-commencement financier. All three of these stakeholders would like to see the business rescue succeed, albeit for different yet self-interested reasons.

The shareholder (via the appointment of the practitioner) loses effective control of the company as the practitioner steps into the shoes of the board of directors, thereby effectively taking over executive management control and commercial decision-making powers of the company. This makes the shareholder vulnerable to potential unethical conduct of the practitioner and potential investors, including post-commencement financiers.

The issue of additional shares during the facilitation of an equity finance transaction under a business rescue plan would not be subject to pre-emptive rights of existing shareholders who would be diluted, and be subject to the practitioner's determination of reasonable consideration for such shares.[88] The appraisal remedy as set out in section 164 of the Act would not apply in the event that the shareholder's rights are negatively affected by the issue of additional shares.[89]

3.1.2. Directors and Employees

The bond between directors (especially executive directors) and the company is a 'fiduciary' bond,[90] which is further amplified by the director liability provisions in the Companies Act which make it clear that the director must place the interest of the company before the interest of the shareholder.[91]

Chapter 6 significantly indorses proactive steps to be taken by 'the company' in initiating business rescue proceedings when it becomes evident that the company may be financially distressed.[92] Section 129 of the Act places this responsibility on the board of directors to initiate proceedings by board resolution in the first instance, as it would logically be expected that the directors, as the primary custodians of the company's interests, would reasonably be expected to foresee impending financial distress. It can only be logically intimated that section 131 was

[87] Levenstein 'Time to Amend the Business Rescue Act?' https://www.werksmans.com/legal-briefs-view/time-to-amend-the-business-rescue-act/ (02/10/2017). The writer suggests that one of the potential amendments to the Act be that the practitioner be allowed to interrogate the shareholders and management to determine the contributory effect of bad management to the demise of the company.

[88] s 152(7); Van der Linde (n 30) 444.

[89] Van der Linde (n 30), s 164.

[90] Radin "700 Families to feed: The challenge of corporate citizenship" 2003 *Vanderbilt Journal of Transnational Law* 619 624.

[91] S 76 and 77 of the Act.

[92] S 129 (1); du Plooy *Is Business Rescue really the so-called "lifejacket" alternative to our "sinking" liquidation proceedings: A critical analysis of the Business Rescue and Liquidation proceedings compared* (2014 dissertation UJ) 4.

envisaged by the legislature as an 'open door' to other stakeholders called 'affected persons'[93] to initiate business rescue proceedings should directors have failed to do so for any reason.

It is here that the interests of directors may potentially collide with the interests of the practitioner, whose primary goal is to rescue the company, irrespective of prior conduct by stakeholders which includes directors. Directors may attempt to cover up previous questionable conduct on their behalf which may or may not have contributed to the demise of the company. The Act obliges the practitioner to investigate the affairs of the company and forward any evidence of malfeasance, reckless trading, fraud or omissions of legal obligations by directors to the relevant authorities.[94] It should be noted that in the event that a section 129 filing is effected, the directors (board) can influence the appointment of a suitable proposed practitioner, whereas the section 131(5) process requires the court to make the appointment with reference to the nomination of a practitioner deemed fit by the affected person who brought the application.

The African Bank business rescue matter was expected to set precedent in this regard as it was believed that directors in that instance acted recklessly. Significant assistance in the form of post-commencement finance was provided by the South African Reserve Bank in an attempt to save thousands of jobs and stabilize a financial institution which had become a significant lender to lower income earners in the local economy. The appointment of an appropriately skilled practitioner along with the co-operation of creditors, being other financial institutions, gave the Reserve Bank the confidence to provide the required post-commencement finance and related support. African Bank has emerged from supervision, further having saved thousands of jobs.[95]

While the practitioner takes over effective control of the company, pre-existing management, which specifically includes directors, are not displaced.[96] Directors retain their responsibilities and have a duty to the company to continue exercising any management functions in line with and subject to the express instructions of the practitioner.[97] Directors must co-operate with the practitioner and provide him with any information about the company that would reasonably assist him in rescuing the business.[98]

There are bound to be disagreements and potential clashes in personality in some instances, most especially when the necessity to succeed is highlighted. Differing views by existing management on how the company should be rescued could lead to a situation where the practitioner and some of the directors are in disagreement. Section 137(5) allows for the practitioner to apply to the court to remove a director in instances where he is actively or passively by omission impeding the practitioner from performing his duties, directing the company or implementing a business rescue plan.[99]

A prudent post-commencement financier could include the resignation of certain directors as conditional covenant to the provision of funding as such director may be regarded as a risk to

[93] See (n 17) with regards to S 128(1)(a).
[94] S 141(2)(c); Levinstein "Top Ten Risks for Creditors of Companies going into Business Rescue" http://www.werksmans.com/legal-briefs-view/top-ten-risks-for-creditors-of-companies-going-into-business-rescue-in-2017/ (15/09/2017).
[95] "Abil emerges from business rescue with R 250m in reserve" https://www.moneyweb.co.za/news/companies-and-deals/abil-emerges-business-rescue-r250m-reserve/ (29/01/2018).
[96] Cassim (n 62) 894.
[97] s 137(2).
[98] s 137(3).
[99] s 137(5)(b).

the potential rescue of the company.[100] It is not clear how such a condition would affect the position of such a director from a labour law perspective.

3.1.3. Creditors, Strategic Investors and Traditional Financiers

Following the decision to file for business rescue, the most central concern for creditors and post-commencement finance providers is the degree of influence that they may have in the decision concerning the appointment of the practitioner.[101] The extensive powers and control over the business, its directors and operations under the authority of the practitioner makes the appointment significant not only for existing creditors but for potential investors and post-commencement financiers as well.

3.1.4. Business Rescue Practitioners and Liquidators

The interaction between business rescue practitioners and liquidators have in many cases become antagonistic and led to lost opportunities for success in the industry. The business rescue process requires the effective interaction between all stakeholders, but most specifically practitioners and liquidators in instances where the company was in business rescue and is subsequently placed into liquidation or where the company was in liquidation and thereafter placed into business rescue.[102] In such instances the sharing of information in the transition between one process to another, is of great importance and in some instances reliant on information gathered and efforts made by both the practitioner and the liquidator.

