

South Africa: A South African Perspective on Restructuring Mechanisms

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Director, Eric Levenstein and Senior Associate, Lara von Wildenrath contribute to *The European, Middle Eastern and African Restructuring Review 2018*. This Review provides exclusive thought leadership, direct from pre-eminent practitioners, as well as gathering the expertise of 25 leading figures from 12 different jurisdictions. Contributors are vetted for international standing and knowledge of complex issues before being approached.

In the 20 years since the beginning of South Africa's democracy, South African consumers have had unprecedented access to credit. In the last quarter of 2008, 66.07 billion rand of new credit was extended to South Africans, and by the third quarter of 2017 this number had doubled, with consumers receiving 123.64 billion rand of new credit^[2]. While access to credit is generally economically beneficial, in South Africa's unique socio-economic environment (which is characterised by high rates of poverty and income inequality), the South African legislature has taken care to shift the approach of insolvency proceedings from solely favouring creditors to focusing on alleviating the plight of debtors.

Similarly, companies or close corporations that often faced an 'all or nothing' liquidation scenario under the Insolvency Act No. 24 of 1936 (the Insolvency Act) read with the Companies Act No. 61 of 1973 (the Old Companies Act), have been given much-needed breathing room in the form of the business rescue mechanism under the new Companies Act No. 71 of 2008 (the New Companies Act).

The business rescue mechanism provides for companies that are financially distressed to be placed into business rescue under the management of a business rescue practitioner with the protection of a moratorium from claims brought by creditors. The business rescue practitioner then has three months (unless agreed to otherwise by the creditors) to produce a business rescue plan aimed at rescuing the business and ideally restoring it a solvent position or, alternatively, securing a better dividend for creditors than a liquidation scenario.

It has now been seven years since the New Companies Act (and the business rescue mechanism) came into force, and the South African mindset towards rescuing companies (debtor-friendly approach) as opposed to automatically selling off assets to pay creditors (creditor-friendly approach) is slowly shifting.

This is evident in the South African courts' approach to business rescue jurisprudence and an emphasis of the ultimate goal of the business rescue mechanism, namely to rescue the company. When our courts have been faced with the two legal definitions of business rescue under the New Companies Act – to restore the company to a solvent position or to secure a better dividend for creditors – there is a clear preference for the former definition.

Two seminal business rescue judgments aptly illustrate the approach of giving businesses a lifeline in order to continue trading rather than using business rescue as a means of staving off a liquidation. In *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd and others*^[3], Dambuza AJA commented that when directors elect to place a company in business rescue by way of a board resolution, they should 'truly believe that prospects of rescue exist and such belief must be based on a concrete foundation'^[4].

In *Diener NO v Minister of Justice and others (South African Restructuring and Insolvency Association and others as amici curiae)*^[5], the court dealt with the issue of whether the fees of a business rescue practitioner were 'super preferent' in the scenario where a company in business rescue subsequently went into liquidation. In analysing this issue, the court remarked that business rescue:

is intended to create an efficient, regulated and effective mechanism to facilitate the rescue of companies in financial distress – as long as they are capable of rescue – in a way that balances the rights and interests of the stakeholders^[6].

As such, it is important for the directors and stakeholders in a company that is in distress to correctly ascertain whether a company is in financial distress and reasonably capable of rescue or whether the company is factually or commercially insolvent, and accordingly would need to be liquidated before electing which process to follow. The tests for business rescue and liquidation are set out below, as well as a general overview of the mechanisms of each process.

THE TEST FOR INSOLVENCY VS BUSINESS RESCUE

A company will be said to be insolvent in terms of the [Insolvency Act](#) read with the Old Companies Act if its liabilities either exceed its assets (factual insolvency) or if it cannot pay its debts as and when they fall due (commercial insolvency). The latter is the more appropriate test (and the test used to determine the status of a company or corporation) as often companies are met with cash-flow issues and, accordingly, cannot pay their debts despite being factually solvent.

In contrast, a company will be financially distressed within the meaning of the New Companies Act when it appears to be reasonably unlikely that the company will be able to pay all of its debts as they become due and payable within the immediately ensuing six months (impending commercial insolvency), or it appears to be reasonably likely that the company will become insolvent (ie, with its liabilities exceeding its assets) within the immediately ensuing six months (impending factual insolvency). The test for financial distress is thus a six-month forward-looking test.

LIQUIDATION

WHAT IS THE AIM OF LIQUIDATION?

