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INSOLVENCY & BUSINESS RESCUE

QUO VADIS – business rescue or liquidation?

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Going under business rescue is proving to be an increasingly attractive option for South African companies that are in financial distress since the advent of Chapter 6 of the Companies Act, 71 of 2008 ("the Act").

INTRODUCTION

Is the preference to proceed into a business rescue process an indication of the weak economic climate, or is business rescue a tempting mechanism for ordinary businesses to make use of the "benefits" of business rescue, such as the moratorium on legal proceedings and the inability to conduct in-depth investigations and inquiries into the running of the business?

Presently, it appears that the market currently favours business rescue over liquidation, and rightfully so, with the purpose of business rescue being the effective rescue and recovery of financially distressed companies specifically provided for in the Act.

Both liquidation and business rescue proceedings can be launched voluntarily or by way of an application to court by creditors and affected parties.

Business rescue provides a moratorium on all legal proceedings and provides a breathing space enabling the company to recover from a position of financial distress. Liquidation proceedings on the other hand automatically stays all civil proceedings until the appointment of a liquidator, who takes possession and realises all the assets of the business (often at fire-sale values), all the proceeds of which are then paid to the creditors of the business by way of liquidation dividends.

Business rescue results in a recovery for the business, whilst liquidation results in the demise of the business.

Business owners must, at as early a stage as possible, consider whether to engage in business rescue proceedings or whether to embark on liquidation proceedings.

CAN THE PROCESSES OVERLAP?

Once business rescue proceedings have commenced, a court may instead order that the company be liquidated, should it be of the view that rehabilitation is unlikely. It is also the obligation of the business rescue practitioner to file for liquidation once it becomes evident that the company cannot be rescued.

THE OBJECTIVE OF BUSINESS RESCUE AND LIQUIDATION?

The purpose of liquidation proceedings is to dispose of the assets of the company and pay whatever proceeds might become available, to the creditors of the business by means of a legal order of preference. Liquidation of the company would result in the following –

- the establishment of a concursus creditorum (coming together of creditors) and the debtor's estate is frozen;
- a stay of all civil proceedings (from date of the provisional liquidation order until the appointment of a final liquidator);
- the attachment or execution of judgments after commencement of proceedings are void and judicial sales can be repudiated by the liquidator in respect of property attached and sold in execution, before winding up, but which has not yet been transferred to the purchaser;

- the Master, the Court or Commissioner may summon and examine various persons (and directors) to an enquiry (in terms of sections 417 and 418 of the Act), to establish the divestment or disposition of company assets and obtain relevant documents to enable the liquidator (and creditors) to investigate the trade, dealings and affairs of the company prior to its winding up. Such requests and questioning prevails over the right to privacy. These so called "section 417" enquiries allows the Master/Court/Commissioner to "pierce the corporate veil" as it were, and investigate possible impeachable transactions entered into by the company, with the view to setting aside such dispositions or preferences or collusive dealings in terms of sections 26, 29, 30 and 31 of the Insolvency Act, 24 of 1936;
- any transfer of shares and disposition of property after commencement of proceedings may be declared to be void (but can be validated by a court, if made between the date of the presentment of the winding up application and the date of the winding up order);
- directors cease to be in charge of the company after liquidation proceedings commence, but are still empowered to oppose the granting of a final order in the event that a provisional order is made;
- all property is placed in control of the Master of the High Court until such time as a liquidator is appointed.