The court a quo decision in *Diener* ,[103] determined that none of the practitioner's fees or costs (which included the costs of attorneys) could be included in the 'costs of administration' of the insolvent estate where rescue proceedings were converted into liquidation proceedings, leaving the practitioner at the back of the queue along with other concurrent creditors. Braatvedt notes that the interpretation of relevant statutes may have been strictly correct but questions whether such result could have been the intention of the drafters of Chapter 6.[104] The practitioner and attorneys contributed significant efforts during the preceding business rescue process and should not be left in the cold once liquidation proceedings commence. The Supreme Court of Appeal clarified that the practitioner must be settled from free residue but ranks behind the costs of liquidation.[105]

In *Industrial Development Corporation of SA Limited and Another v Schroeder N.O and Others,*[106] the duly appointed liquidators of the company, Laman (Pty) Ltd which operated in the mining and quarrying industry, spent significant efforts to preserve business operations by attempting to sell the business as going concern.[107] This was due to the further declining value of assets and operations. The liquidators contended that the alternative would have been to close operations, resulting in considerable loss of employment and a questionable return for

[100] Senbet and Wang (n 38) 43.
[101] Bradstreet (n 65) 201.
[102] Braatvedt "Reflections on Two Cases" http://www.tma-sa.com/info-centre/item/218-reflections-on-two-cases.html (19/08/2017).
[103] See *Diener* case (n 78).
[104]See Braatvedt (n 102) above, par 16.
[105] *Diener* (n 80) 19 at 49.
[106] *Industrial Development Corporation of SA Limited and Another v Schroeder N.O and Others* case no 1958/2015 (unreported).
[107] See *Schroeder* case (n 106) above par 21.

creditors. A section 131 application to place the business into business rescue, thus taking the business out of provisional liquidation, was made by certain shareholders.

The liquidators requested that their liquidators' fees and disbursements, which were incurred since the commencement of liquidation, be paid by the shareholders by means of an issued guarantee so that the business rescue process would not change the preferential nature of their claims. [108]

Nhlangulela ADJP, held that the liquidation order had not yet been confirmed which had the result that the winding-up process had not yet commenced.[109] The court relied on section 143 of the Companies Act which provides for the remuneration of the practitioner and not the liquidator, as well as section 136 (4) which classifies the liquidator as a creditor without providing clear preference to the liquidator above other creditors.[110] This left the liquidator as a concurrent creditor despite having contributed significant efforts during the provisional liquidation phase, during which business rescue was not being contemplated or foreseen.

Again, the strict interpretation of the provisions in Chapter 6 have resulted in an irregular result that fails to consider the practical participation of business rescue practitioners and liquidators who could be left out of pocket. This could not have been the intention of the drafters of Chapter 6 and is a deficiency that must be rectified in future amendments to the Act.

The ultimate result is that practitioners and liquidators do not cooperate and therefore could end up not serving the interests of the wider stakeholder group as a whole, as they are required to protect their own interests in the first instance. A further result could be that liquidators and practitioners take a practical approach, where possible, to assist each other in collecting their fees and costs. This could be achieved by including practitioner costs in liquidation calculations and including preliminary liquidator fees in costs of business rescue.

4. Stakeholder Theory and its Effect on Post-commencement Finance

Under this section, stakeholder theory will be explored and linked to the various interested parties in a business rescue matter which often impact and contribute towards an over-cautious post-commencement finance lender culture.

4.1 Basic Stakeholder Theory

In 1962 Milton Friedman famously pronounced that the only social responsibility of a corporation is to generate profit for its shareholders.[111] The concept of 'shareholder theory' or 'shareholder primacy' was born. This view stands in direct contrast to Freeman and 'stakeholder theorists' who claim that a corporation's responsibilities further extend to other, broader stakeholder interests as well.[112] In other words, a company (and those responsible for acting on its behalf) has a broader responsibility than to provide returns for shareholders. This gives rise to a number of studies on how executives, companies, and other stakeholders do in

[108] *Schroeder* case (n 106) par 7.
[109] *Schroeder* case (n 106) par 40.
[110] *Schroeder* case (n 101) par 42.
[111] Smith "The Shareholders vs. Stakeholders Debate" 2003 *MIT Sloan Management Review* http://sloanreview.mit.edu/article/the-shareholders-vs-stakeholders-debate/ (07-09-2016); Friedman *Capitalism and Freedom* University of Chicago Press (1962) 133.
[112] See Radin (n 90) 639.

fact interact.[113] Stakeholder theory participates in a broader debate about business and ethics which becomes even more prolific in the business rescue arena which sees a company and many of its stakeholders placed in a position of vulnerability, despite legislative protection afforded via Chapter 6.

4.2 A battle of conflicting interests in business rescue unpacked

Bradstreet notes that the functional form of a rescue regime affects creditors as central stakeholders in two ways.[114] Firstly, the greater the effective displacement of management in the process, the more attentive creditors are likely to be to the scope of powers exercisable by the respective practitioner along with his capability and experience. Should the practitioner not be regarded as 'a safe and trustworthy pair of hands' creditors may be disincentivised from investing any further capital in the form of post-commencement finance or become uncooperative in the entire rescue process. Secondly, being party to a business rescue scenario is a tense experience for management and particularly risk-averse individuals may become less motivated to perform when the business needs it most. This is exacerbated under a stricter procedural regime where an external person, such as a practitioner, is brought into the work environment.

Conflict of interest amongst creditors and other claim holders can detract from finding an optimal and equitable resolution for a distressed company in the form of an informal workout scenario or pre-packed business rescue plan.[115] This conundrum is not eliminated in a business rescue scenario but is in fact exacerbated by the requirement to have creditors vote on a proposed business rescue plan during the approval and adoption process. Inter-group conflicts naturally arise as an allocation in favour of one class or group of creditors would always be at the expense of another class or group, which could include post-commencement financiers.[116] Conflicting incentives therefore often make it particularly difficult for the practitioner to get a plan approved timeously which puts further pressure on the value of assets and the chance of a successful rescue. A pertinent example is where one creditor refuses to vote for the approval of the plan as he perceives his claim to be diminished at the interest of an incoming post-commencement financier, or shareholders being uncooperative where a debt to equity conversion is proposed in favour of bond holders.

An interesting dynamic is introduced when one considers which party's interests the practitioner represents when one compares the previous judicial management regime with the Chapter 6 regime.[117] The judicial manager had a fiduciary duty to the creditors whereas the business rescue practitioner has a fiduciary duty to the company which entails the interests of a much wider stakeholder base. Conduct that is favourable to the company may not of necessity be favourable for creditor and post-commencement finance funder interests. Considering the matter from another perspective, a business rescue practitioner who is incentivised on the amount of post-commencement finance he raises for the debtor may lean towards getting such

[113] See Smith (n 111) above.

