

Effects of Business Rescue

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What effect does business rescue have?

1. What happens to the directors during business rescue?

The directors of the company remain the directors. However, their powers and duties are constricted in that the business rescue practitioner has full management control over the company in substitution for the board of the company and its pre-existing management. In terms of section 137, the directors of the company –

- must continue to exercise the functions of a director, subject to the authority of the practitioner;
- have a duty to exercise any management function within the company in accordance with the expressed instructions or direction of the practitioner, to the extent that it is reasonable to do so;
- remain bound by the requirements concerning the personal financial interests of the directors or related persons;
- and to the extent that the director acts in accordance with subsections (b) and (c) of this section, are relieved from the duties of a director as set out in section 76 (standards of directors conduct), and the incurrance of personal liability set out in section 77 (liability of directors and prescribed officers), other than section 77 (3) (a), (b) and (c).

If any director 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 it is approved by the practitioner (section 137(4)).

The directors of the company have a general duty to co-operate with, assist and attend to the requests of the practitioner at all times during business rescue and to provide the practitioner with any information about the companies affairs as may be reasonably required (section 142).

As soon as practically possible after the commencement of business rescue proceedings, the directors of the company must deliver all books and records that relate to the company to the practitioner and which are in the directors' possession. Within five business days after the commencement of business rescue proceedings, or such longer period as the practitioner may allow, the directors must provide the practitioner with a statement of affairs containing certain information as prescribed by the Act (section 142).

In terms of section 137(5) the practitioner may apply to court for an order to remove a director from his office if the director has –

- failed to comply with the duties imposed on him by the provisions of chapter 6; or
- by an act or omission, has impeded, or is impeding, (i) the practitioner in the performance of his powers and functions; (ii) the management of the company by the practitioner; or (iii) the development or implementation of the business rescue plan.

The directors of the company have a general duty to attend to the requests of the practitioner at all times during business rescue and to provide the practitioner with any information about the company's affairs as may be reasonably required.

2. What effect does business rescue have on employees?

Section 136 of the Act regulates the interests of employees during business rescue. It provides that employees who were, immediately prior to the institution of business rescue, employees of the company will remain employed by the company on the same terms and conditions on which they were employed prior to the commencement of business rescue proceedings except to the extent that changes occur in the ordinary course of attrition or if different terms and conditions are agreed between the employee and the company in accordance with labour laws.

3. What effect does business rescue have on shareholders?

During business rescue proceedings, an alteration in the classification or status of any issued securities of a company, other than by way of a transfer of securities in the ordinary course of business, is invalid except to the extent that the court, or the business rescue plan, directs otherwise (section 137).

4. What effect does business rescue have on a creditor?

When business rescue proceedings commence, the company continues to operate as before, but under the supervision of the business rescue practitioner and the creditors will need to comply with their obligations to supply goods or services to the company in the same manner in which they did prior to the commencement of business rescue proceedings, unless the agreement between the company and the creditor regulates the relationship between the parties in the event of an insolvency or business rescue.

However, it is understandable that unsecured creditors and lenders during business rescue would be wary of continuing to service or supply goods to the company on the same basis on which they did prior to a business rescue as their claims will be satisfied last in accordance with the order of preference for the payment of claims prescribed by the Act (S135(3)(a)(ii)).

Further, if a company's obligations towards another have been suspended, or cancelled on application by the practitioner to court, the agreement regulating the relationship between the company and its creditor may prescribe the way in which the relationship between the parties will ensue in the event of an insolvency or the commencement of business rescue. Failing this, it is likely in practice, that the reciprocal party to an agreement will not perform its obligations if the practitioner has suspended the performance of the company's obligations or cancelled the agreement and the other party will have a claim for damages in terms of section 136(3).

5. Can a company be sued during business rescue?

Section 133 of the Act regulates the institution of legal proceedings against the company and the enforcement of any action against the company during business rescue. This is commonly referred to as the "statutory moratorium" or "stay" that is placed on a company from the moment that business rescue proceedings commence.

During business rescue proceedings, no legal proceedings (legal or arbitration proceedings), including enforcement action (execution of a court or other order) against the company or in relation to its property, that belongs to it or which is lawfully in its possession, may be commenced or proceeded with in any forum (court or arbitral forum).

