TOP TEN RISKS FOR CREDITORS OF COMPANIES GOING INTO BUSINESS RESCUE IN 2017

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Continued pressure on business and world economies appears to continue into 2017. In South Africa, 2016 has seen several companies going out of business and with many turning to the South African Business Rescue procedure as a possible alternative to liquidation.

Chapter 6 of the Companies Act No. 73 of 2008 ("the 2008 Companies Act") introduced mechanisms to rescue those companies that are trading in financial distress.

Creditors that do not understand the Chapter 6 business rescue process, place themselves under severe risk in the event that one of their major customers files for the business rescue process and where the rescue legislation intervenes in normal business and trading relationships.

We have identified the top 10 risks for creditors of companies going into business rescue in 2017 and they are as follows:

1. A FAILURE ON THE PART OF CREDITORS TO RECOGNISE WHEN THEIR CUSTOMERS ARE ENTERING A PERIOD OF FINANCIAL DISTRESS CAN LEAD TO SIGNIFICANT FINANCIAL LOSS

> Directors of companies that face a situation where it appears that it is reasonably unlikely that the company will be able to pay all of its debts as they become due and payable in the immediately ensuing 6 month period; or if it appears to be reasonably likely that the company will become insolvent within the immediately ensuing 6 month period, must recognise that their companies are indeed "financially distressed". If this is the case, the directors are obligated to place the company (by board resolution) into the business rescue process and appoint a business rescue practitioner to supervise the company on a temporary basis with the aim to develop and implement a rescue plan for such company.

> Creditors (as affected persons) are entitled to bring court proceedings to place such debtor company (customer) into business rescue and to appoint a business rescue practitioner of their choice to supervise the company in this process. The aim, of course, would be to ensure that such creditor is able to appoint a competent business rescue practitioner who is mandated to achieve a better return for creditors then would result from the immediate liquidation of the company.

> Creditors should be aware that those directors of companies that are in financial distress and continue to trade their companies in such a position, open themselves to personal claims by such creditors against such directors for reckless trading. Section 22 of the 2008 Companies Act states that a company (its board of directors) must not carry on its business recklessly, with gross negligence, with intent to defraud any person or for any fraudulent purpose. Section 77 states that any director of a company is liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director carrying on the company's business in such manner.

> Thus creditors need to recognise, early on, that their debtor (customer) is entering a period of financial distress and enquire from the management (directors) of the company as to whether there is in fact an intention to place their company

into business rescue. A failure to take action on the part of directors would necessitate an application by creditors to place the distressed company into business rescue and appoint a business rescue practitioner. A failure on the part of the creditor to act expeditiously might result in the debtor company going into liquidation with resultant negligible liquidation dividends, causing severe financial loss to creditors. Thus creditors need to appreciate that the early intervention of a business rescue process would in all probability result in a higher business rescue dividend for creditors.

2. FAILURE BY A CREDITOR TO PARTICIPATE IN THE FIRST MEETING OF CREDITORS CAN RESULT IN SUCH CREDITOR BEING PREJUDICED IN THE BUSINESS RESCUE PROCESS

> Within 10 business days after being appointed, the business rescue practitioner must convene and preside over the first meeting of creditors at which he is obligated to inform the creditors whether or not there is a reasonable prospect of rescuing the company and he is further obligated to receive proof of claims by creditors at such meeting.
> The practitioner must further ensure that all creditors of the company are notified of such first meeting of creditors.
> It is vitally important that creditors participate at the first creditors meeting as the creditors of a company in business rescue are entitled to form a Creditors Committee and through such Committee are entitled to be consulted by the practitioner during the development of the business rescue plan. Failure to do so, will thus leave creditors "out in the cold" with no option to participate in the development of the proposed business rescue plan.
> The Creditors Committee serves as a useful forum to engage with the practitioner and further to obtain information relevant to the ongoing administration of the company under business rescue and to ascertain the likelihood and quantum of the business rescue dividend that might be delivered.
> Claims should also be submitted timeously and, if possible, at the first meeting of creditors. It is important that creditors' claims are accurate, contain sufficient information to enable the practitioner to accept such claim and which will ultimately be incorporated in the distribution (payout) subject to the terms of the business rescue plan.