[114] Bradstreet (n 65) 200.

[115] Senbet and Wang (n 38) 19.

[116] See (n 110) above.

[117] Khaole *Factors influencing the provision of turnaround finance to financially distressed companies in SA* (MBA Thesis Gordon Institute of Business Science 2009) 55.

post-commencement finance from creditors under unusually onerous terms, which are beneficial to the creditor and may allow him to take control of the debtor in times to come.[118]

Creditors such as financial institutions furthermore do not inspire transparency from debtors by means of engaging them openly prior to filing for business rescue.[119] *In First Rand Bank Ltd v KJ Foods CC*,[120] the debtor informed representatives of the bank that the debtor was contemplating filing for business rescue following problems with one of its major suppliers. The bank's response included immediately freezing the entity's trading account which then led to an inability to trade at all.

This behaviour is in line with the view of various creditor classes as expressed in a survey which indicates that the majority of creditors prefer liquidation as the main means of dealing with financially distressed companies.[121] This is a concerning finding which is not in the interest of the wider stakeholder group or the economy. Creditors are of the view that liquidation provided more certainty in terms of the status of claims than business rescue.

On the other side of the spectrum are those who regard business rescue as an opportunity. Investors know well that the valuation of a business at an earlier stage of distress or as a 'going concern' is most often greater than the same business in a liquidation scenario where assets are being sold peace-meal at 'fire sale' rates.[122] It is therefore plausible that such investors, also known as 'vulture investors,'[123] may wait as long as possible before acquiring the business or its assets as the chance of a 'better deal' increases daily as the business becomes more distressed. This is a perceived abuse of power which is not prevented by Chapter 6. It is further not plausible that any legislation would be capable of negating such conduct on behalf of opportunistic strategic investors.

4.3 Liquidators in disguise

Although many have criticised the drafting of the Act and taken a view that certain key issues are not covered sufficiently in the drafting structure, it can also be said that provision has been made in Chapter 6 for checks and balances where business rescue is concerned. Sec 140(4) is such an instance where negative stakeholder behaviour or even abuse of the business rescue process is potentially avoided.[124] This section prevents a person who was appointed as business rescue practitioner from subsequently being appointed as liquidator for the same company in the instance where business rescue fails and is converted into a liquidation scenario.

This section seeks to prevent the situation where a person seeks appointment as practitioner merely for purposes of briefly or systematically stripping the company of its assets with the intended eventual result being liquidation. This is in contrast to the Australian requirement in

[118] See Khoale (n 117).
[119] *First Rand Bank Ltd v KJ Foods CC* (In business rescue) (734/2015) 2015 SCA 50 (27 April 2017) at 57.
[120] See *KJ Foods* (n 119) above at 57.
[121] This view was expressed at a survey which formed part of the South African Restructuring and Insolvency Practitioners Association (SARIPA) Conference in 2015. Levenstein and Shaw "Quo Vadis – Business Rescue or Liquidation?" https://www.werksmans.com/wp-content/uploads/2016/11/061873-WERKSMANS-november-business-rescue-or-liquidation.pdf (31/07/2017).
[122] Du Preez (n 6) 20; Hyde and White "Pre-pack administrations: Unwrapped" 2009 Law & Financial Market Review 134 -135.
[123] Khaole (n 117) 22.
[124] S 140(4) expressly limits the extent of negative stakeholder behavior where a person could potentially seek to be appointed as business rescue practitioner for the purpose of systematically stripping a company of its assets.

section 448A and 448C (1A) of the Corporations Act.[125] These sections expressly require that an administrator be a registered liquidator and state that failure to comply is an offense resulting in strict liability.[126]

Although the Act prevents an appointed practitioner from subsequently becoming the Liquidator of the same company,[127] the Act does not expressly prevent the practitioner from colluding with a liquidator or a creditor seeking liquidation.

In the case of *Swanepoel and another v Master Trucking (Pty) Ltd and another*,[128] the business rescue practitioner was accused of colluding with the creditor who had secured his appointment.[129] Strong evidence was presented that the practitioner acted in bad faith, that he failed to properly investigate the affairs of the company and that he failed to disclose crucial information to the court, finally causing the company to be placed under provisional liquidation. This would have resulted in the loss of 300 jobs which would have had a significant social economic effect in the area where the company operated.

In an affidavit by the company's financial director, it was alleged that the practitioner in fact lied to the court in an effort to have the company taken out of business rescue and placed under liquidation:[130]

"Van Greunen was more concerned about taking monies from the cash-flow to pay those creditors that ensured his appointment and to secure his own payment by transferring the amounts … out of the business accounts of the companies and thereafter making an allegation that there was not sufficient funds to operate the companies and continue with their business."

It is believed that these type or alliances between creditors and practitioners, whether actual or perceived, are not uncommon in the market and result in great distrust being directed towards practitioners. One should keep in mind that practitioners are often forced to take steps to ensure that their fees and costs do get paid, as they could otherwise remain without remuneration for months at a time.

4.4 Battle of the Creditors

During the process of voting in a viable business rescue plan for implementation, section 153 (1) of the Act makes provision for the Company to approach a competent court to set aside the result of the vote by holders of voting interests on grounds of 'inappropriateness.'[131] It is during this phase of the business rescue regime that creditors can severely hamper the business rescue process and damage the possibility of raising post-commencement finance. Again, the antagonistic relationship between the business rescue practitioner, who seeks to effectively 'rescue' the business, and creditors, who firstly seeks to protect their own interests, is highlighted.

[125] Australian Corporations Act 50 of 2001.

[126] Hoosein (n 64) 32.

[127] S 140 (4) of the Act.

[128]*Swanepoel and another v Master Trucking* (Pty) Ltd and another (unreported case M196/2016).

[129] See (n 128) above, par 22.

[130] (n 128) above.

[131]S 153 (1) of the Act.

In *Copper Sunset Trading 220 (Pty) Ltd, t/a Build It Lephalale (under business rescue) v Spar Group Limited*,[132] the High Court in Polokwane was approached by the practitioner to set aside the vote against a business rescue plan on the grounds that the vote by 2 creditors was inappropriate.[133]

Antagonism between creditors themselves is not to be underestimated. In the *KJ Foods* case,[134] the revised business rescue plan would presumably have resulted in the full settlement of secured as well as concurrent creditors but was rejected by FNB, a secured creditor. Liquidation would have resulted in full settlement of secured creditors but concurrent creditors would only receive 51 cents in the rand.[135] By FNB voting against the revised plan, a 75% vote could not be achieved and the practitioners made an application to the court to have the vote set aside. The court a quo set the vote aside on the basis that the vote against the plan was inappropriate and further ordered that the revised plan be adopted and implemented. The revised plan proved to be effective and allowed the company to comply with its financial obligations to creditors.

