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# POST COMMENCEMENT FINANCE

# 07

Presented by

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# Overview of post-commencement finance

- An important element of business rescue is a concept called post-commencement finance (also known as "PCF")
- After being placed under supervision, the financially distressed company will require ongoing finance to keep it operating and trading in the marketplace; if not the company must be placed into liquidation
- The Companies Act provides statutory protection for lenders who are prepared to continue financing the company (preference is provided to post-commencement lenders)
- Additional financing after the commencement of business rescue is critical to the survival and turnaround of the company while it is undergoing a restructuring process under business rescue
- Post-commencement finance allows a company to meet its short-term trade obligations, cover turnaround or restructuring costs and may assist in restoring the company's balance sheet to solvency
- Accordingly, securing turnaround finance is an important component of every business rescue plan
- Failure to obtain the necessary funding may result in the company being placed into liquidation
- Post-commencement finance is the lifeblood of a business rescue process

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## Sources of post-commencement finance

- Obtaining turnaround finance presents a significant challenge for distressed companies
- In general, funding may be obtained from the following sources –
    1. Income generated by the company – "with its own face"
    2. Loans/internal funding from shareholders
    3. Further funding from current financiers or lenders
    4. New funding from new financiers or lenders such as venture capitalists; and
    5. Services rendered by current suppliers of the company to it during business rescue.
- Potential post-commencement financiers will usually investigate the distressed company to establish its viability before deciding to provide it with financing
- The nature and extent of post-commencement funding will depend on the nature of the business, the company's current financial situation and prospects of success, as well as the risk appetite of the financiers
- It is imperative for the business rescue practitioner to properly consider the possibility of obtaining post-commencement finance
- In the absence of post-commencement finance, the continued operation of the business of the distressed company may be considered to be reckless

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# Types of post-commencement finance

The Companies Act in section 135 distinguishes between two types of post-commencement finance

1. Section 135(1) covers remuneration, reimbursements for expenses, and other amounts of money relating to employment that becomes due and payable to employees during business rescue proceedings but is not paid to the employees
2. Section 135(2) covers funding which is provided to a company, during the company's business rescue, by means unrelated to employment. This may be provided in exchange for security over unencumbered assets of the company

# Types of post-commencement finance

- Section 135(3) makes reference to "other claims arising out of the expenses of the business rescue proceedings"
- In practice, business rescue practitioners recognise the provision of services by suppliers to the company as "post-commencement finance"
- Accordingly, services that are continuously, or for a period of time, rendered by a current supplier of the company to the company, on credit, during business rescue will also constitute post-commencement finance
- But in this regard, the judgement of South African Property Owners Association v Minister of Trade and Industry and others 2018 (2) SA 523 (GP) must be considered

# Important case law to consider

## South African Property Owners Association v Minister of Trade and Industry and others 2018 (2) SA 523 (GP)

- The ranking of creditors who provide goods and/or services post the commencement of business rescue proceedings under an agreement that was concluded prior to the commencement of these proceedings was dealt with by the High Court
- This judgment is somewhat controversial
- The South African Property Owners Association argued that "rental and other services rendered to property utilised by a legal entity under business rescue" fall within the ambit of either the phrase "post-commencement financing" or "costs arising out of the costs of business rescue proceedings".
- The Court held that –
  - the costs referred to in the application are costs incidental to the leased property and are subject to the terms of the particular lease agreement and arise out of the terms of the lease agreement. Those costs do not constitute by any interpretation costs arising out of the business rescue proceedings.
  - furthermore, the liability of such costs arises out of the relevant lease agreement, despite being continually incurred, even after commencement of the business proceedings. To hold that such costs constitute post-commencement financing would elevate an obligation prior to commencement of business rescue proceedings to a preference over other creditors not provided or contemplated by the provisions of section 135 of the Act, which would defeat the purpose or aim of the business rescue proceedings.

