SOUTH AFRICA'S BUSINESS RESCUE REGIME – FIRING ON ALL CYLINDERS?

By Dr Eric Levenstein[1], Director. This article was reproduced with permission from INSOL World.

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The downturn in world economies has placed business under severe pressure in the last few years. In South Africa, the knock-on effect has been felt, with several businesses going out of business, filing for liquidation and with many turning to the South African business rescue procedure as a possible lifeline.

Chapter 6 of the Companies Act No. 73 of 2008 (the 2008 Companies Act) introduced intervention mechanisms to rescue companies that are in financial distress. The test set out in the 2008 Companies Act is that if it appears to the board of a company that it appears to be reasonably unlikely that the company will be able to pay all of its debts as they become due and payable (commercial test) within the immediately ensuing six–month period; or if it appears to be reasonably likely that the company will become insolvent (factual test) within the immediately ensuing six–month period, then such company would be "financially distressed". A business rescue practitioner would be appointed to supervise the company on a temporary basis with the aim to develop and implement a rescue plan for such company.

The outcome of a plan would be to ensure that the company could continue to exist on a solvent basis, or if it is not possible for the company to so continue in existence, results in a better return for the company's creditors or shareholders, then would result from the immediate liquidation of the company. When a South African company is in financial trouble but the potential still exists to rescue it, various rescue options can be considered other than a formal liquidation process.

If management recognises the signs of financial distress early enough, it is possible to negotiate with the company's creditors in an attempt to reach some kind of informal compromise that would assist the company in overcoming its financial difficulties[2]. Such an informal compromise or workout may in certain instances yield a positive outcome, but in some instances, creditors are not willing to cooperate with the company facing a potential liquidation. In such event, there is a need for a moratorium or stay of liquidation procedures in favour of a formal statutory procedure such as business rescue.

The business rescue process has provided South Africans with the opportunity to move corporate restructuring from a "pro-creditor" system to one of "pro-debtor". The need for a sustainable recognition of creditors' claims being compromised and being forced (if in the minority) to take "the restructured deal" has now been generally accepted by creditors.

For many years, South Africa was left in the doldrums of an archaic judicial management system[3], with few alternatives other than liquidation. Drawing from the best that international restructuring regimes had to offer, Chapter 6 found its way into the South African Company Law Statute in 2011, bringing South Africa, belatedly, into line with standards set by international corporate rescue regimes.

There is a recognition that companies that are already insolvent must be placed into liquidation, and those capable of being rescued must be saved. Clearly, if there is no chance of rescuing the company, then there is no need to continue to "flog the proverbial dead horse". If liquidation is the only alternative, then the practitioner and the creditors must release the company from its rescue proceedings and place it into liquidation.

Modern rescue culture (which started all those years ago in the UK and the US) supports the notion that there is always a need to save debtor companies that are candidates for rescue and which have genuine recovery prospects. These companies are entitled to receive the protection of the moratorium and the opportunity to have the business restructured, rationalised and to exit into a solvent trading position.

The fact that the voluntary entry into business rescue occurs by the mere passing of a board resolution, reflects the South African legislature's intention to make rescue and restructuring an easier mechanism to secure a "fresh start", and supports a shift to a more debtor-friendly (company focused) approach. The current shift in mindset was best stated by Judge Claassen in *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others; Farm Bothasfontein (Kyalami) (Pty) Ltd v Kyalami Events and Exhibitions (Pty) Ltd and others*[4]:

> "The general philosophy permeating the business rescue provisions is the recognition of the value of the business as a going concern rather than the juristic person itself. Hence the name "business rescue" and not "company rescue". This is in line with the modern trend in rescue regimes. It attempts to secure and balance the opposing interests of creditors, shareholders and employees. It encapsulates a shift from creditors' interests to a broader range of interests. The thinking is that to preserve the business coupled with the experience and skill of its employees, may, in the end prove to be a better option for creditors in securing full recovery from the debtor."

The mind shift remains work in progress. Most South African companies, directors and bankers need to resist the temptation of "sinking the Titanic" and placing the financially distressed company into liquidation. Of course, the historical notion of "becoming insolvent" and the sense of failure and shame which goes with it, must be considered by management when they choose business rescue as an alternative. However, as time goes on and we continue to see significant companies being rescued, confidence in the process will increase and no doubt business rescue will gain traction in the South African distressed market place. The banks will play a significant role here[5].