FNB appealed to the Supreme Court of Appeal. The court found that an application to set aside a vote on grounds of 'inappropriateness' under section 153(1) would be made where it is found to be 'reasonable and just' to do so with regards to section 153(7) which entails a value judgement after consideration of all appropriate facts and circumstances.[136] This would include considering the interests of FNB (secured creditor), other creditors and the employees of KJ Foods.

The Supreme Court of Appeal thereby further clarified that the legal result of a vote against a plan being set aside by a court, is adoption of the plan by operation of law.[137]

Close consideration of FNB's arguments in the *KJ Foods* case further inform the perception that financial institutions do not support business rescue and would therefore be less likely to provide post-commencement finance irrespective of the view that such institutions are in the most suitable position to do so.

4.5 Fruit of the poisonous tree – Shareholder abuse

For purposes of this section focus is placed on private companies in which instance shareholders are themselves directors of the respective company. In order to prevent the abuse of the Section 129 voluntary business rescue process by stakeholders such as shareholders, courts have taken a strict view on the application of the filing process and related time-frames as defined in the Act.[138] The primary reason for such abuse would be to obtain immediate temporary relief or respite from creditors through the section 133 moratorium. To date, the CIPC as well as courts have not accepted substantial compliance with legislated time lines as a sufficient standard and make the assumption of a degree of 'urgency' on behalf of stakeholders. In *Advanced Technologies and Engineering Company(Pty) Ltd v Aeronotique et*

[132] *Copper Sunset Trading 220 (Pty) Ltd, t/a Build It Lephalale (under business rescue) v Spar Group Limited and* Another (unreported case 365/2014).
[133] Reineck (n5) 15.
[134] *KJ Foods* case (n 119).
[135] *KJ Foods* case (n 119) par 12.
[136] *KJ Foods* case (n 119) par 84 and 85.
[137] *KJ Foods* case (n 119) par 89.
[138] Sher *The Appropriateness of Business Rescue as opposed to Liquidation: A critical analysis of the requirements for a successful business rescue order as set out in section 131(4) of the Companies Act 71 of 2008* (2013 Thesis University of Johannesburg) 34.

Technologies Embarquees SAS,[139] the court ruled that the prescribed time frames in section 129(3) and (4) were not met and that the resolution to begin business rescue proceedings was null and void due to it lapsing, irrespective of substantial compliance. In such instance the company would be prevented from filing a similar resolution for a period of 3 months unless an ex parte application is made to a court which deems it appropriate to allow deviation from such rule.[140] The court confirmed this view in *Madodza (Pty) Ltd (in business rescue) v Absa Bank Limited and Others*.[141]

It can be argued that the prescribed time frames in the Act are too narrow and potentially unrealistic. Shareholders could abuse this weakness to the potential detriment of other stakeholders which may include post-commencement financiers. Abuse may occur where relief in terms of the section 133 moratorium is sought for a brief period, only to terminate the process soon thereafter due to non-compliance with section 129(3) and (4) leading to the resolution of filing being nullified.[142] The 5 day period between filing of the resolution with the Commission and the appointment of the practitioner in line with compliance with Section 129(4) creates a high-risk situation for post-commencement financiers as it is clear that non-compliance would result in the business rescue being null and void. It is unclear what the position of the financier would be and where his claim would then rank. Did a business rescue ever effectively commence at all?

An understated and truly relevant element in terms of section 129 is the principal of 'good faith' which is implicit in the scheme of Chapter 6 as it seeks to balance the interests of various stakeholders in addition to that of shareholders. In *Griessel and Another v Lizemore and Others*, [143] Spilg J noted the following:

"In my view bad faith will be demonstrated if, for instance, the intention of the directors in passing a section 129(1) resolution is found to be an abuse. This would be considered in conjunction with other factors such as the attitude of major creditors..."[144]

He continues that "the corollary is that a company should not be placed under business rescue as a litigating strategy or to prevent or discourage a creditor from enforcing a claim to the full extent. This brings into focus the intention of the party seeking business rescue and whether that person genuinely seeks to attain the objectives of Chapter 6…"

'Good faith' is further relevant in determining whether it would be 'just and equitable' for the court to set aside a section 129 resolution under a section 130 application.[145] The Supreme Court of Appeal in *Panamo Properties (Pty) Ltd and Another v Nel* ,[146] found that the lack of clear drafting in the Act necessitated the court to interpret the relevant provisions widely and 'purposively' further referring to section 132(2)(a)(i) which had been omitted by pervious High

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[139] Cassim (n 62) 894; *Advanced Technologies and Engineering Company(Pty) Ltd v Aeronotique et* Technologies *Embarquees SAS par 27 and 28. http://corporate-911.co.za/Corporate-911-Advanced-Technologies-Engineering-V-Aeronautique-%20et-Technologies-Embarquees-SAS.pdf (15/09/2017).*
[140] S 129(5)(b).
[141] Sher (n 138); *Madodza (Pty) Ltd (in business rescue) v Absa Bank Limited and Others (38906/2012) [2012] ZAGPPHC 10* par 23-25 http://www.saflii.org/za/cases/ZAGPPHC/2012/165.pdf (15/09/2017).
[142] Sher (n 138) 35.
[143] *Griessel and Another v Lizemore and Others* (2015/24751) [2015] ZAGPJHC 189; [2015] 4 All SA 433 (GJ); 2016 (6) SA 236 (GJ) par 83 http://www.saflii.org/za/cases/ZAGPJHC/2015/189.html (16/09/2017).
[144] See *Griessel* (n 143) par 84 above.
[145] Sec 130 relates to the procedure for affected persons to object to the company resolution in Sec 129 to commence business rescue.
[146] *Griessel* case (n 143) par 84; Panamo Properties (Pty) Ltd and Another v Nel N.O. and Others (35/2014) [2015] ZASCA 76; 2015 (5) SA 63 (SCA); [2015] 3 All SA 274 (SCA) par 24-25, 28. http://www.saflii.org/za/cases/ZASCA/2015/76.pdf (16/09/2017).

