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LEGAL CONSEQUENCES – THE EFFECTS ON SHAREHOLDERS DIRECTORS AND CREDITORS

08

Presented by

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The effect of business rescue on shareholders

- A standout feature of Chapter 6 is the limited role that shareholders play in the outcome of the business rescue process
- The interests of shareholders are regarded as being somewhat subordinate to the interests of creditors and employees
- There is no "shareholders committee" that is established in order for shareholders to consult with the business rescue practitioner
- However, notwithstanding the above, the business rescue practitioner must engage with and manage the expectations of shareholders and the holders of company securities in order to properly manage the restructuring process
- Section 137(1) provides that during business rescue proceedings, an alteration in the classification or status of any issued securities of a company other than by way of a transfer of securities in the ordinary course of business is invalid except –
    1. to the extent that the court otherwise directs; or
    2. as contemplated in an approved business rescue plan

The effect of business rescue on shareholders (continued)

- Section 146 provides that holders of any issued security of the company must be notified of court proceedings, decisions, and meetings and are entitled to participate in court proceedings and the company's business rescue proceedings in certain instances
- In terms of section 146(d), the rights of shareholders to approve or reject a proposed business rescue plan are limited. Shareholders are entitled to vote to approve or reject a proposed business rescue plan, only to the extent that the plan alters or affects their rights
- It is evident that shareholders are not able to do much during the business rescue process despite having a lot to lose when business rescue fails and the distressed company goes into liquidation. However, this is ultimately the financial risk that one takes when investing as a shareholder

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The role and obligations of directors during business rescue

- In terms of section 140(1)(a), the business rescue practitioner has full management control of the company in substitution for the company's incumbent board of directors and pre-existing management
- Accordingly, the business rescue practitioner is obligated (once appointed) to supervise temporarily the company and the management of its affairs, business and property
- In terms of section 140(1)(b), the business rescue practitioner may delegate any power or function of the practitioner to a person who was part of the board or pre-existing management of the company
- The business rescue practitioner may also remove from office any person who forms part of the pre-existing management of the company, or appoint a person as part of the management of the company, whether to fill a vacancy or not – section 140(1)(c)

The role and obligations of directors during business rescue (continued)

- Accordingly, the role of directors during business rescue is as follows:
  - in terms of section 137(2), the directors of the company –
  - must continue to exercise the functions of director, subject to the authority of the business rescue practitioner
  - have the duty to the company to exercise management functions within the company in accordance with the express instructions or directions of the business rescue practitioner to the extent that it is reasonable to do so
  - are required to cooperate fully with the business rescue practitioner and to provide any information about the company's affairs as may be reasonably required by the practitioner
  - remain bound by the requirements of section 75 concerning personal financial interests of the director or a related person; and
  - to the extent that they act in accordance with paragraphs (b) and (c), are relieved from the duties of a director as set out in section 76, and the liabilities set out in section 77, other than section 77 (3) (a), (b) and (c)

Directors and cooperation with the business rescue practitioner

- Section 142 sets out obligations for directors to consider and adhere to once the company has commenced business rescue proceedings
- The most significant of these obligations is the obligation to deliver to the business rescue practitioner all the books and records that relate to the affairs of the company
- The business rescue practitioner is required to consider and investigate the affairs of the company
- Accordingly, it is imperative that directors discharge this duty as soon as possible after the business rescue practitioner has been appointed
- No lien is allowed to be claimed over these books and records. Any person in possession of same must hand such documentation to the practitioner on demand

Directors and cooperation with the business rescue practitioner (continued)

- In terms of section 137(3), during a company's business rescue proceedings, each director of the company must attend to the requests of the business rescue practitioner at all times, and provide the business rescue practitioner with any information about the company's affairs as may reasonably be required
- Furthermore, in terms of section 137(4), if during a company's business rescue proceedings, the board, or one or more directors of the company, purports to take any action on behalf of the company that requires the approval of the business rescue practitioner, that action is void unless approved by the business rescue practitioner

Van Jaarsveld NO v Q-Civils (Pty) Ltd and another (675/2017) [2017] ZAFSHC 53 (30 March 2017