# Important case law to consider

## South African Property Owners Association v Minister of Trade and Industry and others 2018 (2) SA 523 (GP)

- Accordingly, any costs or liability that arise out of an agreement that was concluded prior to business rescue proceedings, and which costs were incurred during business rescue proceedings, will not constitute "post-commencement financing" or "costs arising out of the costs of business rescue proceedings".
- Such costs and/or liabilities, unless already secured, will merely form the subject of an unsecured (concurrent) claim against the company in business rescue and will not enjoy any preference above other creditors
- Unless a creditor concludes a new agreement (makes application) or concludes an addendum to its current agreement which provides that any services provided during business rescue will enjoy a preference during business rescue, such creditor will not enjoy any preference as set out in section 135 of the Companies Act.
- Based on this judgment, business rescue practitioners must now reconsider the manner in which they treat the provision of goods and services after the commencement of the business rescue process
- Business rescue practitioners will only enter into agreements to elevate costs and/or liabilities to preferent status if they are of the view that the contract and the service provided by the creditor is vital to the successful rescue of the company
- A prudent approach for landlords would be to include a standard event-of-default clause in their standard form contracts enabling them to terminate their agreements, at their discretion, once a business rescue process commences

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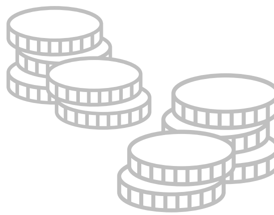
# The ranking of post-commencement finance - in business rescue

The ranking of post-commencement finance claims is as follows (section 135(3))–

1. Business rescue practitioners' remuneration, expenses and claims incurred in terms of section 143 arising our of the costs of the business rescue proceedings
2. post-commencement financing obligations that are related to the remuneration of employees from the date of commencement of the business rescue proceedings
3. secured lenders or creditors, for any loan/supply of goods or services made after business rescue proceedings have commenced (secured post-commencement finance)
4. Unsecured lenders/creditors, for any loan/supply of goods or services made after business rescue proceedings commenced (unsecured post-commencement finance)
5. Secured lenders or other creditors, for any loan or supply of goods made before business rescue proceedings commenced
6. Employees, for any remuneration which became due and payable before business rescue proceedings commenced
7. Unsecured lenders or other creditors for any loan or supply of goods and services made before business rescue proceedings commenced

Section 134(3) must be kept in mind …

- If property is sold during business rescue proceedings, the secured claim must be paid from the proceeds or otherwise alternative security for its payment must be provided to the satisfaction of the secured creditor
- Post-commencement claims are paid separately from the proceeds of security
- The operation of section 135 does not deprive existing rights of security held by secured creditors



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# The ranking of post-commencement finance – in a liquidation scenario (post-business rescue)

- In terms of section 135(4), the order of preference set out in section 135 will remain in force, even if the company is placed in liquidation, except to the extent of any claims arising out of the costs of liquidation.
- There has been much debate about the status of a business rescue practitioner's claim for fees and remuneration once the company has been placed into liquidation

Murgatroyd v Van den Heever NO and others 2015 (2) SA 514 (GJ)

- The court dealt with the entitlement of a business rescue practitioner to be reimbursed for expenses and disbursements incurred in the business rescue once the company has been placed in liquidation
- Held: the business rescue practitioner's entitlement to reimbursement for expenses and disbursements incurred in a business rescue must be linked to whether they were "reasonably necessary to carry out the practitioner's functions and facilitate the conduct of the company's business rescue procedures"
- Accordingly, it involves a factual question which must be determined with due regard to the facts and circumstances of each case, including inter alia the size of the company, as well as the complexity and scope of work undertaken by the business rescue practitioner
- Meyer J held that the business rescue practitioner was entitled to full recovery from the estate of the company in liquidation, in priority before the claims of all other secured and unsecured creditors in terms of section 143 of the Companies Act