Court judgments. This section clearly deals with the termination of the business rescue process. The court ultimately found that even where there had been non-compliance with section 129(4), business rescue proceedings had in effect commenced and must still be set aside by a court even if the respective filing resolution had lapsed and become nullified under section 129(5).[147] The court would apply the Act as such and consider good faith in the event where the passing of a section 129 resolution by directors is used for ulterior purposes and personal gain.

In the Panamo *Properties* case, the company's sole shareholder was a trust of which the trustees were also the directors of the company. The directors filed for business rescue by passing a section 129 resolution with the intent to prevent the sale in execution of a property by a creditor.[148] The creditor, further being a financial institution, got judgment against the company allowing it to legally sell the property. The shareholders cooperated with the business rescue process in the hope that the stayed sale would allow them time to source alternative finance in the form of post-commencement finance to discharge the debt. A business rescue plan was duly approved. The company could not source any post-commencement finance and the practitioner was forced to sell the property in line with the business rescue plan. Shortly prior to transfer of the property to the purchaser, the trust (via the trustee-directors) brought an action based on the argument that the company did not comply with section 129 requirements and that the entire business rescue process was a nullity.[149] The court found that the conduct of the shareholder was in not in good faith and that it would not be 'just and equitable' to set the resolution and business rescue process aside under sction 132(2)(a)(i).

5. *The Role and Interests of Financial Institutions in Post-Commencement Finance and Business Rescue*

Business rescue practitioners regard the mentality and approach taken by financial institutions (mainly mainstream banks) as a major stumbling block in the business rescue process and further as major prohibitor in the effective raising of post-commencement finance, thereby threatening the success of the Chapter 6 process altogether. The over-securitisation by financial institutions could result in a situation where there is little or no available security for PFC funders.

5.1 The 'Banker' Mentality

The published Deloitte South African restructuring survey results for 2017 indicated that a lack of available security was being regarded as the most paramount challenge to distressed companies in their attempt to raise debt finance.[150] The second greatest challenge was perceived to be the lack of risk appetite from lenders.

When the underlying triggers for restructuring activity are analysed, 'unsustainable debt levels' and 'economic downturn' (market stagnation) are two of the most referred to contributors of corporate distress.[151] The 2017 results indicate that a noticeable shift has occurred with focus being placed on 'unsustainable debt levels' as the most noted reason for financial distress.

[147] *Griessel* case (n 143) par 69.
[148] *Panamo Properties* case (n 146) par 3.
[149] *Panamo Properties* case (n 146) par 4.
[150] South African restructuring survey (n 23) 3.
[151] South African restructuring survey (n 23) 13.

The Report notes the following:

"Unsustainable debt levels can arise because of a variety of reasons including an unexpected change in market conditions, a loss of a major contract, a poor lending decision or an increase in interest rates."[152]

The above are extremely pertinent points for any financial institution or post-commencement financier as a lack of available security and the inability to service existing debt make it extremely difficult for a lender to extend any financial assistance or post-commencement finance without increasing its own risk to an unacceptable level, thereby exposing its own stakeholders to undue risk. In order to safeguard the interests of such lenders, commercial measures must prevail.

Debt to equity conversions could be adopted by financiers and may return a balance sheet back to a state of solvency but would not solve any liquidity problems.[153] The effect would further include shareholder dilution with increased control by lenders in addition to potential conditions or covenants.

It can therefore be deduced that, from a banker's perspective, irrespective of the nature of the funder, there really is not much incentive to provide post-commencement finance to a distressed company without taking on undue risk. A major additional consideration should be whether the company could in fact afford to service distressed debt which is by its very nature more expensive debt.

Traditional banks who are the secured creditors in most business rescue matters, are perceived to be generally over-secured due to their own internal rules and procedures. The greatest concern for such a creditor during the initial stages of a business rescue is getting as much of its debt repaid as soon as possible, irrespective of the effect on other stakeholders.[154] Their staff representatives are in fact often incentivised on the amount of debt recovered in the short term. This leads to creditors such as banks often voting against a potentially viable rescue plan in the protection of their own interests and to the detriment of other stakeholders. The *KJ Foods* case is a prime example of this approach which is mirrored in the *Oakdene Square Properties* case where the two major shareholders,[155] Nebank and Imperial Holdings, made it clear that they would accept nothing less than a liquidation order.

This leads us back to the concept of 'reasonable prospect' in the sense that only those companies that objectively have a chance of successfully being rescued should be allowed to be placed under administration in terms of Chapter 6. In addition, greater focus should be placed on a 'pre-assessment' process as well as early filing, as this would likely free up capital for the most promising prospective rescue targets. This could be the key do delivering a better outcome for all stakeholders concerned.

The ability to fix companies that are broken would be greatly assisted if business could replace the outright denial and hope of boards with a sense of realism at a far earlier stage.[156]

Despite the above, business rescue stakeholders, which include a large representation from the banking sector, still regard the existing bankers of distressed companies as the best source of

[152] See n 151 above.
[153] South African restructuring survey (n 23) 16.
[154] *KJ Foods* case (n 119) par 85.
[155] *Oakdene Square Properties* case (n 21); Bradstreet "Business Rescue proves to be creditor-friendly: CJ Claassen J's analysis of the new business rescue procedure in Oakdene Square Properties" 2013 *SALJ* 44 46.
[156] South African restructuring survey (n 23) 17.

distressed funding. [157] The nature of such funding is mostly through the extension of existing facilities, asset based lending and new equity. But if one is realistic, it becomes clear that financial institutions have a taken an extremely risk averse approach to debt. Healthy companies are struggling to gain access to growth funding despite being subjected to significant red tape and strenuous evaluation processes, how much more a company that is in clear financial distress.

5.2 An international perspective on post-commencement finance

There are two approaches internationally with regards to legislation governing business rescue or 'corporate restructure'.[158] The first approach is where business rescue or equivalent regimes are governed by insolvency legislation, as is done in the United States, Canada as well as the United Kingdom.[159] Alternatively, business rescue is governed by corporate legislation as is the case in South Africa and Australia.

The South African judicial management regime was governed by Insolvency Legislation and was founded upon a "creditor-friendly" base as opposed to the more "debtor-friendly" business rescue regime under the Companies Act of 2008. [160] This signifies a material shift in our legislation.

The World Bank and UNCITRAL both lay down further provisions and recommendations regarding the provision of post-commencement finance for application and guidance in rescue legislation.[161] Wide reference is made to debtor-in-possession (DIP) finance which is fashioned on the United States model under Chapter 11 of the Bankruptcy Code.[162] This speaks to the distressed company (the debtor) being in control of its operations during the restructuring process rather than under the control of an external individual such as a business rescue practitioner.

