

# BUSINESS RESCUE MATTERS

## IN THIS ISSUE

Shareholder involvement in business rescue proceedings

Business rescue - the role of creditors

Business rescue practitioner - a new vocation

The business rescue plan

The impact of the practitioner's discretionary powers on the employment relationship and managers

## Shareholder involvement in business rescue proceedings

Shareholders are one of the categories of 'affected persons' in business rescue proceedings. As an affected person, a shareholder has significant influence over the course that is ultimately followed by a company in financial distress.

The board of directors of a company may commence business rescue proceedings by resolution. All shareholders are entitled to receive written notice of such resolution, the consequent appointment of a business rescue practitioner and of all relevant events leading up to and during business rescue proceedings. A shareholder may apply to court for an order setting aside such resolution on the grounds listed in section 130(1)(a) of the Companies Act (the Act). The grounds include that the company has failed to satisfy the procedural requirements of the Act.

Where the board has not resolved to commence business rescue proceedings, shareholders may apply to court for an order placing the company under supervision and commencing business rescue proceedings. Contrary to the entitlement of the board of directors, shareholders may bring this application even if liquidation proceedings have been instituted, resulting in the liquidation of the company being suspended. The shareholders are in a more influential position than the board of directors for which business rescue ceases to be an option once liquidation proceedings have been instituted.

Once proceedings have commenced, the business rescue practitioner is obliged to consult with, *inter alia*, shareholders prior to the formulation of the business rescue plan. The plan must contain sufficient information so that shareholders are able to decide whether to accept or reject it. Notably, the business rescue plan is not formulated in consultation with the shareholders but only after consultation with the shareholders. It is important for the shareholders to raise any issues, concerns or proposals, including any alteration in the classification or status of their shares at the initial point of consultation by the practitioner, as subsequent to the adoption of the business rescue plan each shareholder of the company (as well as the company and each creditor of the company) will be bound by the business rescue plan irrespective of whether or not such shareholder attended the meeting or voted in favour of the adoption of the plan.

Shareholders must consider whether the business rescue plan will result in the alteration in the classification or status of any issued securities of the company. The Act is clear that, subject to two exceptions, any such alteration, other than by transfer of securities in the ordinary course of business, is invalid. The first exception is if the court directs otherwise and the second is if it is so contemplated in the approved business rescue plan. Should the proposed business plan alter the issued securities, the shareholders are entitled to vote to approve or reject the plan. If the shareholders

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reject the plan they are further entitled to propose an alternative plan or present an offer to acquire the interests of any or all of the creditors or other holders of the securities.

Shareholders, as affected persons, are further entitled to approach a court with an application to have a business rescue practitioner removed on the grounds listed in section 130(1)(b) of the Act. One such ground is that the practitioner lacks the necessary skills, having regard to the company's circumstances. They may also require the practitioner to provide security, on application to the court and to the satisfaction of the court, to secure the interests of the company and affected persons.

In summary, the Act envisages the intimate and formal involvement of the shareholders of a company in business rescue proceedings, ranging from the choice of method by which the proceedings are instituted to participation in court proceedings. Shareholders are advised to acquaint themselves with their entitlements in business rescue proceedings in order to ensure their interests are suitably protected.

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## Business Rescue - the role of creditors

It does not bode well for creditors that the directors of a company can commence business rescue process by resolution. In contrast to judicial management, this allows directors of a financially distressed company to obtain a moratorium on all legal proceedings against the company without first having to obtain a court order to that effect.

Creditors must be notified of the resolution and of the identity of the business rescue practitioner appointed. A creditor may then apply to court to have the resolution or the appointment of the practitioner set aside or require that the practitioner must provide security. Creditors may also apply for a court order placing the company under supervision and commencing business rescue proceedings.

Once rescue proceedings have commenced, the course and outcome of the proceedings are primarily decided by the creditors who are entitled to both formally and informally participate in the process. The Companies Act (the Act) provides expressly that the company and each creditor is entitled to notice of all court proceedings, meetings or other relevant events concerning the rescue proceedings.

Within 10 business days of being appointed, the practitioner must convene the first meeting of creditors. At this meeting claims may be proved and the creditors may determine whether or not to appoint a committee of creditors. If a committee of creditors is appointed, the committee is entitled to give input and be consulted by the practitioner in the development of the business rescue plan. If business rescue proceedings were instituted by an affected person, the appointment of the practitioner nominated by the affected person will be subject to ratification by the majority of creditors' voting rights, at the first creditors meeting.

The practitioner and the management of the company must prepare a business rescue plan for consideration and possible adoption by creditors and, if applicable, shareholders and employees, at a meeting convened for this purpose. At this meeting, creditors are entitled to vote to amend the proposed plan, or to direct the practitioner to adjourn the meeting in order to revise the plan for further consideration. The proposed plan must be approved by the holders of more than 75% of the creditors' voting interests that were voted and at least 50% of the independent creditors voting interests, if any, that were voted.