However, there are certain instances in which one would be able to commence or proceed with any legal proceedings or enforcement action against the company, in terms of section 133(a) to (f), namely –

- with the written consent of the practitioner;
- with the leave of the court (and in accordance with any terms the court consider suitable);
- as a set-off against any claim made by the company in any legal proceedings, irrespective as to whether those proceedings commenced before or after the business rescue proceedings began;
- criminal proceedings against the company or any of its directors or officers; or proceedings concerning any property or right over which the company exercises the powers of a trustee; or proceedings by a regulatory authority in execution of its duties after written notification to the business rescue practitioner.

6. Can one enforce a suretyship or guarantee during business rescue?

Section 133(2) provides that during business rescue proceedings, a guarantee or surety provided by the company in favour of any other person may not be enforced by any person against the company except with the leave of the court and in accordance with any terms that the court considers to be just and equitable.

In a recent decision of the Western Cape High Court, in the case of *Investec Bank Ltd v Bruyns* 2011 JDR 1563 (WCC) the court considered the meaning of section 133 and the status of a surety and guarantee provided by the company, or by another person or entity in favour of the company, during business rescue. It held that –

- section 133(2) is unambiguous in that it prohibits a third party from enforcing a suretyship or guarantee, provided by the company, against the company, during business rescue; and
- the statutory moratorium that arises for the benefit of a company does not automatically arise for the benefit of a surety provided in favour of the company on the basis that the statutory moratorium is a personal defence that arises for the benefit of the principal debtor (ie the distressed company) and not for the benefit of a surety.

7. What effect does business rescue have on contracts?

Section 136 also aims to regulate the position of the company in respect of its obligations in terms of any existing contracts that may apply at the time the business rescue proceedings commence.

Section 136(2) provides that the business rescue practitioner may, during business rescue proceedings, and despite any provision to the contrary in an agreement, –

- entirely, partially or conditionally suspend, for the duration of the business rescue proceedings, any obligation of the company that –
- arises under an agreement to which the company was a party at the commencement of business rescue proceedings; and
- would otherwise become due during the proceedings;
- apply urgently to a court to entirely, partially or conditionally cancel, on any terms that are just and reasonable in the circumstances, any obligation of the company contemplated above.

The proviso to the above is that, in terms of section 136(2A), a business rescue practitioner must not, suspend or cancel respectively, any provision of an employment contract or an agreement to which section 35A or 35B of the [Insolvency Act 24 of 1936](#) (transactions on exchange and agreements providing for termination and netting) would apply if the company had been liquidated. Further, if a practitioner suspends a provision of an agreement relating to security granted by the company to a creditor, that provision continues to apply for the purposes of section 134.

8. Does the party to the contract that has been suspended or cancelled, have any claim against the company?

Section 136(3) provides that any party to an agreement that has been suspended or cancelled, or any provision which has been suspended or cancelled, may assert a claim against the company only for damages.

9. What effect does a distribution during liquidation have on a subsequent business rescue?

Section 141(2)(c) provides that if at any time during the business rescue proceedings the practitioner concludes that "there is evidence, in the dealings of the company before the business rescue proceedings began, of voidable transactions, or the failure by the company or any director to perform any material obligation relating to the company, the practitioner must take any necessary steps to rectify the matter and may direct the management to take appropriate steps".

The phrase "voidable transaction" is not defined by the Act and it is not yet clear whether or not such a phrase will take on the meaning ascribed to impeachable dispositions in terms of the [Insolvency Act 24 of 1936](#). It is also not clear for what period of time prior to the commencement of business rescue proceedings transactions will be held to be voidable.

We believe that the distribution of money or the sale of assets, in the ordinary course of liquidation proceedings (and particularly in the order of preference to the creditors), and prior to a business rescue commencing, would not be held to be a voidable transaction in the business rescue unless a business rescue practitioner can identify an element of fraud or dishonesty in the process. It would appear that a practitioner would act upon a "voidable transaction" which occurs prior to a business rescue (and not in the ordinary course of a liquidation) and which becomes known to him during business rescue.

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Post-Commencement Finance

1. What is post-commencement finance?

Post-commencement finance is finance provided to the company once business rescue proceedings have commenced.

Section 135(1) of the Act also provides that any remuneration, reimbursement for expenses or other amount of money relating to employment that becomes due and payable by a company to an employee during business rescue, is also considered to be post commencement finance.

2. Who can provide post-commencement finance?

Section 135(2) of the Act provides that "during business rescue proceedings, the company may obtain financing other than as contemplated in subsection (1)..." From this it appears that the Act does not prescribe who in fact may provide the finance.

3. Can post-commencement financiers obtain security for their finance?

Any finance provided by a post-commencement financier may be secured by utilising any asset of the company to the extent that it is not already encumbered (section 135(2)).

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