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5.2.1 Canada

The Canadian corporate rescue regime is two-tiered and unique in many ways. Canadian bankruptcy and insolvency law falls under federal government jurisdiction, is governed mainly by two pieces of legislation and is mainly court driven.[163] The Companies' Creditors Arrangement Act (the CCAA) is intended to assist larger corporations to reorganise their affairs in a similar process to Chapter 11 of the US Bankruptcy Code under debtor-in-possession principles. This is a more expensive but more popular and flexible process where the court is

[157] South African restructuring survey (n 23) 23.
[158] See Hoosein (n 64) 1.
[159] Both South African and Australian corporate rescue regimes are governed by the Companies Act 71 of 2008 and the Corporations Act respectively.
[160] Act 21 of 1936 (n 53); Du Preez (n 6) 4.
[161] Du Preez (n 6) 21.
[162] Hunter, Levin and Lamek "DIP Financing Strategies for Distressed Companies" 1-2 http://www.fasken.com/files/Publication/94873f15-c81c-42f7-92f4-0484427ff57a/Presentation/PublicationAttachment/3c4764d5-a732-4c63-a96a-38f52d302c7e/DIP_Financing_Strategies_for_Distressed_Companies.pdf (03/09/2017).
[163] Casgrain, A General Overview of Canadian Bankruptcy, Insolvency and Restructuring Law. http://www.acc.com/legalresources/quickcounsel/agoocbiarl.cfm (03/09/2017).

regarded to have more discretion and therefore the ability to be more liberal in its approach.[164] A moratorium against creditors action similar to the South African section 133 moratorium applies. This seeks to allow the debtor company and its creditors to agree on a reorganisation plan which is referred to as a 'compromise' or 'an arrangement' of reorganisation and must be approved by a two-third majority of creditors.[165] A 'monitor' is appointed by the court to observe and report to the court on progress. The monitor is an officer of the court, must be registered and independent from the company. The position is similar to the business rescue practitioner in South African law. Great consideration is given to transparency and notice to other stakeholders during the process and has the effect of building trust amongst all stakeholders. This process is regarded as advantageous and allows far greater flexibility in fashioning a restructuring solution with both secured and unsecured creditors.

The Bankruptcy and Insolvency Act (the BIA) process is generally less expensive to implement although far less court discretion applies along with more inflexible rules and time-lines. Proceedings under the BIA may be brought by an insolvent person, which includes partnerships and corporations. Interestingly a proposal made on behalf of a corporation may, over and above compromising the corporation's debts, include compromises of claims against directors of that corporation.[166]

It is noteworthy that neither the CCAA or BIA expressly contemplate, on a statutory basis, distressed finance such as DIP finance or "post-petition financing" (PPF).[167] Legal precedent in the form of case law give financiers consistent implied comfort that super priority status will be given in the instance where all secured creditors consent and it is reasonably proven that such secured creditors will not be prejudiced in a material manner. Courts apply a 'balance of prejudices test' with regards to the interests of existing creditors prior to filing for formal reorganisation and DIP creditor interests.[168] Canadian DIP financing in the instance of corporate restructuring has been the result of collaboration, negotiation and ingenuity between financial stakeholders for the ultimate benefit of the distressed enterprise.[169] This is an example of how an aligned stakeholder base in the face of corporate distress can collaborate successfully for the benefit of the larger stakeholder environment. In such instance, the structure of DIP finance has already been agreed between stakeholders prior to the matter being brought before the court. The probability of the finance being challenged is decreased and the courts can take a less interventionist approach due to parties driving the process amongst themselves. Only in instances of major disputes or allegations of major prejudice to creditors in particular, would the court be required to actively intervene.[170]

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5.2.2 United States of America

The American approach to corporate rescue is debtor-friendly and is governed by insolvency legislation, being Chapter 11 of the Bankruptcy Code. The process is prescriptive and involves an 'upfront' consultative approach with creditors subject to a strictly court-driven regime.[171] Specialist insolvency courts operate in a rescue culture that is transparent, evolved, and where

[164] McMillan LLP, Insolvency Proceedings in Canada 2012, 6 http://mcmillan.ca/files/Insolvency%20Proceedings%20in%20Canada.pdf (03/09/2017).
[165] Du Preez (n 6) 30.
[166] Mc Millan (n 164) 4.
[167] Du Preez (n 6) 30.
[168] McCormack *Corporate Rescue Law – An Anglo-American Perspective* (2008) 203.
[169] Hunter, Levin and Lamek (n 162).
[170] Hunter, Levin and Lamek (n 162) 2.
[171] Pretorius and du Preez (n3) 173.

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stakeholders, which include major financial institutions, support the corporate rescue process in the absence of the negative connotations experienced in the South African context. The rescue regime is essentially a Debtor in Possession (DIP) regime during which the management remain in control and retain ownership of the enterprise subject to the court's oversight.[172] DIP financing is treated as more senior than debt or equity or any other form of securities issued by the Company. But such financing would generally come with strict conditions or covenants.[173] The United States Trustee's office is charged with the supervision of the administration of bankruptcy cases. It has wide-ranging responsibilities and broad, discretionary authority to ensure that all procedural matters are complied with by the debtor in possession who is essentially put into a fiduciary role over the corporation.[174] It is unclear what the position would be should it be determined that the very management remaining in control of the distressed corporation is at the heart of or at least a contributing factor to the financial demise of the corporation. It seems that an external administrator or trustee could be appointed by the court in the case of exceptional circumstances involving gross mismanagement, fraud or other instances of dishonesty.[175] There has further been increased focus on the correlation between financial distress and corporate governance.[176]

From a stakeholder perspective, a bankruptcy court has the authority to bind dissenting parties to a reorganisation plan that has been rejected by a claimant class through a cram-down procedure.[177] This is certainly one area where the South African regime leaves the approval of the business rescue plan largely in the hands of creditors who often cannot agree or do not wish to agree to a plan which forces affected persons or the practitioner to approach the court at additional cost and loss of valuable time.