Once a rescue plan has been adopted, it becomes binding on each and every creditor and shareholder of the company irrespective of whether they were present at the meeting or voted in favour of the adopted plan.

If the proposed plan is rejected, the practitioner, failing which any creditor, may call for a vote of approval from the holders of voting interest to prepare and publish a revised plan for adoption at a further meeting. If this is not done, a creditor may apply to court to set aside the result of the vote rejecting the plan. Alternatively, any creditor or other affected person/s may make a binding offer to purchase the voting interests of such persons, who opposed adoption of the rescue plan at a value which is a fair and reasonable estimate of the return to those persons if the company were to be liquidated. If none of the above leads to the adoption of a rescue plan, the rescue proceedings will terminate and the company will thereafter in all likelihood be liquidated.

To encourage financiers to assist companies to rehabilitate, the Act introduces the concept of 'post commencement finance'. This means that the claims of creditors who provided companies with finance during rescue proceedings would be paid in preference and in the

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order in which they were incurred over all unsecured claims against the company. The claims of the creditors may also be secured to the lender by utilising any asset of the company to the extent that it is not otherwise encumbered.

Consequently, creditors of financially distressed companies are afforded considerable latitude in deciding the direction of business rescue proceedings and can use this process as an effective mechanism to achieve returns that could exceed expected returns in a liquidation.

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## Business rescue practitioner - a new vocation

The considerable task of overseeing the business rescue process and turning the financially distressed company around rests with the business rescue practitioner (the Practitioner). A Practitioner can be appointed in one of two ways. The board is responsible for nominating and appointing the Practitioner if the business rescue process is commenced by a resolution by the board. The court must appoint an interim Practitioner nominated by the affected person who applied to court, subject to ratification by the majority of the independent creditors if the business rescue process is commenced as a result of a court order.

The role of the Practitioner is a demanding one as he or she is expected to succeed in a task at which the board of directors of the company have failed. Section 138 of the Companies Act 2008 sets out the eligibility criteria for Practitioners. Only a "*person in good standing of a profession subject to regulation by a regulatory authority prescribed by the Minister*" may be appointed as a Practitioner. Persons who are subject to an order of probation or who would be disqualified as acting as directors of the company or who have a relationship with the company that could jeopardise their independence, are not permitted to be appointed as Practitioners. The Minister has not yet given any indication as to which person or association it will appoint to regulate Practitioners.

During the business rescue process, the Practitioner has full management control of the company in substitution for its board and pre-existing management. The Practitioner is given the power to remove any person from office, who forms part of the pre-existing management of the company. The Practitioner may delegate any part of his or her functions to a person who was part of the board or pre-existing management of the company. Directors of the company are expected to co-operate with and assist the Practitioner and provide the Practitioner with all relevant information

about the company. The Practitioner is responsible for developing a business rescue plan and for the implementation of such a plan.

The Practitioner must, as soon as possible, commence investigating the company's affairs. If the Practitioner finds that there is no prospect of rescuing the company the Practitioner must apply to court to place the company in liquidation. If the Practitioner finds that the company is no longer financially distressed, the Practitioner must take steps to terminate the rescue proceedings. There is some scepticism as to whether there will be any incentive for Practitioners to take steps to terminate rescue proceedings, since for as long as rescue proceedings continue, the Practitioners will be remunerated by the company.

Practitioners are entitled to charge an amount to the company for remuneration and expenses in accordance with a tariff to be prescribed by the Minister. There is also no indication of what the tariff will be or how the remuneration will be calculated. The Practitioner may also propose an arrangement with the company for further remuneration on a contingency basis, related to the adoption of the business rescue plan and the attainment of certain results in relation to the business rescue process. The contingency agreement must be approved by the majority of creditor's voting interests.

A potentially lucrative opportunity exists for highly skilled individuals and organisations with the necessary experience in turning around businesses to fill the role of Practitioners.

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## The business rescue plan

The business rescue practitioner must prepare a business rescue plan (the plan) after consulting with all affected persons and the management of the company. The plan must contain all information reasonably required to assist affected persons in deciding whether to accept the plan, and must be divided into three parts, namely:

### **Part A: Background, which must include at least a -**

- list of the material assets of the company, and an indication as to which assets were held as security by creditors;
- list of creditors of the company and an indication as to which creditors qualify as secured, preferent and concurrent in terms of insolvency law;
- probable dividend that would be received by creditors if the company were to be placed in liquidation;
- list of the holders of the company's securities; and
- statement whether the plan includes a proposal made informally by a creditor of the company.