# The ranking of post-commencement finance – in a liquidation scenario (post-business rescue)

Diener NO v Minister of Justice and others (South African Restructuring and Insolvency Practitioners Association (SARIPA) and others as amici curiae) [2018] 1 All SA 317 (SCA)

- The applicant (a business rescue practitioner) had provided an account for his fees and the bill of costs of his attorneys to the joint liquidators of the company for payment
- Both the applicant's and the attorneys' fees remained unpaid after the commencement of liquidation and a dispute arose amongst the liquidators as to the treatment of the practitioner's and liquidator's fees in the liquidation and distribution account of the liquidated estate
- After the applicant was unsuccessful in the court a quo, the Supreme Court of Appeal was tasked with inter alia deciding whether, in instances where a company is placed in liquidation following an unsuccessful business rescue, a business rescue practitioner's claim for his or her expenses and remuneration, enjoys preference over all the company's secured and unsecured creditors
- The applicant on Appeal to the SCA argued that by virtue of section 143(5) of the Companies Act, he enjoyed a "super-preference" over all creditors whether secured or not, after the costs of liquidation for the payment of his fees and expenses
- SCA held that the reference to "secured and unsecured" creditors in section 143(5) ought to be understood within the scope and context of section 135, that is with reference to post-commencement financiers and not to the company's pre-business rescue creditors
- The SCA therefore did not find any indication that pre-commencement security is to be diluted or undermined in any way in business rescue proceedings
- Accordingly, a practitioner only enjoys a preference in respect of his or her remuneration to claim against the free residue after the costs of the liquidation, but before post-commencement financiers and any other unsecured creditors

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# The ranking of post-commencement finance – in a liquidation scenario (post-business rescue)

In summary, the ranking of claims in liquidation are as follows

- Proceeds from the sale of the encumbered assets –
    1. Costs of maintaining, conserving, and realising any property, including the trustee's remuneration in respect of any such property and a proportionate share of the costs incurred by the trustee in giving security for his proper administration of the estate, calculated on the proceeds of the sale of the property, a proportionate share of the Master's fees, and if the property is immovable, any [property] tax [and penalties thereon] (Section 89 of Insolvency Act)
    2. Secured creditors (Section 95(1) of the Insolvency Act)

# The ranking of post-commencement finance – in a liquidation scenario (post-business rescue)

Proceeds from the sale of the unencumbered assets –

1. Costs of Liquidation (Section 97 of Insolvency Act, read with section 135(4) of the Companies)
2. Section 135(3) and (4) of the Companies Act, read with Diener N.O. v Minister of Justice and Correctional Services and Others [2018] ZACC 48
   - Payment of the Business Rescue Practitioner's remuneration and expenses, and other claims arising out of the costs of business rescue
   - Payment of any remuneration, reimbursement for expenses or other amount of money relating to employment that becomes due and payable by a company to an employee during business rescue
   - Payment of unsecured PCF
3. Costs of execution (Section 98 of the Insolvency Act)
4. Salaries or wages of former employees of the company, subject to the limits described in this section. It is worth pointing out that this section would only become applicable if salaries and wages became payable prior to the commencement of business rescue proceedings, failing which it will fall under section 135(3), as described aforesaid (Section 98A of Act 24 of 1936)
5. Statutory obligations, e.g Workmen's Compensation, Taxes, UIF, etc (Section 99 of the Insolvency Act)
6. Taxes on persons or the incomes or profits of persons per any Act of Parliament (Section 101 of the Insolvency Act)
7. Unperfected general notarial bonds (Section 102 of the Insolvency Act)
8. Payment of concurrent creditors, including those concurrent creditors who provide services and supply goods after the commencement of business rescue proceedings under an agreement that was concluded prior to the commencement of business rescue proceedings and from whom the company did not "obtain financing" in terms of section 135(2) (Section 103 of the Insolvency Act read with South African Property Owners Association v Minister of Trade and Industry and Others 2018 (2) SA 523 (GP))

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