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Should Post-Commencement Financiers have a vote on Business Rescue Plans?

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A critical look at *Wescoal Mining (Pty) Ltd & Another v Mkhombo NO & Others* (2023-079991) [2023] ZAGPJHC 1097 (2 October 2023)

On 2 October 2023 Judge Wilson of the Gauteng Division of the High Court of South Africa endeavoured to ascribe a meaning to the undefined term "creditor" in Chapter 6 of the Companies Act 71 of 2008 ("the Companies Act"). His finding, which has caused a seismic event across the restructuring profession, found that post-commencement financiers (the essential providers of lifeblood to any company in financial distress) are not "creditors" and cannot vote on a business rescue plan ("Plan").

Only those persons who were creditors when the business rescue proceedings commenced, he found, are entitled to vote on a business rescue plan.

In our view, the court did not take into account the fact that in business rescue proceedings, like its predecessor, judicial management, but unlike in liquidation and sequestration proceedings, no *concursus creditorum* is created. Consequently, no specific preference is conferred on pre-commencement creditors for the duration of business rescue, nor does it freeze the claims against (and consequently the 'debts owed' by) the company concerned.

That is, no recognition was given to the fact that the voting landscape may well, and often does change prior to a meeting convened for the purpose of approving a business rescue plan.

For example, certain pre-commencement creditors may be paid in full by the Company in business rescue in order for services and goods that are critical to the ongoing business of that company to be delivered. In other instances, shareholding could change hands, from a more conservative shareholder to a more bullish investor.

Due recognition was, however, given by the legislature to this changing landscape in section 128(1)(j) of the Companies Act, as read with section 145(4) of the Companies Act.

These sections provide that a creditor (which is ordinarily defined as a person to whom monies are owed) has a voting interest equal to the amount owed to that creditor by the company. No timestamp is provided in these sections, as is the case in other sections of Chapter 6 of the Companies Act.

The rational for this is simple: the outcome for all creditors, be they pre- or post-commencement creditors, is tied to the fate of the company in business rescue, and the business rescue plan is, in essence, the crystal ball that predicts its future.

It is also worth mentioning that often a company in financial distress has very little unsecured assets available to use as security for post-commencement finance. In addition to the very real possibility of being unsecured, post-commencement financiers and creditors do not have the "payment priority" that other jurisdictions afford these types of creditors. For instances, secured creditors, who hold security for claims that arose prior to the commencement of business rescue, are protected under section 134 of the Companies Act. As a result, secured creditors often take the lion's share of the distributions in business rescue by virtue of their security and always ahead of any (pre- or post-commencement) unsecured creditors – they also, by the way, have a vote on the business rescue plan for the full value of their claims. As a consequence, from the (often) limited unsecured funds that are available in business rescue, payment will be made first to pay the business rescue practitioner and the costs of business rescue, then the post-commencement employees, and only thereafter may unsecured post-commencement financiers expect to receive a distribution.

In our view, a business-like construction would dictate that post-commencement financiers are creditors and should have a voting interest on the approval of the business rescue plan.

This judgment will regrettably have the effect of disenfranchising a great number of post commencement financiers and creditors who are essential to the ongoing business of a company in financial distress and who would otherwise have rightfully held a voting interest in business rescue proceedings.

The Court's concern that there is "little to stop speculators or asset strippers preying on business rescue proceedings, blocking the adoption of appropriate business rescue plans" is entirely unfounded. The learned judge entirely ignored the relief afforded to business rescue practitioners under section 153(1)(a)(ii), and to affected persons under section 153(1)(b)(i)(bb) of the Companies Act, which entitles them to apply to Court to set aside the result of the vote on the business rescue plan on the grounds that the dissenting votes were inappropriate.

Lastly, it is worth mentioning that Chapter 6 of the Companies Act does specifically mention pre-commencement creditors in certain specified instances. One such instance can be found in section 150(2)(a)(ii) where, as the learned Judge pointed out, the Companies Act requires that a business rescue plan contains "a complete list of the creditors of the company when business rescue proceedings began".

This list is necessary if regard is had to section 154(2) of the Companies Act which provides that once a business rescue plan is implemented, a creditor will not be entitled to enforce any debt owed by the company immediately before the beginning of the company's business rescue proceedings.

However, while these sections would at face value appear to support the Court's finding that "[t]here is no indication in the [Companies] Act that there ought to be account taken of any type of creditor other than those who existed at the time the company went into business rescue", they ought to be interpreted in context with the other provisions of and precedent surrounding Chapter 6.

Most notably, the Supreme Court of Appeal's judgement in *Van Zyl v Auto Commodities (Pty) Ltd* (279/2020) [2021] ZASCA 67 (3 June 2021) which held that section 154(1) "refers to the discharge of some or all of a debt, and requires – in order for the subsection to be operative – that the creditor should have 'acceded' to such discharge", whilst section 154(2) operates against pre-commencement creditors "even if they fought tooth and nail against the adoption of the business rescue plan".

There may well be, and more often than not are instances where a Post-Commencement Financier will, following the usual negotiations around the provisions of business rescue plan, vote for the plan, thereby acceding to any discharge of the post-commencement debt which the business rescue plan may contemplate.

This judgement entirely misses the legislated objective of business rescue, namely "the efficient rescue and recovery of financially distressed companies in a manner that balances the rights and interests of all relevant stakeholders" per section 7(k) of the Companies Act.

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