### **Part B: Proposals, which must include at least the -**

- nature and duration of any moratorium for which the plan makes provision;
- extent to which the company is to be released from the payment of its debts, and the extent to which any debt is proposed to be converted to equity in the company;
- ongoing role of the company, and the treatment of any agreements;
- property of the company that is to be available to pay its creditors' claims;
- order of preference in which the proceeds of property will be applied to pay creditors if the plan is adopted;
- benefits of adopting the plan as opposed to those that would be received if the company were to be liquidated; and
- effect that the plan will have on the holders of the company's issued securities.

### **Part C: Assumptions and conditions, which must include at least-**

- a statement of the conditions that must be satisfied for the plan to come into operation and be implemented;
- how the plan will affect employees;
- the circumstances in which the plan will end; and
- a projected balance sheet for the company and statement of income and expenses for the ensuing three years prepared on the assumption that the proposed plan is adopted.

The business rescue practitioner must convene a meeting where creditors and any other interested persons can consider the plan.

The proposed plan will have been approved on a preliminary basis if it was supported by the holders of more than 75% of the creditors' voting interests that were voted and the votes in support of the proposed plan included at least 50% of the independent creditors' voting interests that were voted.

If a proposed plan alters the rights of any class of holders of the company's securities the business rescue practitioner must immediately hold a meeting of holders of the class, or classes of securities whose rights would be altered by the plan, and call for a vote by them to approve its adoption. If in such a vote a majority of the voting rights that were exercised support adoption of the plan, it will have been finally adopted.

A plan that has been adopted is binding on the company, each of the creditors of the company and every shareholder of the company. The company must take all necessary steps to satisfy any conditions on which the plan is contingent and implement the plan.

To the extent necessary, the business rescue practitioner may, in accordance with the plan, determine the consideration for, and issue, any authorised securities of the company. If the plan was approved by the shareholders of the company, the business rescue practitioner may amend the company's Memorandum of Incorporation to authorise, and determine the preferences, rights, limitations and other terms of, any securities that are not otherwise authorised, but are contemplated to be issued in terms the plan. This gives the business rescue practitioner much wider powers than those of a judicial manager in terms of the Companies Act of 1973, section 433 of which prescribes that a judicial manager shall be empowered to assume the management of the company subject to the provisions of the memorandum and articles of the company concerned in so far as they are not inconsistent with any direction contained in the relevant judicial management order.

When the plan has been substantially implemented, the business rescue practitioner must file a notice of substantial implementation of the plan.

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## The impact of the practitioner's discretionary powers on the employment relationship and managers

The new Companies Act (the Act) was published on 9 April 2009 and is likely to come into effect during 2010. The Act introduces the entirely new concept of 'Business Rescue', which is intended to replace immediate liquidations or judicial administration in an attempt to nurse an ailing company back to financial wealth. The 'financially distressed' company is afforded an opportunity to continue to trade under the supervision of a business rescue practitioner (the practitioner) in an attempt to turn the business around, thereby reducing the amount of liquidations but also protecting employment.

Business Rescue is likely to have a significant impact on employment law. In this article, we focus on the impact of the practitioner's powers and duties on the employment relationship, with particular emphasis on the role of managers and their managerial prerogative. We will be addressing other employment consequences of the Act in subsequent articles.

Section 136 of the Act provides for employees of a company undergoing Business Rescue proceedings to continue to be employed on the same terms and conditions of employment except to the extent that changes occur 'in the ordinary course of attrition' or by agreement with employees.

Whilst it seems as if employees remain relatively unaffected by Business Rescue proceedings, the same may not necessarily be said of managers.

Section 140 of the Act provides that for the duration of the practitioner's appointment, he/she will have full management control of the company in the stead of its management and board. The practitioner has the discretion to delegate any power or function to a person who was part of the board or pre-existing management of the company, but it is equally possible for the practitioner to remove all management functions from existing management, and he/she may even appoint an external person to management, whether or not a vacancy exists. It is not difficult to imagine that

directors and management are likely to be reluctant to hand over power of the business to the practitioner. For this reason alone, the concept of Business Rescue may not win favour.

The practitioner may further remove from office any person who forms part of the pre-existing management of the company. It is unclear how this provision can be reconciled with the protection offered by section 136, or indeed the Labour Relations Act (LRA). The removal from office ought not to be interpreted to mean that managers may be demoted to a lesser status, as demotions can only be implemented by agreement. Equally, dismissal is probably also not intended unless such dismissal would be fair under the LRA, as there does not seem to be a basis to conclude that the legislature had intended to exclude management from the LRA's protection against unfair dismissal. The most vanilla flavoured interpretation of this provision is that managers could be suspended, either just from performing their functions, or completely, whilst the Business Rescue proceedings are underway. The only contrary indication is that section 137 expressly requires a practitioner to seek a court order to remove a director from office, while no special requirement is introduced for removal of a manager.

The provisions we have dealt with not only temporarily abolish the managerial prerogative to hire and fire, but in fact put management at risk of, at best temporary suspension, and at worst, a permanent removal from office.

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