It is the opinion of the American Scholars, Senbet and Wang, that "the Code impacts the balance of power among managers, equity holders, and the firm's remaining stakeholders in economically important and identifiable ways. Since the Code specifies the set of rules under which claimants bargain for their entitlements, it also influences the behaviour of the various stakeholders outside of the formal bankruptcy process. This point is important because it suggests that any reform of the Code must also consider its impact on the behaviour of corporate stakeholders outside of the formal bankruptcy process."[178]

5.2.3 Australia

Australia operates under the 'Voluntary Administration' regime and does not have a separate corporate insolvency statute but includes such provisions in Chapter 5 Part 5.3 A of its Corporations Act which specifically deals with the Voluntary Administration process.[179] It is therefore evident that the clear separation between corporate and personal insolvency reflects the common English heritage of both Australian and South African law.[180]

[172] Du Preez (n 6) 25.
[173] Senbet and Wang (n 38) 13.
[174] United States Department of Justice, US Trustee Program Guidelines, https://www.justice.gov/ust-regions-r17/us-trustees-guidelines#4. (03/09/2017).
[175] Du Preez (n 6) 25.
[176] Senbet and Wang (n 38) 2.
[177] Senbet and Wang (n 38) 5.
[178] Senbet and Wang (n 38) 6.
[179] Corporations Act 50 of 2001 as amended, which can be found online at http://www.comlaw.gov.au.
[180] Anderson "Viewing the proposed South African Business Rescue Provisions from an Australian Perspective" 2008 *PER* 11 [1] 105.

The Corporations Act provides for three formal arrangements, namely Voluntary Administration, a Scheme of Arrangement and Receivership.[181]

The Voluntary Administration process, as proposed under the Harmer Report of 1988, has two main objectives which are expressly stated in s 435 A of the Corporations Act.

> "…to provide for the business, property and affairs of an insolvent company to be administered in a way that:
>
> (a) maximises the chances of the company, or as much as possible of its business, continuing in existence; or
>
> (b) if it is not possible for the company or its business to continue in existence—results in a better return for the company's creditors and members than would result from an immediate winding up of the company.[182]"

In simplistic terms, the objective is to allow for a flexible process which can save companies from liquidation thereby preferring the continuity and survival of the company while attempting to strike a balance between the interests of the wider stakeholder pool which indirectly includes employees.[183] This objective mirrors the Chapter 6 objective.

The Voluntary Administration regime follows a significantly more involved creditor-focussed approach and is likened to the South African 'practitioner in control' (PIC) approach. The process can be commenced by the appointment of an administrator by Board resolution, by a liquidator or by a secured creditor holding charge over all or substantially all of the company's property.[184] Note that a court does not in the first instance have the option to appoint an administrator. Under this model, the significant moratorium on the enforcement of claims against the company will apply to all creditors and owners of property until such time as the deed of company arrangement (DOCA) or rescue plan is adopted, at which point the moratorium will only apply to 'unsecured creditors.' Secured creditors and owners of property in possession of the company may in fact enforce their claims in accordance with their rights unless they have voted in favour of the DOCA or under a court order.[185] Such secured creditors or property owners therefore have significant influence and can effectively disrupt and bring the reorganisation to an abrupt end, which may not necessarily be in the interest of the wider stakeholder group. A mature and disciplined approach by such creditors is therefore required and it is understandable that support for the "Value Maximising Policy" theory. [186] This theory states that reorganisation is only justified if the company or its assets are worth more if reorganised than if not, when considered on an economic basis.

[181] Noome "The Sources and Obstacles of Post-Commencement Finance in South Africa: a Comparison with the United Kingdom and Australia, 6 (2014 UJ Dissertation) https://ujcontent.uj.ac.za/vital/access/manager/Repository/uj:13140?expert=sm_subject%3A%22Bankruptcy+-+Australia%22&f0=sm_subject%3A%22Bankruptcy+-+Australia%22 (19/09/2017).

[182] s 435 A Corporations Act.

[183] Anderson (n 180) 8; s 128 (1)(b)(iii) Companies Act.

[184] s 436 A-C of the Corporations Act.

[185] Ritchie *An Analysis of debt relief measures allowing the compromise of tax debts in south Africa and Australia* (UJ Dissertation 2014) 29.

[186] Eow "The Door to Reorganisation: Strategic Behavior or Abuse of Voluntary Administration?" 2006 *MULR* 308.

There is no express reference in the Corporations Act to distressed finance or how such finance should be dealt with.[187] Du Preez therefore makes the assumption that any additional operational funding required must be provided by existing stakeholders such as existing creditors and lenders.[188] This position leaves uncertainty regarding the ranking priority of funding which would essentially be classified as post-commencement finance.

In the absence of an established "pre-pack" DOCA culture which would be regarded as a practice which compromises the independence of the administrator,[189] it seems that 'rescue by restructure' is the preferred practice in Australia.

6. Creating Confidence for Future Stakeholders

The fundamental question regarding the business rescue regime is whether the system effectively rehabilitates economically efficient but financially distressed companies and liquidates economically inefficient companies without prejudicing creditors and other stakeholders.[190] A very prudent issue which has only recently been addressed by our courts in *Diener*,[191] relates to whether or not the ranking created by section 135 of the Act, which remains of force and effect even if the company is subsequently liquidated, gives rise to a new order of preference delineated by the Insolvency Act. Further questions, however, arise about the treatment of secured post-commencement financiers in a subsequent liquidation.[192] Recommendation 68 of the UNCITRAL Guide on Insolvency Law states the following:

> "… insolvency law should specify that where reorganization proceedings are converted to liquidation, any priority accorded to post-commencement finance in the reorganization should continue to be recognized in the liquidation." [193]

Sections 135(4) and 134(3) do clearly address the matter thereby partially vindicating Chapter 6 were it not for the lack of drafting finesse. But case law such as *Merchant West*[194] and *Redpath Mining*[195] are in direct conflict with the Act and creates confusion, as the ranking of post-commencement finance claims as set out there, were in the obiter and therefore not binding on other courts. As discussed above, these cases received harsh criticism.[196] This further exacerbates the already antagonistic relationship between liquidators and practitioners. The question should be asked whether the unpaid fees (and not necessarily other costs) of the practitioner should not be recognised as the ultimate form of post-commencement finance when conversion to liquidation proceedings occur. Without the practitioner, there could not have been a rescue attempt to start with. In *Diener*,[197] the Supreme Court of Appeal has clarified that the practitioner should be first in line to recover unpaid fees, subject only to costs of

[187] Du Preez (n 6) 33.
[188] See (n 187) above.
[189] Baker McKenzie publication "US Chapter 11 Bankruptcy and Australian Voluntary Administration Compared" 2016 4 https://www.lexology.com/library/detail.aspx?g=ef42c5e0-569a-44a6-9825-2685eabd96ac (19/09/2017).
[190] Senbet and Wang (n 38) 2.
[191] *Diener* (n 80) 19 at 49; (n 105).
[192] See *Diener* (n 191) above; *Schroeder* case (n 106).
[193] UNCITRAL (n 13) 119 recommendation 68.
[194] *Merchant west* case (n 72).
[195] *Redpath Mining* case (n 75).
[196] Refer (n72) and (n75).
[197] *Diener* (n 80) 19 at 49.

liquidation as per section 135(4). Other costs to the practitioner by service providers are seemingly regarded as unsecured post-commencement finance.

