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INSOLVENCY & BUSINESS RESCUE

Can business rescue minimise the effects of COVID-19 on your business?

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Business Rescue is aimed at creating a culture of corporate rescue which is appropriate for the modern South African economy. The aim is to provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders.

The practitioner aims to return the company to solvency in order to carry on its business or to achieve a better return for shareholders and creditors than would otherwise result from a liquidation. The practitioner has the task of restructuring the company and to restore it to profitability, as an alternative to being liquidated. This task becomes increasingly difficult within the context of the current national and global economic turmoil caused by the impact of the COVID-19 pandemic. Our own national lockdown had been preceded by downgrades from the rating agencies, lower GDP levels and increasing rates of unemployment. Many companies were already facing financial distress and the possibility of insolvency, even before the lockdown.

It is important to note that not all companies are appropriate for the regime of business rescue. There must be a reasonable prospect of rescuing the company and this is usually a factual enquiry based upon the advice of experts. This should not be used as a substitute for liquidation proceedings where companies cannot be rehabilitated, neither as a tool used to frustrate creditors.

The process itself has three stages: (i) The company's affairs are temporarily supervised, (ii) there is a temporary moratorium placed on claims and proceedings against the company, and (iii) a business rescue plan is developed and implemented.

What are the advantages and disadvantages of entering into business rescue?

Once the company is placed under business rescue, it enjoys a moratorium on legal proceedings and property interests which "freezes" the rights of all creditors, including dissenting and secured creditors. This provides the company with the opportunity to restructure its assets and liabilities, while continuing with business and operational activities. The practitioner has the power to suspend the obligations of the company, which arose during business from pre-commencement contracts. Furthermore, the practitioner may, under the appropriate circumstances, apply to court to cancel the contractual obligations, excluding employment contracts and financial markets contracts. It must be shown that the cancellation is "just and reasonable" under the circumstances. This is often where the problem lies, the determination of what constitutes "just and reasonable circumstances".

The moratorium affords the practitioner the opportunity to create a business rescue plan in order to achieve the purpose of the proceedings. The success thereof depends largely on the experience and skills of the appointed practitioner, who is required to have either a legal, business or accounting qualification.

The Act stipulates that business rescue proceedings should last for three months, but our experience is that it often takes about 6-8 months or even longer. The length of time it takes to implement an agreed plan may adversely affect the success of the rescue. The costs are increased and the market starts adjusting without the business. Clients gradually find substitutes in the market.

Practitioners are required to rectify voidable transactions and to ensure the company's performance of material obligations. They do not have any powers to set aside voidable transactions. These are powers specific to an appointed liquidator, who has the powers to set aside certain transactions concluded before the liquidation of the company. This may pose difficulties to a business aiming to avoid the obligations of certain transactions during the Covid-19 lockdown, through the use of business rescue proceedings.

Business rescue need not result in the return to solvency in order for it to be successful, as it is also aimed at achieving a better return for shareholders and creditors than would otherwise result from an immediate liquidation. The likelihood is that companies which experienced financial distress prior to the lockdown, would be less viable to return to solvency. The companies which are experiencing financial distress directly due to the lockdown, may be more viable for a return to solvency. A good example is in the airline industry with Comair.

Research indicates that a financially distressed company may improve its chances of a successful rescue, by entering into business rescue sooner rather than later. Financial distress can be detected by considering liquidity problems, analysing financial ratios that may be indicative of financial distress and by undertaking scenario planning for the business. Arrangements must also be made for post commencement funding as early as possible in order to avoid the failure of proceedings due to a lack of funding for the business rescue.[1]

Business rescue may just be a beacon of hope for financially distressed companies directly affected by the lockdown. Such companies may need to be restructured in such a way as to be geared for the changes which the COVID-19 pandemic has forced upon the economy. The way business is conducted has most likely been changed forever and it is those companies who restructure appropriately within the shortest time period, that may just come out successfully on the other side.

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[1] Business Rescue: Economic Remedy for Covid-19? Available electronically at: https://www.accountancysa.org.za/business-rescue-economic-remedy-for-covid-19/



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