When a company (or corporation) is no longer able to trade as a consequence of it being insolvent, the company's assets are liquidated – that is, sold either by way of private treaty or by way of public auction in order to pay costs, charges and expenses incurred in its winding-up as well as a dividend to the creditors of the company. Any residue is thereafter divided among the former shareholders of the company in accordance with their rights and interest in the company.

PROCESS REQUIRED TO COMMENCE A LIQUIDATION

In South African law, as it currently stands, a distinction must be drawn between insolvent companies and solvent companies. Insolvent companies, as set out above, are regulated by the provisions of the Old Companies Act, while the liquidation of solvent companies, is by and large regulated by the provisions of the New Companies Act. The regulation and administration of the liquidation of a company is then regulated by the Old Companies Act.

Insofar as an insolvent company is concerned, a company may be liquidated: (i) voluntarily by the board of directors' passing a resolution to that effect and thereafter filing such resolution and various other forms and documents with the Companies and Intellectual Properties Commission (CIPC); or (ii) pursuant to a formal application having been made to court by (among others) a creditor, the company itself or one or more of the company's shareholders.

AT WHAT POINT DOES THE LIQUIDATION PROCESS COMMENCE?

For insolvent companies, a voluntary winding-up commences when the resolution passed, which initiates the process, is registered with the CIPC. For a compulsory liquidation, initiated by an application to court, the liquidation shall be deemed to commence at the time of the presentation to the court of the application for the winding-up, once the court has granted a final liquidation order.

DURATION OF THE LIQUIDATION PROCESS

Once a company is in liquidation, the liquidator is appointed to administer the estate and wind it down. Liquidation and thereafter winding-up proceedings, from start to finish, can take anything from six months to two years depending on the size of the estate and the nature and complexity of the transactions with which the company or corporation was involved.

MANAGEMENT OF THE COMPANY WHILE IN LIQUIDATION

When a company is placed in liquidation, the company remains a corporate body and retains all its powers but will, from the date of the commencement of the winding-up, cease to carry on its business except insofar as may be required for the winding-up of the company. From the date of the commencement of a voluntary winding-up, all the powers of the directors of a company cease, except insofar as their continuance is sanctioned (i) by the liquidator or the creditors in a creditors' voluntary winding-up; or (ii) by the liquidator or the company in a general meeting in a members' voluntary winding-up. As soon as a winding-up order has been made in relation to a company, or a special resolution for a voluntary winding-up of a company has been filed with the CIPC, the Master of the High Court may appoint any suitable person as a provisional liquidator of the company and who shall hold office until the appointment of a liquidator.

FILING OF CLAIMS – FORM, TIMING, ADJUDICATION AND PROCESS

Creditors' claims are filed on affidavit and supported with evidence to indicate that the company is in fact indebted to the creditor. A creditor must file his or her claim with the liquidator at the first or second meeting of creditors. Thereafter, if the creditor wishes to file a claim he or she may request to convene a meeting at which he or she will file his or her claim. The costs of convening such meeting will be for that creditor's account. Only creditors who have proved their claims will benefit from a distribution, which is usually only a portion of what that creditor is owed unless the creditor is in a position to rely on its security.

CREDITORS

Creditors' claims are ranked and paid out in accordance with an order of preference determined by the Insolvency Act. Once all the costs of winding-up have been paid, creditors will be entitled to their proportionate share of the residue of the company's estate. Preferent creditors are entitled to be paid before concurrent creditors. Secured creditors are those who hold security for their claims and they are paid from the proceeds of a sale of the security that they hold. Concurrent creditors (including preferent and secured creditors whose claims are not satisfied in full) are paid out of the residue of the estate and are the last of the creditors to be paid.

HOW IS THE LIQUIDATION PROCESS TERMINATED?

Once the affairs of a company have been wound up and if the liquidator has complied with all the requirements of the Master of the High Court, the liquidator may apply in writing to the Master of the High Court for a certificate to that effect. The Master of the High Court shall, when he or she issues the certificate, state that he or she consents to the reduction of the security by the liquidator to a stated amount or to its cancellation. The liquidation and winding-up proceedings would be terminated at this point.