- The court considered the implications of section 137(2) as read with section 140(1)(a)
- Section 140(1)(a) provides that the business rescue practitioner has full management control of the company in substitution of its board and pre-existing management
- The court held that the intention of the legislature in providing for the appointment of a business rescue practitioner was to give authority to an individual who will provide an objective and independent analysis of the financial status of the company
- The directors in these circumstances may continue to exercise their powers as directors but such powers may only be exercised with the express authorisation of the business rescue practitioner
- Accordingly, the business rescue practitioner assumes a position of authority over the directors and any action taken by directors are invalid unless authorised by the practitioner
- The court held further that the aim of business rescue is to limit the powers of those that contributed in placing the company into financial distress

Directors and cooperation with the business rescue practitioner (continued)

- In terms of section 137(5) – at any time during the business rescue proceedings, the business rescue practitioner may apply to a court for an order removing a director from office on the grounds that –
  - the director has failed to comply with a requirement of Chapter 6; or
  - by act or omission, has impeded, or is impeding, the practitioner in the performance of the powers and functions of a practitioner
- This enables the business rescue practitioner to remove obstructive directors that hamper the effective supervision of the company under business rescue, as well as the development and implementation of the business rescue plan
- In terms of section 137(6), the right in terms of section 137(5) is in addition to any right of a person to apply to court for an order contemplated in section 162 of the Companies Act, relating to delinquent directors

- Cross-Med Health Centre (Pty) Limited (in business rescue) and others v Crossmed Mthatha Private Hospital (Pty) Limited and another [2018] JOL 40146 (ECG)
- The court reaffirmed the principle that a business rescue practitioner has the right not to be obstructed in the exercise of his or her duties
- In the event that the practitioner is obstructed the practitioner may apply for appropriate relief, including the removal of directors who impede the practitioner in the performance of his or her powers and functions

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The role and treatment of creditors during business rescue

- South Africa, at least in theory, has moved away from a creditor-driven rescue regime to a more debtor oriented approach
- However, participation by creditors during the voting process remains paramount in approving and voting in a business rescue plan
- In terms of section 145(1)(a)-(d) creditors are entitled to –
    - notice of all court proceedings, decisions, meetings or any other relevant event concerning the business rescue proceedings
    - participate in court proceedings arising during the business rescue proceedings
    - formally participate in the company's business rescue proceedings
    - informally participate in the business rescue proceedings by making proposals for a business rescue plan to the practitioner
- In terms of section 145(2)(a), creditors have the right to vote to amend, approve or reject a proposed business rescue plan
- In terms of section 145(2)(b), if the proposed business rescue plan is rejected, creditors have a further right to propose the development of an alternative plan, in terms of section 153(1)(a) or to make a binding offer in terms of section 153(1)(b)(ii) to purchase the voting interests of any or all persons who opposed the adoption of the business rescue plan (and as a result of which the plan was rejected)
- The voting interests are purchased at a value that is independently and expertly determined to be a fair and reasonable estimate of the return to that person, or those persons, if the company were to be liquidated
- This buy-out contemplated in section 153(1)(b)(ii) is an important and fundamental right of creditors to purchase the voting interests of creditors who vote against the plan

The creditors committee in terms of section 145(3)

- Section 145(3) allows creditors to form a creditors' committee which represents the independent creditors
- Creditors are entitled to be consulted by the business rescue practitioner during the development of the business rescue plan
- Creditors are limited to making proposals to the business rescue practitioner and may not direct him or her to take action, nor may creditors instruct the business rescue practitioner to do anything in the course of the business rescue practitioner's conduct in the business rescue proceedings
- The power of creditors are limited in that they may only consult with the business rescue practitioner
- In practice, the business rescue practitioner usually consults extensively with major creditors in respect of the content and feasibility of the plan, with the view of ensuring that the plan will have the support of the major creditors when it comes to the approval or "voting in" of the plan

Creditors' voting interests and the practitioner's determinations in terms of section 145(4) – (6)