On the other hand, the purpose of business rescue proceedings is the rehabilitation of a financially distressed company. The objective of business rescue is to rescue the company and prepare a plan that will allow the company to trade out of its financial predicament on a solvent basis into the future. Business rescue provides the company with a number of methods of protection and brings into effect the temporary supervision of a company and its management, whilst in business rescue. In effect, business rescue:

- protects the company's assets against creditors (thus preserving the value of the company's business and assets) by the imposition of a moratorium (stay of all claims);
- allows employees to continue to be employed in terms of their employment contracts, unless different terms are agreed upon – any remuneration not paid places the employees in the position of a preferential creditor;
- allows the business rescue practitioner to suspend almost any contract entered into by the company entirely, partially or conditionally, for the duration of business rescue proceedings. There are exceptions such as contracts related to employment. Parties to contracts that are suspended or cancelled (by application to court) have a claim for damages in respect of such suspended/cancelled contracts for losses suffered as a result;
- allows directors to continue exercising their duties, subject to the authority of the business rescue practitioner;
- renders any guarantee or surety given by the company unenforceable;
- allows the company in lawful possession of another party's property (under a contract entered into prior to commencement of business rescue) to retain possession of such property; and
- allows the company to dispose of property, if it is in the ordinary course of business, for fair value, where such sale has been approved in advance or as part of the implementation of the business rescue plan.

Business rescue provides a sound alternative to liquidation during periods of insufficient and poor cash-flow. A business rescue plan must be voted on and accepted by 75% of the creditors' voting interests and 50% of the independent creditors' voting interests, which were voted. If adopted, the plan binds the company, its creditors and holder of securities. A necessary pre-requisite is that the business is able to generate a better monetary return for its creditors (by setting out the dividend that could be obtained as compared to that in a liquidation). The plan must also set out the advantages of business rescue over liquidation.

Ultimately, business rescue provides alternatives for financially distressed companies that can result in the company's debt, management and contracts being restructured and reorganised in a manner that could result in the company continuing to trade on a solvent basis. If the business rescue is successful, the benefits would far outweigh the prospect of a liquidation of the company as it would support job preservation and a company which has exited from a period of financial distress and which would continue to contribute to the South African economy. Examples of the successes of business rescue are the cases of Pearl Valley Golf Estate in the Western Cape, Advanced Technologies and Engineering Company in Gauteng (ATE), Meltz Success, Moyo Restaurants, ODM, Southgold, Ellerines and more recently Optimum Coal Mine.

Once a plan is presented and approved by creditors, the business rescue practitioner would be in a position to implement the business rescue plan to its successful conclusion.

QUO VADIS – LIQUIDATION V BUSINESS RESCUE?

Both regimes have their own rightful place in the South African economy and the choice of which regime to follow will largely depend on the purpose for which the options are being considered, as well as the desired outcomes.

Yet interestingly, in the Participate Report ("the report") conducted as part of the South African Restructuring and Insolvency Practitioners Association (SARIPA) Conference in 2015 in which creditors, including banks, participated as 30% of the focus group, the majority of creditors indicated that the preferred method for dealing with financially distressed companies is liquidation. The debate centred around whether a business could be sold as a going concern more effectively in business rescue proceedings than in liquidation proceedings.

The focus group in the report concurred that liquidations provide more certainty regarding the status of claims than is provided by business rescue. This view may very well be as a result of the long-standing existence and certainty of the liquidation regime, as compared to the business rescue regime.

The report also indicated that South African trade unions are not using business rescue to place financially distressed companies into the business rescue process, thus losing the opportunity to save jobs. Business rescue clearly has potential benefits to employees. Should trade unions support the business rescue process in the future, it would likely result in the preservation of jobs which in liquidation would be terminated.

CONCLUSION

Business rescue enables the company to continue to exist on a solvent basis whilst liquidation is probably the better option in hostile proceedings where there has been fraud.

Ultimately there is a place for both processes. Not every financially distressed company can be rescued. Certain companies might not have a realistic prospect of being rescued. These companies should be "put out of its misery" and be placed into liquidation. There is no point in "flogging the proverbial dead horse" in such circumstances.

Thus, the right companies, which have a sustainable and potentially profitable business and where there are realistic prospects for rescue deserve to be saved. Business rescue provides such companies with a viable option, namely the restructuring/rescue opportunities provided for in the Act.

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