BUSINESS RESCUE

PROCESS REQUIRED TO COMMENCE A BUSINESS RESCUE

A company or close corporation can be placed in business rescue voluntarily by the board of directors adopting and filing a resolution to commence business rescue and place the company under the supervision of a business rescue practitioner. Thereafter, a number of forms and documents would need to be submitted to the CIPC for filing. A formal application can also be made to court by affected persons (creditors, employees, shareholders) to place a company in business rescue (compulsory business rescue). Once the company is placed under business rescue, the order of the court must be provided to all affected persons, notifying them of the commencement of business rescue. A voluntary business rescue application cannot be filed if a compulsory business rescue application has been initiated, or if liquidation proceedings have already been initiated by or against the company.

AT WHAT POINT DOES THE BUSINESS RESCUE PROCESS COMMENCE?

A voluntary business rescue commences when the requisite documents are filed with the CIPC. A compulsory business rescue, arising following an application made to court, commences when the business rescue order is granted by the court.

Business rescue proceedings are designed to last for a period of three months from start to finish. However, in practice, business rescue proceedings are extended from time to time with the support of the majority of creditors, and can take anything from six months to two years, depending on the complexities of the business. Factors that necessitate the continuation of business rescue, beyond the three-month period, include but are not limited to: (i) the business rescue practitioner attempting to procure a purchaser for the business or assets; (ii) the need to obtain regulatory approvals in respect of a plan that has been adopted with the requisite support; and (iii) the fulfillment of any conditions precedent, following the adoption of a plan, or even a general lack of cooperation from creditors or shareholders.

MANAGEMENT OF THE COMPANY WHILE IN BUSINESS RESCUE

During business rescue proceedings, the business rescue practitioner has full management control of the company, and the directors, though not exonerated from their duties and responsibilities (and corresponding liabilities), are answerable to the business rescue practitioner. Any action taken by a director while the company is in business rescue requires the approval of the business rescue practitioner. If not, any action taken by the directors will be void. The business rescue practitioner can, however, delegate management functions to the directors if it is required.

FILING OF CLAIMS – FORM, TIMING, ADJUDICATION AND PROCESS

Claims in a business rescue are usually submitted on affidavit. In practice, business rescue practitioners either compile their own claim forms for the submission of creditors' claims, or creditors, through their legal advisers, prepare the necessary claim forms. There is no specific time period within which a business rescue practitioner may receive claims. Typically though, claims are submitted at the first meeting of creditors and can be received up until such time that the business rescue plan is published by the practitioner. The practitioner may, however, determine a date by which all claims must be submitted. In certain instances, and following a consideration of the books and accounts of the company, practitioners take into account the position of all creditors, whether or not they prove their claims, when preparing the business rescue plan.

FUNDING OF THE COMPANY WHILE IN BUSINESS RESCUE

During business rescue, the company may obtain post-commencement finance, which is either new money injected into the company following the commencement of business rescue, or services rendered by employees and suppliers of the company for the duration of the business rescue as the company usually continues trading throughout the process. Post-commencement finance will rank in preference to the claims of unsecured creditors. Post-commencement financiers may also take security for their funding but only over unsecured assets belonging to the company in distress.

CREDITORS

The historic position and claims of creditors are crystallised at the date of the commencement of business rescue. Creditors are entitled to submit claims to the business rescue practitioner but may not enforce any claims against the company by way of the institution of legal proceedings. This is a consequence of the 'stay' on legal proceedings against the company.

PENDING CLAIMS, LITIGATION, ARBITRATION AND THE EFFECTS OF MORATORIUM

The commencement of business rescue proceedings gives rise to the operation of a general moratorium on the rights of creditors to enforce their claims against a company or in respect of property belonging to the company or that is lawfully in its possession. A creditor may also not continue with enforcement action against a company (ie, execution of a writ). In certain instances, proceedings may be brought against a company with the written consent of the business rescue practitioner or with the leave of the court. If a claim is subject to a time limit, the claim will not be prescribed during the period in which the company is in business rescue; rather, prescription will be interrupted.

THE BUSINESS RESCUE PLAN

The business rescue process culminates in the preparation of a business rescue plan by the business rescue practitioner. The business rescue practitioner will consult with all affected persons, creditors and the management of the company when preparing the plan. Broadly speaking, the plan will set out details relating to the background of the company, any proposals made for the rescue or rehabilitation of the company, and any assumptions or conditions upon which the plan is based. The plan will also include how the assets, liabilities, contracts and employees will be treated following the adoption of the plan.

