The Leak in the Chapter 6 Lifeboat: Inadequate Regulation of Business Rescue Practitioners May Adversely Affect Lenders’ Willingness and the Growth of the Economy*

RICHARD BRADSTREET**
University of Cape Town

1 Recent Corporate Rescue Reform in South Africa

The Companies Act 71 of 20081 (‘Companies Act 2008’) provides in its Chapter 6 (‘Chapter 6’) for ‘business rescue’.2 This procedure is intended to provide for temporary measures to facilitate the rehabilitation of financially distressed companies. During business rescue, the company’s management will be under supervision and a moratorium on the rights of claimants against the company will operate. The rescue itself will be effected by a ‘business rescue plan’ provided for in the Act,3 in terms of which the company’s affairs, business, property, debt and other liabilities and equity will be restructured ‘in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, [if this is not possible], results in a better return for the company’s creditors or shareholders than would result from the immediate liquidation of the company. . .’.4

These provisions, based on the improvements made in foreign5 jurisdictions,6 will replace Chapter XV of the current Companies Act 61 of 1973

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** BA LLB (UCT). Currently completing an LLM in Commercial Law at the University of Cape Town.

1 Act 71 of 2008 was signed by the State President on 8 April 2009 and published in Government Notice 421 Government Gazette 32121 of 9 April 2009 and, at the time of writing, is expected to come into operation in the second half of 2010.

2 Chapter 6 uses the more inclusive term ‘business rescue’ rather than ‘corporate rescue’. Although these terms are often used interchangeably, the term ‘corporate rescue’ might arguably be more accurate as referring specifically to the rescue of corporate entities than the term ‘business rescue’, which might be considered to refer more broadly to include the rescue of business debtors that are not corporate entities. However, it is perhaps worth noting that in these rescue mechanisms the real emphasis falls less on the survival of the juristic person and more on that of the ‘enterprise and the real business carried on by the juristic person, in whole or part’ so that the term ‘business rescue’, even in the context of corporate legislation, might be considered more apt. See P Omar ‘Thoughts on the Purpose of Corporate Rescue’ (1997) 12(4) Journal of International Banking Law 127 at 127; P Kloppers ‘Judicial Management – A Corporate Rescue Mechanism in Need of Reform?’ (1999) 3 Stellenbosch LR 417 at 418.

3 Part D of Chapter 6 deals with the development and approval of the business rescue plan.

4 Section 128(1)(b).

5 In particular, the United States of America, Australia and the United Kingdom.

6 Despite warnings such as that issued by A Loubser ‘Judicial Management as a Business Rescue Procedure in South African Corporate Law’ (2004) 16 SA Merc LJ 137 at 162, where the author suggests
(‘Companies Act 1973’), which provides for what is currently the equivalent of business rescue, referred to as ‘judicial management’ of financially distressed companies. The reform of this aspect of companies legislation in South Africa both addresses the need to reform the unsuccessful current judicial management mechanism and reflects a trend evident worldwide to implement rescue mechanisms for financially ailing companies rather than simply provide for their demise through liquidation.

The trend to rescue arises from an increasing recognition of the value in many instances to creditors and other stakeholders such as employees of ‘the revival of companies on the brink of economic collapse and the salvage of economically viable units to restore production capacity, employment and the continued rewarding of capital and investment’.

Corporate rescue provides an alternative to using insolvency laws to convert a debtor’s assets to cash by ‘restructuring the financial structure of the debtor involving the issuance of new debt and equity in accordance with the claimant’s priorities’ (A Smits ‘Corporate Administration: A Proposed Model’ (1999) 32 De Juris 80 at 81).

that judicial management be amended rather than replaced, partly because a new procedure derived from another legal system imposed on South African law may not suit the circumstances peculiar to our system of law.


Whereas eligible debtors in terms of the Companies Act 1973 were limited to companies registered in terms of that Act, the Companies Act 2008 extends access to, theoretically, any form of business. It seems, however, that the intention is similarly to restrict access in terms of the 2008 Act and regulations to the forms of companies provided for in the Act. The terms ‘company’ and ‘business’ have been used loosely throughout this article.