The decision serves as a reminder that the practitioner is not automatically entitled to his fees and costs once the company goes into liquidation and still has to submit and prove his claims in this regard.[198]

Practitioners are often required to incur expenses of professionals which include attorneys and financial professionals during the rescue process even though funding may not immediately be available.

It is comforting to see that greater, and much needed, clarity is now being provided by our courts with regard to questions that have remained unanswered since the introduction of the business rescue regime in 2011.

6.1 Policy considerations and proposed amendments to Chapter 6

It is evident that Chapter 6 will require review and reconsideration from a drafting and practical application perspective if business rescue is to become an accepted and truly effective regime.

The ranking of pre-commencement and post-commencement creditor claims, whether secured or unsecured, must be clearly set out in the Act in relation to subsequent liquidation proceedings – and linked to a more robust definition of what constitutes post-commencement finance.

Van der Linde notes the following in this regard:

> "Policy considerations in favour of a priority for post-commencement financing have to be balanced against established principles including the pari passu rule, the vested rights principle, the ideal of upholding commercial bargains and, in regard to secured claims, the prior in tempore maxim."[199]

Any proposed amendments to Chapter 6 should not in any way undermine the concept of commercial securitisation of debt under commercial contractual relationships.

Greater consideration should be given to concepts which have been found effective in other jurisdictions. The 'pre-pack' procedure whereby a company arranges to sell all or some of its business and assets to a buyer, before appointing a business rescue practitioner to facilitate the sale, is a very attractive option to follow and is similar to the 'pre-negotiation' phase under Chapter 11 of the American Bankruptcy code.[200] The process could be carried out with great transparency and soften the perceived conflicts between various stakeholder interests.[201] The

[198] Rhoodie "Business rescue proceedings superseded by liquidation order: no proof of costs, no claim!" https://www.cliffedekkerhofmeyr.com/en/news/publications/2016/dispute/dispute-resolution-alert-13-april-business-rescue-proceedings-superseded-by-liquidation-order-no-proof-of-costs-no-claim.html (27/08/2017).

[199] Van der Linde *Priority Issues in Post-Commencement Financing: A View from South Africa* in Wessels and Omar *The Intersection of Insolvency and Company Laws – Papers from the INSOL Europe Academic Forum Annual Conference (2008) 42.*

[200] South African restructuring survey (n 23) 25.

[201] Hyde & White (n 122) 134, 138.

United Kingdom have also successfully adopted the 'pre-pack' process but formally regulates that administrators must give full disclosure of the reasons for, and terms, of such deals.[202]

The process offers improved preservation of goodwill and employment but could offer an opportunity for the acquisition of operations at a reduced price as the process would not necessarily have gone to the open market.[203] A "pre-pack" often entails selling the business as a 'going concern' which allows for a more clinical handover to the new owner with minimal disruption, while preventing further value depreciation of assets. The Companies Act does not however make provision for such a process and it is recommended that this option be considered in future legislative changes.

Regulation 126 of the Act places the power to licence business rescue practitioners in the sphere of the Companies and Intellectual Property Commission (CIPC) and deviates substantially from the draft regulation 133 which referred to a body, called the Business Rescue Practice Regulatory Board to be established.[204] Establishing such an independent, professional body of oversight could assist in regaining trust and faith in the business rescue regime and should be strongly considered in future.

South Africa does not currently have a business culture that embraces business rescue or the provision of post-commencement finance. The stigma related to business rescue leaves managers and shareholders being viewed as failures. For the business rescue regime to truly succeed, this corporate culture dynamic must be changed and such a change would require buy-in and collaboration from all stakeholder groups.[205]

7. Conclusion

It is clearer than ever that the availability of post-commencement finance is the life-blood of a successful business rescue regime. Analysis of the behaviour driven by Chapter 6 brings forth valuable insights with regards to the conflicting interests of various stakeholders in business recue and the impact thereof on the provision of post-commencement finance.

It is pertinent that section 135, which is a key provision in Chapter 6, lacks drafting finesse in its current form and does not provide sufficient protection and express clarity regarding the definition and ranking of post-commencement finance during business rescue or in the event of a subsequent liquidation. It is further apparent that a significant mind-shift is required from financial institutions, lenders and other providers of post-commencement finance. This shift can only be realistically expected to occur when sufficient and robust legislative protection is put in place to protect such parties in a practical, consistent and meaningful way, supported by legal precedent which is aligned to well drafted legislation. In a global economy which is plagued by unpredictability, stringent regulation and systemic risk factors that cannot be managed on a one-dimensional level, the 'modern lender' is forced to take a very risk-averse approach to distressed funding. There is an abundance of 'cautious capital' in the market which could be unlocked for purposes of distressed funding.

Du Preez, in her analysis of the status of post-commencement finance in South Africa, has found that there is a severe lack of post-commencement finance origination in South Africa. A

[202] Walton "When is pre-packed administration appropriate? – A theoretical consideration" 2011 *Nottingham Law Journal* 20 1.
[203] See n 202 above, 3.
[204] Loubser *Some Comparative Aspects of Corporate Rescue in South African Company Law* (2010 Thesis UNISA) 100.
[205] Khaole (n 117) 47.

major reason for this is that financial institutions, who are in most cases also the secured creditors, do not support the business rescue process as it is inevitable that there may be a trade-off between interests of secured pre-commencement creditors and providers of post-commencement finance. The *KJ Foods* case, which is mirrored in the *Oakdene Square Properties* case, is an indication of the large 'institutional' mindset towards business rescue from a corporate shareholder point of view. The major shareholders, being large financial institutions, would accept nothing less than a liquidation order despite a potentially viable business rescue plan being put forward for consideration.

In order for the business rescue regime to give life to the objectives of Chapter 6, it must be supported by the 'stakeholder collective' which includes practitioners, employees and creditors in the widest sense. In the absence of a 'stakeholder collective' approach, business rescue in its current form cannot truly succeed.

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