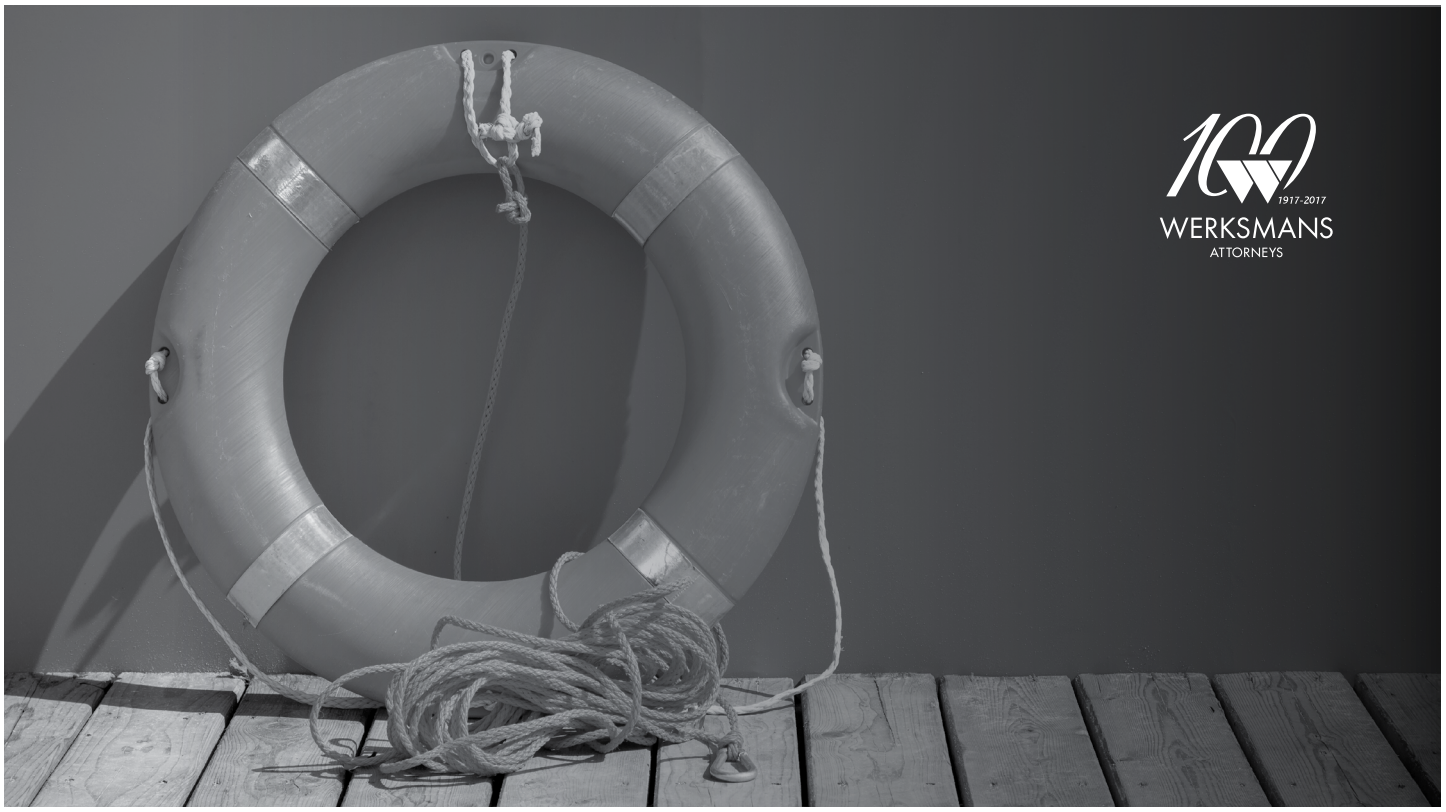

INFORMAL RESTRUCTURING OR BUSINESS RESCUE

By Nastascha Harduth, Director

LEGAL BRIEF DEC/JAN 2018

Business rescue proceedings are formal legislated proceedings, under Chapter 6 of the South African Companies Act 71 of 2008 ("The Companies Act"), that are aimed at restructuring the affairs of a company in such a way that either maximises the likelihood of the company continuing in existence on a solvent basis, or results in a better return for the creditors of the company than would ordinarily result from the liquidation of the company. It provides for the temporary supervision of the company by a business rescue practitioner; a stay on the rights of claimants against the company which arose prior to business rescue or in respect of property in its possession; and the development and implementation, if approved, of a business rescue plan to rescue the company by restructuring its business, property, debt, affairs, other liabilities and equity.

