

Success fees to Business Rescue Practitioners: important aspects to consider

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By Malachizodok Mpolokeng, Candidate Attorney

Reviewed by: Dr. Eric Levenstein, Director and head of the Insolvency, Business Rescue & Restructuring practice.

Setting the scene

The COVID-19 pandemic has had a devastating global impact. Governments around the world have had to take drastic steps to curb the spread of this novel virus. South Africa is no exception. On 25 March 2020, the South African government took decisive action by declaring a nationwide lockdown in an effort to flatten the COVID-19 curve. This five week lockdown, which is set to end on 30 April 2020, was a necessary step given the critical and life-threatening nature of the pandemic. However, it is undeniable that the economic cost and impact of this lockdown will be far-reaching, and will undoubtedly result in challenging trading conditions in South Africa for the foreseeable future.

Against this adverse backdrop, directors of South African companies and businesses are encouraged to take practical and proactive steps to mitigate losses to facilitate the survival of their businesses during these difficult times. However, with that being said, challenges such as financial distress remain a serious consideration, and business rescue proceedings will certainly be one of the options considered by financially stressed companies in the months and years ahead.

Business Rescue & Remuneration of Practitioners

Business rescue was introduced by Chapter 6 of the Companies Act 71 of 2008 ("Companies Act") as a means of facilitating the rehabilitation of a financially distressed company in a manner that balances the rights and interests of all relevant stakeholders. This is achieved by reorganising or restructuring the distressed company's affairs and business in a manner that maximises the likelihood of the company continuing to exist on a solvent basis as a commercially viable entity. In this regard, business rescue practitioners ("practitioners") play a pivotal role and are tasked with managing and overseeing the distressed company, in substitution for the company's incumbent board of directors, with the objective of turning the company around according to the business rescue plan.

Practitioners are entitled to remuneration in terms of section 143 of the Companies Act. Section 143 of the Companies Act provides for remuneration in terms of statutory tariffs or by agreement between the practitioner and the company. In all instances, it is important to carefully consider the basis of remuneration paid to practitioners, as it may have an impact on the impartiality and the independence of the practitioner. Practitioners are officers of the court and are required to act impartially and honestly. A high standard of conduct is expected from practitioners during business rescue proceedings. Therefore, whether practitioners may receive remuneration from third-parties (including creditors of the distressed company) is an important question, which was recently dealt with by the Supreme Court of Appeal in *Caratco (Pty) Ltd v Independent Advisory (Pty) Ltd* [2020] ZASCA 17 (25 March 2020) ("*Caratco*").

The findings of the Supreme Court of Appeal in *Caratco*

In the *Caratco* case, the Supreme Court of Appeal had to determine whether the payment of special fees (or so-called “success fees”) by creditors to practitioners is prohibited, void for illegality, or otherwise contrary to public policy. In this case, Caratco (Pty) Ltd (“the appellant”), a creditor of the financially distressed company, entered into a “success fee” agreement with Independent Advisory (Pty) Ltd (“the respondent”). The respondent is a company specialising in business rescue, and two of its directors were appointed as joint practitioners by the financially distressed company. The agreement provided that the appellant would make payment of a sum of money to the respondent once the joint practitioners had implemented the business rescue of the financially distressed company. After complying with their obligations in terms of the “success fee” agreement, the respondent invoiced the appellant for payment of the special fee. The appellant ignored the respondent’s invoice as well as their subsequent demand for payment. As a result, the respondent brought the matter before the court *a quo*. The court *a quo* held that the appellant had failed to establish any of its defences, and ordered the appellant to pay the success fee to the respondent in terms of their agreement. After being denied leave to appeal by the court *a quo*, the appellant applied for leave to appeal to the Supreme Court of Appeal.

In its application for leave to appeal, the appellant relied on three main arguments. Firstly, the appellant argued that the special fee agreement was illegal on the basis that fees agreed upon outside the parameters of section 143 of the Companies Act were impliedly prohibited by the Companies Act and should be declared void. Secondly, the appellant alleged that the joint practitioners had breached their responsibilities and duties in terms of section 140(3)(b) of the Companies Act. The appellant specifically relied on sections 75(3) and 76 of the Companies Act, and alleged that since the joint practitioners had failed to fulfil the responsibilities and duties incumbent upon them, the special fee agreement ought to be declared void. Lastly, the appellant contended that the success fee agreement was contrary to public policy, on the basis that the practitioners “subverted the democratic vote of the majority of creditors” and breached their duties to act independently and impartially towards the company, by entering into the agreement.