- Section 145(4)(a) - (b) provides that in respect of any decision contemplated in Chapter 6 that requires the support of the holders of creditors' voting interests –
    - a secured or unsecured creditor has a voting interest equal to the value of the amount owed to that creditor by the company; and
    - a concurrent creditor who would be subordinated in a liquidation has a voting interest, as independently and expertly appraised and valued at the request of the practitioner, equal to the amount, if any, that the creditor could reasonably expect to receive in such a liquidation of the company

- In terms of section 145(5)(a) – (c), the business rescue practitioner of a company must —
    - determine whether a creditor is independent for the purposes of Chapter 6;
    - request a suitably qualified person to independently and expertly appraise and value concurrent creditors' interests as set out above; and
    - give a written notice of the determination, or appraisal and valuation, to the person concerned at least 15 business days before the date of the meeting to be convened in terms of section 151 (the meeting to determine the future of the company)

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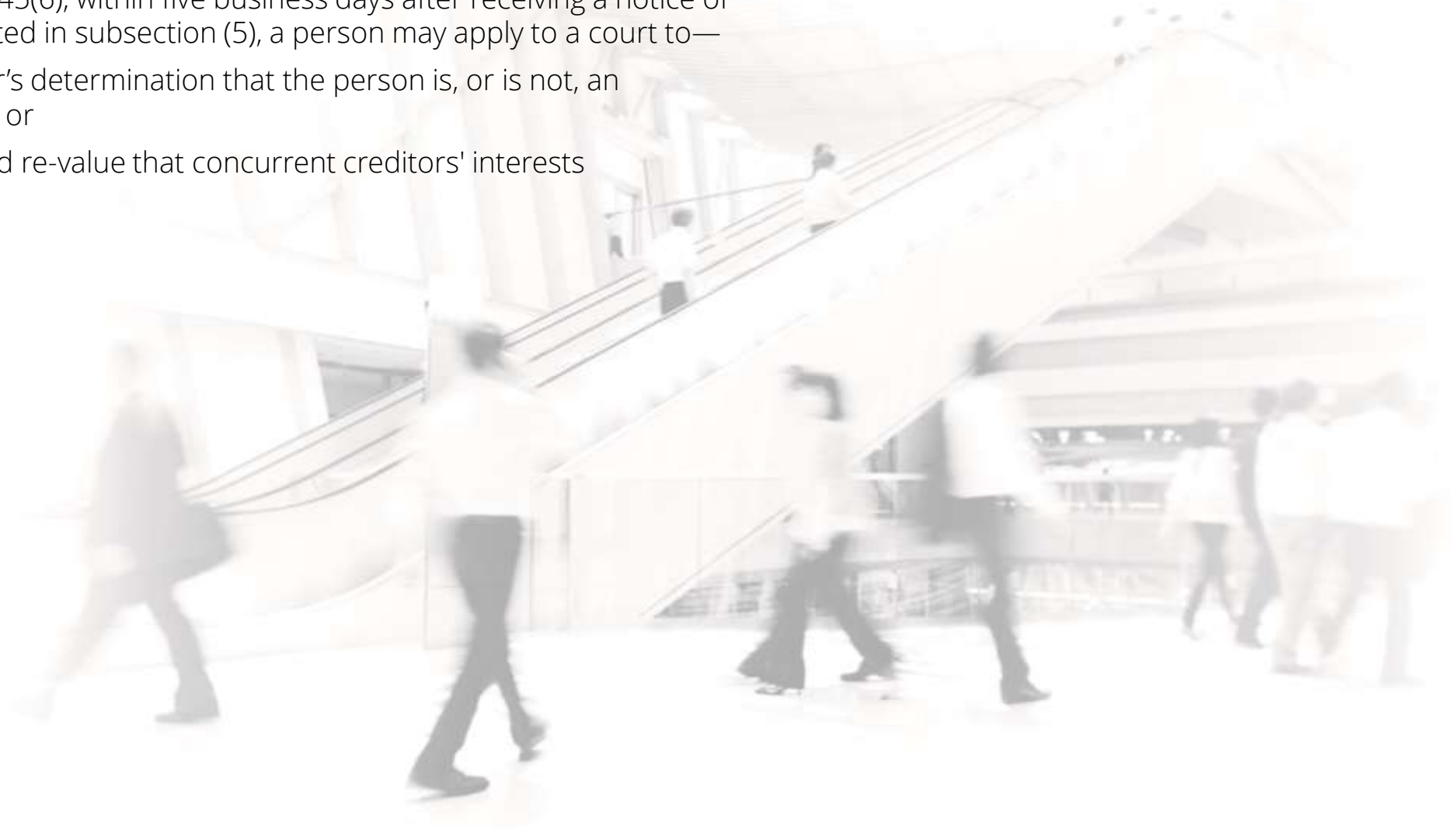
Creditors' voting interests and the practitioner's determinations in terms of section 145(4) – (6) (continued)

