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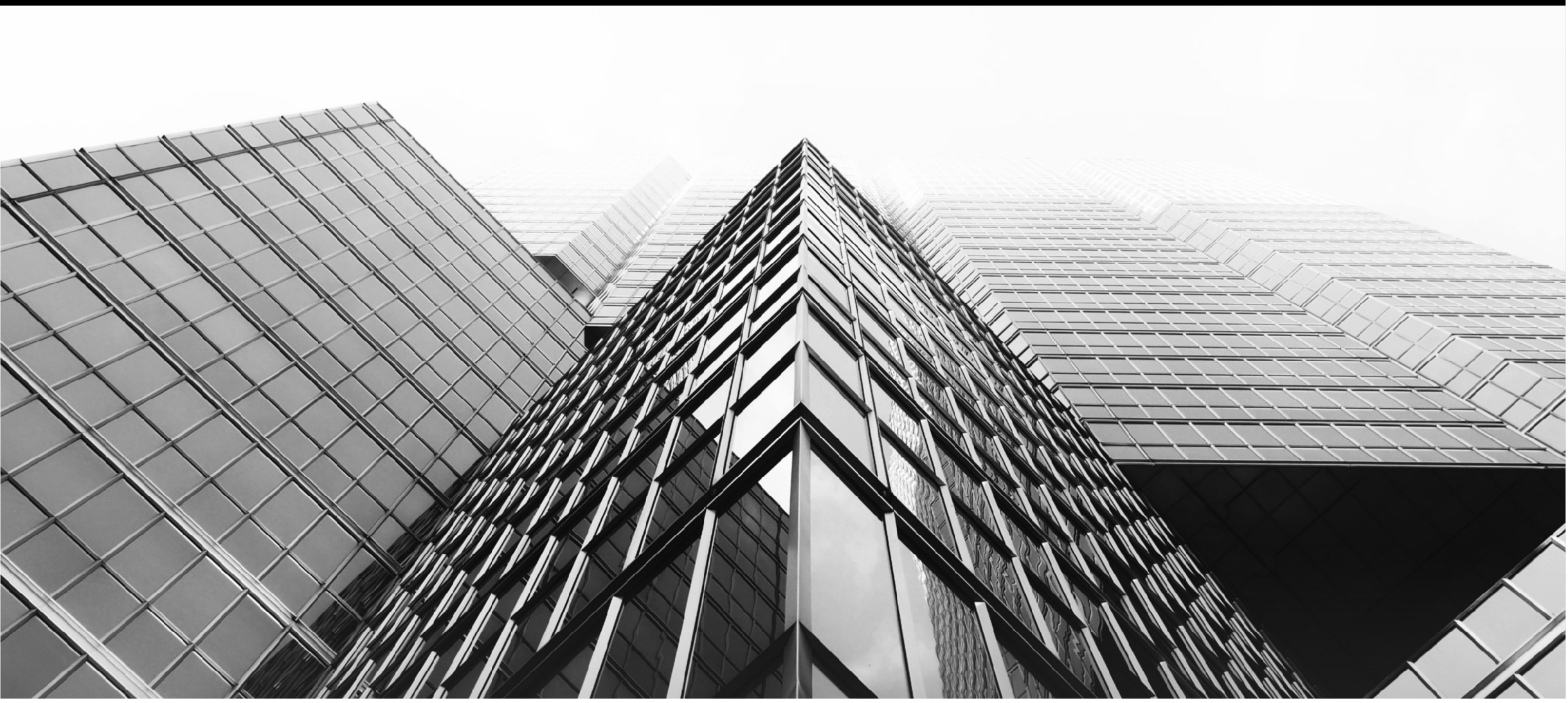

INSOLVENCY & BUSINESS RESCUE

Your customer has entered business rescue. The next move matters

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The notice is usually brief. Your customer has entered business rescue, a business rescue practitioner has been appointed, and creditors will shortly be invited to submit their claims.

What the notice does not tell you is whether you should stop supplying goods or services, what happens to the invoices already outstanding, whether you can cancel your supply contract, or whether the next order you fulfil will ever be paid.

Those decisions should not be deferred until the business rescue plan is published. By then, you may have supplied another month's goods or services, missed an opportunity to exercise an important contractual right, or discovered that your claim has been recorded incorrectly.

When a customer enters business rescue, your unpaid account is only the beginning of the enquiry.

Business rescue a game changer for recovery

Business rescue is intended to rehabilitate a financially distressed company by temporarily placing it under the supervision of a business rescue practitioner and allowing a plan to be published and approved by affected persons. The plan may seek to preserve the company as a solvent business. Alternatively, it may propose a restructuring that achieves a better return for creditors than an immediate liquidation.

For creditors, one of the most significant consequences is the general moratorium under section 133 of the Companies Act 71 of 2008 applies. While the rescue continues, legal proceedings and enforcement action against the company, or in relation to property belonging to or lawfully possessed by it, generally cannot be commenced or continued without the practitioner's written consent or the leave of the court.

The moratorium provides the company with breathing space. It does not extinguish your claim and it does not necessarily suspend your contractual rights.

