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INSOLVENCY & BUSINESS RESCUE

Directors' duties and obligations in the business rescue process

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Introduction

Once a company is placed into a business rescue proceeding, the business rescue practitioners immediately step into a supervisory role and where the board of directors of the company become answerable, to a large degree, to such practitioners in respect of the ongoing conduct of the company's operations and affairs.

When this occurs, we often find immediate tension arising between the duly appointed practitioners and the board of directors. Such directors (who have never been through a business rescue process before) are often confused and somewhat bewildered by their change of status and are often unsure as to their continued role in the company.

In this article, we explore the rights, duties and obligations of directors of companies that have been placed under the supervision of the business rescue practitioner in business rescue proceedings. Before we consider the practical approach that should be taken by directors in such a situation, we thought it useful to set out, in brief, aspects of what is expected of directors, standards of conduct and the potential of claims against directors if they fail in their duties and obligations.

Standards of Directors conduct

- Section 76 of the Companies Act 71 of 2008 ("the Act") addresses the standard of conduct expected from directors and prescribed officers (hereinafter collectively referred to as "directors"). Section 76(3) states that a director of a company, when acting in that capacity, must exercise the powers and perform the functions of a director:
    - in good faith and for a proper purpose;
    - in the best interests of the company; and
    - with the degree of care, skill and diligence that may reasonably be expected of a person:
        - carrying out the same functions in relation to the company as those carried out by that director; and
        - having the general knowledge, skill and experience of that director.
- Section 76(4) states that in respect of any particular matter arising in the exercise of the powers or the performance of the functions of a director, a particular company director will have satisfied the obligations set out in section 76(3), if the director has taken reasonably diligent steps to become informed about the matter. This goes to the degree of knowledge that a particular director would have as to the financial status and affairs of the company.
- Furthermore, in terms of section 76(4) of the Act, a director would have satisfied the obligations of section 76(3), if the director made a decision, or supported the decision of a committee or the board, with regard to that matter, and the director had a rational basis for believing, and did believe, that the decision was in the best interests of the company.

Claims against directors

- There are certain instances, where a company's board or directors ("the board") can be held personally liable for the company's debts.
- In terms of section 77(2)(a) of the Act, a director of a company may be held liable in accordance with the principles of the common law relating to the breach of a fiduciary duty, for any loss, damages or costs sustained by the company as a consequence of any breach by the director of duties contemplated, inter alia, in section 76.
- Also, section 77(3)(b) of the Act, as read with section 22 of the Act, penalises and holds directors personally liable to the company for any loss incurred through knowingly carrying on the business of the company recklessly, with gross negligence, with the intent to defraud any person or for any fraudulent purpose.
- However, it is important to note that the Act does not limit the application of section 77 only to directors as such. It applies to prescribed officers as well, which includes any person who exercises general executive control over and management of the whole or a part of the business and activities of the company, or who regularly participates to a material degree in the exercise of general executive control over and management of the whole or a portion of the company.
- Section 77(6) states that: "The liability of a person in terms of this section is joint and several with any other person who is or may be held liable for the same act".
- Section 77(6) thus allows the company to claim against more than one director and against any person who contravened the provisions of the Act.
- Also, section 218(2) states that any person who contravenes any provision of the Act is liable to any other person for any loss or damage suffered by that person as a result of that contravention. Therefore, the liability contemplated in section 77(3)(b) of the Act extends beyond the company to any person who may be adversely affected by the unlawful conduct.

The role and obligations of directors of a company in business rescue

Once a company goes into business rescue, Chapter 6 of the Act sets out certain roles and obligations (in this changed environment) for directors.

- Section 140(1)(a) and (b) states that "[d]uring a company's business rescue proceedings, the practitioner, in addition to any other powers and duties set out in this Chapter- (a) has full management control of the company in substitution for its board and pre-existing management; (b) may delegate any power or function of the practitioner to a person who was part of the board or pre-existing management of the company".
- Section 137(2)(b) of the Act provides that during a company's business rescue proceedings "each director of the company has a duty to the company to exercise any management function within the company in accordance with the express instructions or direction of the practitioner, to the extent that it is reasonable to do so". In fact, section 137(3) goes further and states that "[d]uring a company's business rescue proceedings, each director of the company must attend to the requests of the practitioner at all times, and provide the practitioner with any information about the company's affairs as may reasonably be required".
- In addition, section 137(4) provides that if, during a company's business rescue proceedings, the board, or one or more directors of the company, purports to take any action on behalf of the company that requires the approval of the practitioner, that action is void unless approved by the practitioner.
- For these reasons, section 137(2)(d) states that "to the extent that the director acts in accordance with paragraphs (b) [to act in accordance with the practitioner's express instructions] and (c) [requiring compliance with section 75 of the Act which concerns disclosure to the board of personal financial interests], is relieved from the duties of a director as set out in section 76, and the liabilities set out in section 77, other than section 77(3)(a), (b) and (c)" [our insertion for ease of reference].
- If at any time during the business rescue proceedings, the director has:
    - failed to comply with a requirement of Chapter 6; or
    - by act or omission, has impeded, or is impeding –
        - the practitioner in the performance of the powers and functions of practitioner;
        - the management of the company by the practitioner; or