3. A FAILURE BY CREDITORS TO UNDERSTAND THE IMPACT OF THE MORATORIUM CREATED BY THE BUSINESS RESCUE PROCESS CAN RESULT IN WASTED COSTS IN THE FRUITLESS PURSUIT OF SUCH CLAIMS

> Once a company has been placed under business rescue, no legal proceedings, including enforcement actions, may be continued against the company, or in relation to any property belonging to the company.
> Thus creditors need to understand that there is a "freezing" of all claims once a company enters the business rescue process.
> There is no purpose in spending money on legal fees in continuing with such legal proceedings or enforcement actions once the company has entered the business rescue process. In this respect, creditors should submit information relevant to these claims to the business rescue practitioner for his consideration and reaction.
> Creditors should submit information relevant to these claims to the business rescue practitioner for his consideration and reaction and for inclusion in the business rescue plan.

4. SECURED CREDITORS MUST ENSURE THAT THEIR SECURED PROPERTY IS PROTECTED AND ARE NOT PREJUDICED BY THE BUSINESS RESCUE PROCESS

> Once a company has commenced with business rescue proceedings, the business rescue practitioner may only dispose of property over which a creditor has security or title interest, with the consent of such creditor.
> Thus, it is important for secured creditors to immediately engage with the business rescue practitioner to ensure that their property is not sold or disposed of at negligible values and which would ultimately prejudice such creditor.
> Negotiations should immediately ensue between secured creditors and the business rescue practitioner to establish the manner in which such secured property should be dealt with, if at all, during the business rescue process.

5. CREDITORS MUST APPRECIATE THAT THEY ARE ENTITLED TO REMOVE ERRANT BUSINESS RESCUE PRACTITIONERS WHO ARE DELAYING THE BUSINESS RESCUE PROCESS

> Once appointed, the business rescue practitioner is obligated to develop a business rescue plan to be considered by all creditors and other affected persons. In terms of the legislation, the business rescue plan should be circulated to all creditors within 25 business days after the date upon which the practitioner was appointed. Although such time period is short and on many occasions is extended with the consent of creditors, there is no reason for a business rescue practitioner to unduly delay the publication of a business rescue plan.
> The longer the plan takes to publish, the stronger the likelihood of the business rescue dividend to creditors being diminished. Of course, if a sale of the business or its assets or of the company shares is being negotiated by the practitioner, there may be a very good reason to delay the publication of the business rescue plan.
> Ultimately, the business rescue practitioner's objective is to ensure that the creditors receive a better dividend than they would receive in liquidation and if delay would result in such consequence, then the relevant time period should be extended.
> If the business rescue practitioner is of the view that there is no reasonable prospect for the company to be rescued, he must apply to court for an order discontinuing the business rescue proceedings and place the company into liquidation. Delay in doing so could result in the business rescue practitioner being sued for damages by creditors who argue that such practitioner should have placed the company into liquidation at a far earlier stage.
> Should a practitioner continue to delay the publication of a plan or not attend to the administration of the business rescue in terms of Chapter 6 of 2008 Companies Act, a creditor can apply to court to have the practitioner removed from office for incompetence or failure to perform the duties of a business rescue practitioner in terms of the 2008 Companies Act.
> The practitioner is obligated to exercise a duty of care in the performance of his functions and not engage in illegal acts or conduct. The practitioner should not exhibit a conflict of interest or lack of independence in his administration of the company

under business rescue. Failure to comply with these obligations would warrant his removal.

6. CREDITORS SHOULD BE AWARE THAT THE BUSINESS RESCUE PRACTITIONER IS OBLIGATED TO INVESTIGATE MALFEASANCE/UNLAWFUL CONDUCT ON THE PART OF THE MANAGEMENT OF THE COMPANY PRIOR TO COMMENCEMENT OF BUSINESS RESCUE

> Creditors are entitled to request the practitioner to investigate the affairs of the company and which will include the manner in which its business, property and financial affairs were conducted prior to the appointment of the business rescue practitioner.
> Furthermore, a practitioner is obligated to investigate whether or not there is evidence, in respect of the dealings of the company prior to the business rescue proceedings, of voidable transactions (transactions that should be set aside) or the failure by the company or any director to perform material obligations relating to the company prior to it entering the business rescue process.
> The practitioner must further investigate reckless trading, fraud or any other contravention of the law relating to the company. The practitioner is obligated to forward evidence of such conduct to the appropriate authorities for further investigation and possible prosecution.