A creditor exposed to a customer in business rescue may, depending on the circumstances, retain existing rights allowing it to enforce against security held, such as a cession of debtors, a notarial bond registered against the company's moveable assets or a mortgage bond registered against immovable property. In addition, a suretyship, the application of set-off, reservation of ownership of goods or a valid right to cancel an agreement will have to be considered if applicable. The Supreme Court of Appeal has confirmed that cancellation of an agreement does not, without more, constitute enforcement action prohibited by section 133. However, the existence and proper exercise of a right to cancel must still be considered against the terms of the relevant contract and the facts.

The critical point is that the words "business rescue" should not result in immediate action or complete inaction. Legal advice should be taken so that rights are not waived or squandered.

Distinguish the old debt from the next order (continuation of trade)

Claiming an existing outstanding amount owed when business rescue commenced and any new exposure incurred subsequent to the commencement of business rescue (post commencement debt), have different legal consequences.

The pre-rescue claim must be reconciled as at the commencement date of business rescue. Invoices should be checked against payments, credit notes, delivery records and any existing disputes relevant to the supply of goods and services. The claim should then be submitted to the practitioner with the relevant agreements and documentation supporting the claim.

It is equally important to establish the manner in which the practitioner has classified the claim. A creditor holding security, relying on a reservation of ownership clause or a third-party suretyship, may be in a materially different position from an ordinary concurrent creditor. Claims must be accurately recorded when submitted for proof to the practitioner, as it can affect the proposed treatment of the claim and the creditor's voting interest.

Then comes the more difficult question: should you continue trading with the company?

Business rescue does not automatically release either party from rights recorded in an existing contract of supply. Section 136 also gives the practitioner certain powers to suspend or cancel contractual obligations of the company, subject to the provisions of the Company's Act. A supplier or service provider should therefore not assume that it may simply stop performing. The ability to do so depends on the terms of the agreement, any existing breach and the steps taken by the practitioner.

At the same time, there is no commercial sense in continuing to supply goods and services to a company in business rescue or allowing further credit to accumulate without considering the prospects of receiving payment. Careful consideration must be given to the following issues –

- Who has authorised the further work or supply of goods and services?
- Is such supply in terms of an existing agreement?
- Has the practitioner approved it?
- From what funds will the new invoices be paid?
- Can payment be made in advance, on a cash basis, on delivery or against agreed milestones?
- What protection is available if the company defaults again?

Whatever occurs should be recorded in writing and where the rights of the party providing the goods and services are carefully dealt with. Claims arising after date of commencement (are deemed to be post-commencement finance) and may be treated (with the written consent of the practitioner) differently from pre-rescue debt, but that does not mean every new invoice automatically enjoys priority or is guaranteed to be paid.

Treat the rescue plan as an investment proposal

The practitioner must convene the first meeting of creditors within 10 business days of appointment and advise whether there is a belief that there is a reasonable prospect of rescuing the company. The business rescue plan must ordinarily be published within 25 business days of the practitioner's appointment, unless the required extension is obtained. Generally, business rescue plans are published some months after the date of commencement of the rescue, provided the consent of creditors for an extension has been obtained by the practitioner.

When the plan is published, one should not only focus only on the proposed dividend to be paid on the outstanding debt. A promise to pay 60 cents (for example) in the rand is not meaningful without understanding the mechanics of the business rescue plan. Firstly, one has to consider if the plan is workable and whether it will be approved by creditors. Secondly, when will the payment be made and where will the money come from. Is the proposal dependent on the sale of an asset, a new investor, litigation proceeds or improved future trading? Has funding been secured, or is it merely anticipated? What happens if the transaction is delayed or the assumptions prove incorrect?

The plan should also compare the proposed business rescue outcome with the estimated return in liquidation. That comparison must be considered critically. A rescue proposal should not be supported merely because it produces a higher percentage on paper. The proposed return must be credible, properly funded and achievable within a commercially acceptable period.

Once the business rescue plan has been published, creditors are entitled to participate, by asking questions and proposing amendments to the plan. This matters because an adopted plan binds creditors regardless of whether they attended the meeting, voted against it or proved their claims.

Silence is therefore not a neutral position and can have consequences.

Remain informed and act timeously

The business rescue process can be complex, and one needs to act on an informed basis before it is too late. On receiving a business rescue notice, establish the commencement date of the rescue process, quantify the exposure and review the relevant underlying contracts. In addition, it is necessary to review existing supply agreements, identify your claim and any security held, review supporting documentation (such as invoices, credit notes), suretyships held, and any rights of reservation in goods supplied. Importantly, has the filing for rescue breached any ongoing rights to supply goods and services. Take legal advice so that no mistakes are made in the process.

Most importantly, decide whether further trade remains commercially viable and, if so, on what terms. Engage with the practitioner before the plan is put to a vote.

The correct response will depend on the size and nature of the pre-commencement claim, the importance of the ongoing relationship with the company in the future, and the rights contained in the relevant supply agreements.

What should remain consistent is the timing. The best opportunity to take legal advice in order to protect a creditor's position is often at the commencement of the rescue. Advice should be taken before further exposure is incurred and before the proposed treatment of the claim becomes embedded and approved in the plan.

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