However, companies often consider informal restructurings as an alternative to business rescue. An informal restructuring requires a company to work with some or all of its creditors outside of a formal process in order to come to a negotiated solution where the company can return to financial health. In fact, according to a 2016 survey [1] informal restructurings overall seem to have a higher success rate than business rescue, which in itself would suggest that informal restructurings have significant advantages over business rescue.

This survey reported that pre-packs (essentially, a pre-agreed "tailor made" restructuring plan) were often used during informal restructurings and that it increased the level of transparency and accountability which built trust in the process. Further, as informal restructurings are usually confidential, the company's reputation remains intact, and its market value and relationships with employees, customers and supplier are preserved.

Moreover, an informal restructuring, if run in a sensible and credible manner, can also offer the same protection to the company's management and directors against incurring personal liability for conducting the business of the company in a reckless manner. In this regard, the South African Supreme Court of Appeal in the case of *Fourie NO v Newton* [2010] JOL 26517 (SCA) stated that *"where there are sufficient other potential or existing sources of funding it does not follow that where group support is or may be withdrawn, the members of the board would immediately have to shut up shop on pain of contravening s 424* [of the Companies Act 61 of 1973, which is comparable to section 77(3)(b) as read with sections 22 and 218 of the Companies Act]. *The essential question is whether the board would be acting recklessly in seeking to exploit the other sources of funding. The answer to that question would in the first place depend on the amount of funding required, for how long it would be required, and the likelihood of it being obtained – whether timeously or at all; and in the second place, on how realistic the possibility is that the company's fortunes will be turned around. The second consideration will materially depend on whether there is a credible business plan or strategy that is*

1 "Deloitte Restructuring Outlook Survey 2016" at http://www.tma-sa.com/info-centre/knowledge-base/116-deloitte-restructuring-survey-2016/file.html visited on 27 September 2016.

being or could be implemented to rescue the company. A business that may appear on analysis of past performance to be a hopeless case, may legitimately be perceived as a golden opportunity for a turnaround strategy." [insertion]

However, the greatest disadvantage of an informal restructuring is that companies cannot rely on the statutory moratorium (stay) which business rescue offers. That is, a race to collect can easily develop; and creditors may seek to get paid in advance of other creditors. Aggressive creditors may even apply for liquidation of the debtor company in order to enforce payment.

In addition, section 129(7) of the Companies Act requires a board of a financially distressed company, which does not adopt a resolution placing the company formally in business rescue, to deliver a written notice to each affected person (which includes all creditors, shareholders, employees and trade unions) setting out that the company is financially distressed, why it is distressed, and the reasons for not adopting a resolution to place the company in business rescue. The likely result of delivering such a notice will be commercial suicide, as most creditors will choose not to continue with the supply goods and services on favourable credit terms. If such a notice is not delivered, then the directors may be held liable under section 218 of the Companies Act for the damages suffered.

Consequently, an informal restructuring must be commenced well before the company becomes financially distressed as defined in the Companies *Act, that is, where "[i] 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; or it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months".*

An early intervention will, of course, have the added benefit of increasing the prospect of the informal restructuring succeeding.

However, in other jurisdictions a hybrid approach is often followed, where pre-packs are agreed with the majority of company's creditors and key suppliers before the company enters into a formal process. Not only will the company's relationship with those creditors and suppliers remain intact, but it can also be confident that the restructuring plan will be approved in the formal process with the benefit of the protection that such a formal process provides.

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