- Finally, in terms of section 145(6), within five business days after receiving a notice of a determination contemplated in subsection (5), a person may apply to a court to—
  - review the practitioner's determination that the person is, or is not, an independent creditor; or
  - review, re-appraise and re-value that concurrent creditors' interests



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The first meeting of creditors

- Section 147 provides that within 10 business days after being appointed, the business rescue practitioner must convene, and preside over, a first meeting of creditors, at which -
    1. the practitioner must inform the creditors whether the practitioner believes that there is a reasonable prospect of rescuing the company
    2. may receive proof of claims by creditors
    3. the creditors may determine whether or not a committee of creditors should be appointed and, if so, may appoint the members of the committee
    4. If the business rescue commenced by way of a court order, the business rescue practitioner's appointment must be ratified by a majority of independent creditors at the first meeting of creditors, in terms of section 131(5) of the Companies Act
- It is noteworthy that no approval of the appointment of the business rescue practitioner is required if the practitioner was appointed and business rescue commenced in terms of a section 129 resolution
- The business rescue practitioner must give notice of the first meeting of creditors to every creditor of the company whose name and address is known to, or can reasonably be obtained by, the business rescue practioner, setting out the –
    - date, time and place of the meeting and
    - the agenda for the meeting
- At any meeting of creditors, other than the meeting contemplated in section 151, a decision supported by the holders of a simple majority of the independent creditors' voting interests voted on a matter, is the decision of the meeting on that matter.

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The effect of business rescue on the claims of creditors

- In terms of section 147(1)(a)(ii), the business rescue practitioner, may receive proof of claims by creditors at the first meeting
- In practice, a submission of a claim at the first meeting is not obligatory. Creditors can submit a claim at a later stage but before the publication of the business rescue plan
- There is no set format for submitting a claim; however, it is recommended that a claim be submitted in the form of an affidavit
- It is advisable for the business rescue practitioner to receive claims at a very early stage in order to assess the extent of the existing liabilities of the company. In this way, the business rescue practitioner can determine whether there is a reasonable prospect of rescuing the company

- In terms of section 154(1), a business rescue plan "may" provide that a creditor will lose the right to enforce its debt against the company
- If a business rescue plan has been approved and implemented in accordance with Chapter 6, then no creditor will in terms of section 154(2) be entitled to enforce any debt owed by the company except to the extent provided for in the business rescue plan
- The plan is binding on all creditors and affected persons
- Creditors (including those who have not participated) are forced to accept a "compromise" on their claims
- This allows the company to continue to trade in a solvent position into the future

Snapshot of Business Rescue Process and Time Periods

The Business Rescue Practitioner (BRP) must (as soon as practicable after being appointed) investigate company's affairs and consider if there are reasonable prospects of the company being rescued. If not, apply to court to discontinue proceedings and place the company in liquidation (this can be done at any time)

Practitioner appointed

As soon as practicable

- Delivery by directors of all books and records
- Inform regulatory authorities of commencement

5 days

- Directors to provide statement of affairs

10 days from date of appointment

- **If rejected** – Vote on revised plan / apply to court to set aside inappropriate vote / offer to purchase voting interests of dissenting parties
- **If rejected and no steps taken** – BRP to file a notice of termination
- Approved and plan implemented (notice of substantial implementation)

First meeting of creditors / employees

25 days from date of appointment

- Section 150 (5) Preparation and Publication of pan

10 days

- Section 152 Meeting to consider and vote on plan

Note: Business rescue should generally end within three months, or an extended time as granted by court on application by the practitioner (days = business days)

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End of Unit 08

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