7. CREDITORS NEED TO UNDERSTAND THE MANNER IN WHICH THEY ARE ENTITLED TO VOTE ON THE BUSINESS RESCUE PLAN AS A FAILURE TO DO SO COULD RESULT IN DIMINISHED RETURNS

> Creditors are entitled to vote on a business rescue plan and which includes the right to vote on an amendment or rejection of such proposed business rescue plan. Creditors can also propose the development of an alternative plan or present an offer to acquire the interests of any or all of the other creditors.
> Within 10 business days after publishing the business rescue plan, the practitioner must convene and preside over a meeting of creditors called for the purpose of considering and voting on the plan.
> Creditors are entitled to vote on the plan and the plan will be approved if it was supported by the holders of more than 75% of the creditors' voting interests that were voted, and where such votes included at least 50% of the independent creditors voting interest.
> Once approved, the business rescue plan is binding on all of the creditors of the company.
> Generally creditors would support a business rescue plan as, in most instances, the plan would confirm the distribution of a business rescue dividend that would be higher than would be received by creditors if the company went into liquidation.

8. CREDITORS NEED TO APPRECIATE THAT ONCE A PLAN HAS BEEN APPROVED, ALL CLAIMS AGAINST THE COMPANY ARE DISCHARGED

> Creditors need to understand that once a business rescue plan has been approved and implemented, a creditor is not entitled to enforce any debt owed by the company to such creditor and which existed immediately before the business rescue process, except to the extent provided in the business rescue plan.
> It is thus important for creditors to realise that participation in the business rescue process, and in particular understanding and voting on the business rescue plan will directly affect the manner in which they will be entitled to receive a business rescue dividend.

9. CREDITORS SHOULD APPRECIATE THAT PARTIES THAT PROVIDE POST-COMMENCEMENT FINANCE TO THE COMPANY IN BUSINESS RESCUE MIGHT RESULT IN THEIR CLAIMS BEING ELEVATED TO A SUPER-PRIORITY STATUS IN BUSINESS RESCUE

> Any party that provides post-commencement finance to a company under business rescue will entitle such party to receive repayment in priority to all other creditors.
> Additionally, any employee that provides services to a company in business rescue, will entitle such employee to payment on a post-commencement finance basis in priority to all other creditors.

10. CREDITORS SHOULD REALISE THAT BUSINESS RESCUE PROVIDES A "BETTER" OUTCOME THEN LIQUIDATION AND THUS SHOULD SERIOUSLY CONSIDER SUPPORTING THE PROCESS

> Unsecured creditors facing the liquidation of its customer would in all likelihood receive a zero (or negligible) dividend after all secured and preferent creditors have been paid in liquidation.
> Generally, business rescue dividends should result in a higher return for creditors than would result in a liquidation.

Overall, the South African business rescue process is robust and effective and can result in positive outcomes for all stakeholders. In 2017, we expect to see continued support on the part of creditors for the business rescue process and which should continue to see companies being rescued and where there is a sustainable business model for ongoing trading. Examples of successful business rescues include Pearl Valley Golf Estate in the Western Cape, Advanced Technologies and Engineering Company in Gauteng (ATE), Meltz Success, Moyo Restaurants, ODM, President Stores, Southgold, Ellerines and more recently Optimum Coal Mine, which have all contributed to a renewed vigour in the business rescue space and in renewed confidence in the possibility of successful outcomes.

It appears that generally, South Africans have accepted that business rescue is a viable alternative to liquidation and one which supports job preservation and the ability to bring distressed companies back from the brink of liquidation and to a position where such companies can continue to contribute to 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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LEX Africa was established in 1993 as the first and largest African legal alliance and offers huge potential for Werksmans' clients seeking to do business on the continent by providing a gateway to Africa.

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