VOTING ON THE PLAN

The business rescue practitioner must convene and preside over a meeting of the creditors within 10 business days of the publication of the plan. At this meeting, the plan must be introduced, the employees' representatives may address all persons at the meeting, and a discussion is held on the proposed plan. The practitioner will then procure a vote for the approval of the plan. A plan will be accepted if at least 75 per cent of the creditors' voting at value and 50 per cent of the independent creditors' in general vote in favour of the plan. If the plan affects the rights of shareholders, a separate vote of the shareholders is procured. A simple majority vote is required for a plan to be supported by shareholders. If a plan is rejected, affected persons or the practitioner himself can take steps to implement the plan (ie, apply to court to set aside the vote on a plan or procure a vote from creditors to draft a revised plan), failing which the plan will be held to have been rejected.

CRAMDOWNS ON CREDITORS

Once the business rescue plan has been approved, it is binding on all creditors. This applies whether or not the creditors were present at the meeting, voted in favour or against the plan or abstained from voting. The business rescue practitioner must take all steps necessary to fulfil the conditions of and implement the plan.

DISCHARGE OF CLAIMS

If a business rescue plan that is approved by creditors and shareholders compromises the claims of creditors, such creditors are not entitled to enforce the balance of their claims against the company unless the business rescue plan provides otherwise.

HOW IS THE PROCESS TERMINATED?

Business rescue proceedings end when: (i) the court sets aside the resolution or order that began the business rescue proceedings or when the court converts business rescue proceedings into liquidation proceedings; (ii) the business rescue practitioner files a notice of termination of business rescue proceedings with the CIPC; and (iii) the business rescue plan has been proposed and rejected and no affected person has acted to extend the proceedings in any manner contemplated by the New Companies Act, or a business rescue plan has been adopted and the business rescue practitioner has subsequently filed a notice of substantial implementation of the plan.

WHAT IS THE STATUS OF THE COMPANY AFTER THE BUSINESS RESCUE?

If a business rescue plan is adopted and implemented in accordance with its terms, the company will continue to trade (or in the alternative the company will be wound down to achieve a better dividend for creditors) and will exit from the terms of the business rescue process. If a plan is rejected, and steps are not taken to implement a revised plan, the practitioner is obligated to make an application to court to place the company in liquidation. A similar result may ensue if the conditions precedent to a plan are not fulfilled.

INFORMAL RESTRUCTURING PROCEDURES

In addition to the restructuring processes set out above, a company can also undertake an informal restructuring process by agreement with creditors. A company with a small number of manageable creditors can informally convene a meeting of its creditors and attempt to reach an agreement with them to compromise their debt. Such an agreement would need to be accepted by all of the creditors of the company for it to be binding on all creditors. A company would also need to obtain undertakings from the creditors not to make an application to court (agree to a moratorium on a stay on claims) to place the company into liquidation or business rescue.

FORMAL COMPROMISE WITH CREDITORS

A company (whether it is financially distressed or not) that has not entered into business rescue proceedings can reach a formal compromise with creditors in respect of that company's debts. The board of directors of the company makes a proposal to all of its creditors (which must also be delivered to the CIPC) and convenes a meeting for the consideration of the proposal. The proposal must contain certain information such as the company's financial circumstances, and specific detail about how long a debt moratorium would last and the effect it would have on creditors' claims. The proposal is adopted if it is voted for by the majority of the creditors, or class of creditors, representing at least 75 per cent in value of the creditors, or class of creditors, present and voting. Once a proposal is adopted, the company can make it an order of court and file it with the CIPC.

CONCLUSION

The business rescue mechanism, as an alternative to liquidation, is a restructuring mechanism that is still coming of age in South Africa. Business rescue practitioners and legal advisers operating in the business rescue landscape in South Africa are currently developing the modus operandi of how to deal with novel issues that arise practically in the business rescue process. To this end, our courts often compare and contrast 'the old with the new'. The Insolvency Act, which has regulated the liquidations of insolvent companies since 1936, has assisted in the interpretation of some the unique provisions relating to business rescue. However such an approach to interpreting business rescue legislation is undertaken with caution as, by its nature, business rescue is aimed at rehabilitation rather than the ultimate demise of a company. This continued development will ultimately crystallise in a more debtor-friendly approach to restructuring businesses, thus ensuring a better commercial environment within which South African businesses can operate.

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[1] National Credit Regulator 'Consumer Credit Report – Fourth Quarter 2008'

[2] [National Credit Regulator 'Consumer Credit Report – Third Quarter 2017'](#)

[3] [2015] JOL 33243 (SCA).

[4] Para 30.

[5] [2018] 1 All SA 317 (SCA).

[6] Para 41.



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