    - the development or implementation of a business rescue plan in accordance with this Chapter 6 of the Act, then the practitioner may, in terms of section 137(5) of the Act, apply to a court for an order removing a director from office and may apply to have a director declared delinquent in terms of section 137(6) read with section 162 of the Act.
- Moreover, if a director has acted in the manner set out in paragraph 3.5 above, then section 218(2) provides that such director would be liable to any person who has suffered any loss or damage as a result thereof.

Practical Aspects

Practically, any duly appointed business rescue practitioner comes into the company cold. Such practitioner is heavily reliant on the existing board members and management. The practitioner is obligated, within a short space of time, to consult with creditors, suppliers and contracting parties, in order to ascertain whether or not there is a realistic prospect of the company being rescued. If not, the practitioner is obligated to place the company into liquidation.

Where the practitioner is of the view that there is a realistic prospect of rescuing the company, then the practitioner must develop and publish a business rescue plan, which would result in the company being placed into a position, where it can continue to trade on a solvent basis (after being restructured), or where the plan delivers a better dividend than what would have been achieved from the immediate liquidation of the company. These practitioners will, therefore, need to achieve a high level of cooperation with board members from the outset.

Further, section 142(1) and (2) places an obligation on the board to deliver to the practitioner (as soon as practicable after business rescue proceedings has commenced) all of the books and records of the company that relate to the affairs of the company and which are in the board's possession. The director must, in terms of section 142(3) also provide the practitioner with a statement of affairs containing particulars relating to:

(a) Any material transactions involving the company or the assets of the company, and occurring within 12 months immediately before the business rescue proceedings began;

(b) any court, arbitration or administrative proceedings, including pending enforcement proceedings, involving the company;

(c) the assets and liabilities of the company, and its income and disbursements within the immediately preceding 12 months;

(d) the number of employees, and any collective agreements or other agreements relating to the rights of employees;

(e) any debtors and their obligations to the company; and

(f) any creditors and their rights or claims against the company.

Thus, there is an expectation on the part of the practitioner to be given full access to all of the relevant and pertinent information relating to the financial and operational affairs of the company. This will enable the practitioner to properly investigate the affairs of the company (section 141) and to develop a business rescue plan that can be published and placed before all affected persons at a section 151 meeting for approval.

During business rescue proceedings, the directors of the company will be relieved from their duties of a director as set out in section 76, and their liabilities as set out in section 77 of the Act, if the directors have acted in accordance with the express instructions or direction of the practitioner, to the extent that it was reasonable for them to do so.

In practice, the practitioners would engage with the board and report to the board on the business rescue process, the continued operation of the company, suspension/termination of contracts, the provision of post-commencement finance, and on the development of the business rescue plan.

If the practitioners require the board to assist them in the business rescue process, then the practitioners are entitled to request the board to do so in terms of section 137 of Act. If the practitioners' request is reasonable, then the board is obliged to act in accordance with the practitioners' express instructions or directions.

Having regard to section 137(3) and 137(5) of the Act, if any directors on the board do not wish to act in accordance with the practitioners' express instructions or directions, then those directors should resign.

A failure to do so could result in the directors being removed from the board and declared delinquent, in terms of section 162 read with section 137(5), and the directors may also be held liable for any losses incurred as a result of their conduct in terms of section 218 of the Act.

Notwithstanding the above and for the sake of clarity, the practitioners are entitled to proceed to conduct the business rescue process without the consent of the board and which includes the practitioner obtaining post commencement finance and determining the suspension or cancellation of contracts. Further the practitioners are entitled to develop, publish and implement the business rescue plan without the consent of the board.

Conclusion

Business rescue proceedings can be complex and daunting for directors. In particular, if the business rescue proceedings become protracted and drawn out over a lengthy period of time.

It is suggested that if a director is faced with his/her company going into business rescue, that close attention is given to the above and to the provisions set out in Chapter 6 of the Act. If directors do not comply with their obligations, they might find themselves facing removal and where their already damaged reputation can be placed at further risk.



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