This need has long been recognised. See A Olver ‘Judicial Management – A Case for Law Reform’ 1986 *Tydskrif vir Hedendaagse Romeins-Hollandse Reëg* 84 at 86 and *Le Roux Hotel Management (Pty) Ltd & Another v E Rand (PTY) Ltd (FBC Fidelity Bank Ltd (under Curatorship), Intervening)* 2001 (2) SA 727 (C) in par 55 where Josman J states:

‘The review of the cases reveals the limited scope of judicial management in this country.

Mr Steenkamp, in a very able argument, urged me to try to breathe some new life into this moribund old horse and to take a cue from developments in other parts of the world. Clearly one has to take note of the fact that in the first world countries referred to above, the need for a business rescue provision in company law has been recognised. Nor can one overlook the distinct possibility that the flourishing economies in the countries mentioned might have something to do with the progressive attitude adopted towards assisting an enterprise that encounters difficulty which is capable of being overcome.’


‘the spread of the so called “rescue culture” in insolvency has been a recognisable trend across jurisdictions in recent times’ and that ‘it is difficult to find a developed economy where there has not been at least some consideration given to implementing a specific updated rescue regime aimed at salvaging the corporate structure in certain circumstances of insolvency’.

Corporate rescue provides an alternative to using insolvency laws to convert a debtor’s assets to cash by ‘restructuring the financial structure of the debtor involving the issuance of new debt and equity in accordance with the claimant’s priorities’ (A Smits ‘Corporate Administration: A Proposed Model’ (1999) 32 De Juris 80 at 81).

See the definition of corporate rescue in Omar op cit note 2 at 127.

Kloppers op cit note 2 at 418.
a ‘market oriented’ procedure to one that is ‘bargain oriented’, capturing the essence of the provisions to this effect in the United States’ Bankruptcy Code.

The more recent initiatives of the United Kingdom and Australia are of particular relevance for South Africa. The relevance of the United Kingdom’s law lies in the general relationship between South African and English company law, while that of Australian law lies in the common-law heritage that it shares with South Africa. These jurisdictions will therefore be the primary sources of comparative law raised for discussion here where they are able to offer insight.

The provisions of Chapter 6 of the Companies Act 2008 have been hailed as a vast improvement on the previous judicial management mechanism. The judicial management provisions of the Companies Act 1973 focussed primarily, if not exclusively, on protecting the interests of creditors, rather than the actual rescue of the company in question, as a going concern or otherwise, and have been, by most if not all accounts, a dismal failure.

The provisions of the Companies Act 2008, in stark contrast with the ‘creditor-friendly’ focus of the preceding legislation, aim more specifically

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14 This emphasises the going-concern value of a company, implying an impersonal relationship between shareholders and the company itself; directors will therefore be relatively free of shareholder interference in the fulfilment of their tasks. In terms of this theory, it may be relevant that a company is ‘worth more as [a going-concern] run by existing managers and with existing shareholders than if sold to third parties and managed by new teams’ (McCormack Corporate Rescue Law: An Anglo-American Perspective (2008) at 8). When the going-concern value exceeds what is owed to creditors, such creditors ‘capture for themselves’ the difference between the value of the company and the amount of money available to settle the claims against it; but when the going-concern value is less, unsecured claims may vanish, leaving unsecured creditors entitled to nothing (Douglas G Baird & Randal C Picker ‘A Simple Noncooperative Bargaining Model of Corporate Reorganizations’ (1991) 20 Journal of Legal Studies 311 at 314-5). See also M Ricketts The Economics of Business Enterprise: An Introduction to Economic Organisation and the Theory of the Firm (2003) at 332-3.

15 ‘The creditors’ bargain view of the world contains a central contractarian core based on the normative premise that insolvency law should generally reflect the hypothetical agreement that creditors would reach if they were to bargain amongst themselves before extending credit to the company’ (McCormack op cit note 14 at 23).

16 Chapter 11 of the United States Bankruptcy Code is the forerunner in corporate rescue legislation of this kind and therefore widely relevant in this area of law.