The successes of business rescue in the cases of Pearl Valley Golf Estate in the Western Cape[6], Advanced Technologies and Engineering Company in Gauteng (ATE)[7], Meltz Success[8], Moyo Restaurants, ODM, President Stores[9], Southgold, Ellerines and more recently Optimum Coal Mine[10], have all contributed to a renewed vigour in the business rescue space and in renewed confidence in the possibility of successful outcomes[11].

The ability to achieve a strategic acquisition of a distressed company within a short time frame by using the business rescue process, is one which requires an early identification of the distressed asset, the immediate availability of cash to fund an acquisition, as well as a commitment to propping up the company by introducing post-commencing funding to pay ongoing expenses and overheads, while the company is undergoing its restructuring and/or its acquisition process in business rescue.

Despite initial reservations, South Africa has embraced the opportunity to resuscitate companies in distress that, without Chapter 6, would have been placed in liquidation with all of the negative outcomes flowing therefrom.

1 Eric Levenstein recently graduated with an LLD (Doctorate of Laws) in Business Rescue at the University of Pretoria.
2 The section 155 compromise procedure is available to financially distressed companies but it does not have the comfort of a moratorium (stay) of creditor claims. Thus, the Chapter 6 business rescue process is often favoured.
3 Judicial management was not successful for various reasons. One of the features which led to its downfall was the expectation that all claims of the company be paid (in full) as an outcome of the judicial management process.
4 Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others; Farm Bothasfontein (Kyalami) (Pty) Ltd v Kyalami Events and Exhibitions (Pty) Ltd and others 2012 (3) SA 273 (GSJ) 438 at para 12.
5 South Africa has a stable, well-managed and well-regulated financial sector, which is a great asset. There is a limited range of banks able to lend against strong security and at lower risk. When a company is in financial distress, banks often believe they have sufficient security and that they do not need to throw their weight behind the business rescue process. In some instances, they seem to regard business rescue as an irritating obstacle blocking the path to an orderly recovery.
6 Standard Bank of South Africa Ltd acquired Pearl Valley Golf Estate (Pty) Ltd out of a business rescue plan, which was successfully implemented in January 2013.
7 ATE was acquired by the Paramount Group out of a business rescue proceeding in March 2013.
8 Moyo Restaurants (in business rescue) were acquired by Fournews in 2013.
9 Southgold (in business rescue) was acquired by Witsgold in 2012.
10 In September 2016 Optimum Coal Mine exited from business rescue after being acquired by Tegeta, a subsidiary of Oakbay.
11 The latest statistics reflect an increasing trend towards business rescue being on the increase and liquidations on the decrease – see http://www.statssa.gov.za/publications/P0043/P0043June2016.pdf where it has been reported that in June 2016, the total number of liquidations had decreased by 22,8 per cent year on year when compared with the same period in 2015. Further, in the University of Pretoria report (UP Report available at http://www.cipc.co.za/files/9614/6857/6141/Status_of_Business_Rescue_Proceedings_in_South_Africa_March_2016.pdf) published in March 2016, reports that there were 310 successful filings for business rescue (out of 1911 filings) – a success ratio of 14 per cent – although this figure is fairly low, it does indicate that the South African rescue industry is hard at work in an effort to save failing companies in the South African economy.

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Dr Eric Levenstein has been a director at Werksmans Attorneys since 1993 and is currently the head of the firm's Business Rescue, Insolvency & Restructuring Practice. He specialises in litigation and dispute resolution with a particular focus on business rescue, insolvency and restructuring. In addition, Eric specialises in banking and finance, corporate/commercial recoveries of debt, shareholder/director disputes, corporate governance (director's liability) issues and intellectual property. He regularly delivers seminars and writes for various publications on these topics among others. He is a member of the South African Restructuring and Insolvency Practitioners Association (SARIPA) and sits on the National Board of SARIPA. In addition, Eric is a member of INSOL, a worldwide group of insolvency practitioners and attorneys. Eric also sits on SARIPA's Restructuring, Business Rescue and Government Liaison Committees.

Eric has been ranked as a highly recommended lawyer in Dispute Resolution (Business Rescue) in *Legal 500* in 2012-2016. He has also been named as a recommended lawyer in restructuring and insolvency by *PLC Which Lawyer 2013*. Eric has given numerous presentations on insolvency, business rescue and director's liability. He is a regular contributor to the media on the effect of business rescue on companies and creditors, consumer protection law, insolvency and director's liability.

Eric is named as a leading insolvency and restructuring lawyer by *Who's Who Legal*, 2014 and 2016, has BCom and LLB degrees, higher diplomas in Company Law and Tax, and a diploma in Insolvency Law. He recently received an LLD (Doctorate of Laws) in Business Rescue from the University of Pretoria.

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