In a well-reasoned judgment delivered by Chachalia JA, the Supreme Court of Appeal found that the special fee agreement was not invalid, illegal, or otherwise contrary to public policy, and dismissed the appellant’s application for leave to appeal. The Supreme Court of Appeal’s judgment was based on the following findings:

Firstly, the court held that section 143 of the Companies Act only applies to the remuneration of practitioners by the company under business rescue and does not deal with fee arrangements concluded between practitioners and third parties. Furthermore, the court found that there is nothing in section 143 of the Companies Act that suggests that an agreement not falling within its ambit is void. In addition, the Companies Act does not penalise the conclusion of such agreements, nor does it contain language entitling a court to draw an inference that the lawmaker intended to invalidate such agreements. Therefore, the Supreme Court of Appeal found that there was no substance to the appellant’s “illegality” complaints.

Secondly, the Supreme Court of Appeal held that the appellant’s reliance on sections 75(3) and 76 of the Companies Act were unmeritorious in that the appellant failed to plead facts to bring the conclusion of the fee agreement within the ambits of these sections. For instance, the appellant had failed to show that the distressed company had an interest in the fee agreement, which is a requirement of section 75(3). Furthermore, as to section 76, the appellant failed to plead the specific sub-section on which it relied. Accordingly, the Supreme Court of Appeal rejected the appellant’s second argument regarding the breach of the practitioners’ responsibilities and duties.

Lastly, on the issue of public policy, the Supreme Court of Appeal held that the appellant’s submissions were without merit and were not supported by any evidence. The appellant’s contention that the practitioner had “subverted the democratic vote of the majority of creditors” had no factual basis since the practitioners had intended to include the success fee in the draft business rescue plan, which was to be voted on. The practitioners only agreed to delete the fee agreement from the business rescue plan at the appellant’s request. Furthermore, the facts indicated that the “success fee” agreement was such that it did not cause any prejudice to the body of creditors, as it did not affect the distribution paid to them. The Supreme Court of Appeal accordingly concluded that the appellant’s public policy defence was without any merit.

The *Caratco* judgment – not a blanket authorisation for success fees paid by creditors

The conclusion of the Supreme Court of Appeal in *Caratco* was that the “success fee” agreement concluded by the parties was neither prohibited, illegal nor contrary to public policy. However, it must be noted that this finding was based on the facts and

circumstances of the case, as well the peculiar approach to litigation adopted by the appellant. Where the courts are confronted with different facts and circumstances, a different conclusion may be reached by the courts. In certain circumstances, the acceptance of a “success fee” by a practitioner could possibly constitute a breach of the practitioners’ responsibilities or duties, including the duty to act with the utmost good faith. This can occur where the payment of special fees impacts on the practitioners’ ability to act impartially and independently towards the court, the distressed company and the general body of creditors. Accordingly, it is important to note that this judgement should not be viewed as providing a general seal of approval or a blanket authorisation for the payment of success fees in all circumstances. There will be instances where the payment to and the acceptance of fees by practitioners will indeed be declared invalid by the courts, particularly where the remuneration paid to the practitioner has an impact on the distribution paid to creditors or where the impartiality and independence of the practitioner is affected.

Duties of Practitioners remain paramount

Given the wide range of powers conferred upon practitioners during business rescue proceedings, including full managerial control of the company, it is imperative that practitioners conduct themselves with integrity. The payment of fees by third parties to the practitioner must not be for an improper purpose and must in no way cause a breach of the practitioner’s duties towards the court, the company, and the general body of creditors. In terms of section 140(3)(b) of the Companies Act, practitioners have the same responsibilities, duties and liabilities as directors. Therefore, practitioners have the duty to exercise their powers and perform their functions in good faith and for a proper purpose, in the best interests of the company, with reasonable care and skill.

Failure to adhere to these responsibilities and duties may result in the removal of the practitioner in terms of section 139(2) of the Companies Act, on the grounds that the practitioner has failed to perform his or her duties or has shown a lack of independence. The practitioner may also be held personally liable in terms of section 218(2) of the Companies Act, if any person has suffered any loss or damage as a result of the practitioner’s contravention of the Companies Act. This is undesirable as it will hamper the smooth running and proper conclusion of business rescue proceedings. Therefore, it goes without saying that when a success fee agreement is concluded, the duties of the practitioner remain paramount and must be kept in mind.

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Eric Levenstein

Head of Insolvency & Business Rescue

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