17 McCormack op cit note 14 at 115.

18 Inserted into the Insolvency Act 1986 (c. 45) (‘UK Insolvency Act’) by the Enterprise Act 2002 (c. 40).

19 Contained in the Corporations Act 50 of 2001 (‘Corporations Act’).

20 Kloppers op cit note 2 at 417.

21 Although both these jurisdictions are directly relevant to this paper, the Australian approach often tends further towards resembling ‘voluntary arrangements’. When this is so, an engagement with the more conservative English law may be more fruitful for drawing comparisons, bearing in mind that the United Kingdom’s insolvency law has traditionally been considered more creditor orientated.


23 Loubser op cit note 6 at 162.

24 The success rate of judicial management in avoiding an ultimate winding-up was less than 20 per cent of the few companies that actually had recourse to the judicial management procedure (see Olver op cit note 9 at 84).

25 A creditor-friendly bankruptcy process.
at the rescue of a business, and therefore, at least on the face of it, appear more 'debtor friendly'. This shift in emphasis from a primarily creditor-friendly dispensation is likely to affect the interests of various parties in different ways, giving rise to new issues for courts to confront. Saving a viable business enterprise is necessarily in the interests of the economy; but to be too generous with debtor protection afforded in this regard is to tend towards creating disincentives for creditors to contribute capital to a particular over-protected business. The Companies Act 2008 provides, in s 7(k), that one of the purposes of the Act itself is to effect successful rescues 'in a manner that balances the rights and interests of all relevant stakeholders'; but one must also bear in mind that all stakeholders' interests are served by affording sufficient protection to creditors in the first place.

The new business rescue mechanism introduced by the Companies Act 2008 is broadly accessible and strikes a better balance between the interests of stakeholders generally than was previously the case under judicial management. Chapter 6 of the 2008 Act identifies a number of classes of stakeholders and empowers them as 'affected persons' to participate throughout the process. A business rescue practitioner, though, is given effective control of implementing the rescue plan. His wide range of powers for overseeing the process may – because of incompetence, partiality or otherwise – serve to undo the measures taken in Chapter 6 aimed at protecting all interested parties. In this sense, the practitioner is the weakest link in the new business rescue procedure. Here I will attempt to explore the extent and consequences of this weakness in the rescue process and, where possible, propose solutions.

I will emphasise the role of the business rescue practitioner in so far as it may harm creditors whose contributions are required for the functioning of a business enterprise and whose reluctance to contribute financially to this would ultimately pose the risk of slowing down economic growth in South Africa – particularly that part contributed in the future by businesses that are currently less established. This is particularly important in the context of the current financial situation, the aim of business rescue being to preserve the integrity of potentially successful business enterprises, assisting them to function as the cogs that drive South Africa’s developing economy.

'sets the reimbursement of creditors as the main target of the bankruptcy process. In addition, the seniority of debt is of high importance and is therefore recognised in the procedure. In this type of procedure, creditors gain control or at least retain substantial powers in the process. This type of process generally results in the liquidation of the firm.' See P Vernimmen Corporate Finance: Theory and Practice (2009) at 933.

26 Although the provisions of Chapter 6 do envisage the possibility of liquidation: see ss 129(6), 131(8)(a), 132(2)(a)(ii), 135(4), 140(4), 141(2)(a)(ii), 145(4)(b), 150(2)(a)(ii), 150(2)(b)(vi), 155(3)(a)(iii) and 155(3)(a)(vi).

27 A debtor-friendly bankruptcy process 'will give the maximum chance to the company to restructure. These procedures will generally allow management to stay in place and give sufficient time to come up with a restructuring plan' (Vernimmen op cit note 25 at 933).

28 'Affected person' is defined in s 128(1)(a) and includes shareholders and creditors of the company, trade unions representing company employees and, where any employees are not represented by a trade union, each of those employees personally or their respective representatives.
Furthermore, this is broadly relevant in the light of the purposes of the new Act, as set out in s 7: s 7(b) providing for promotion of ‘the development of the South African economy’, and s 7(g) more specifically for creating ‘optimum conditions for the aggregation of capital for productive purposes’. Although protection of a struggling company will serve the interests of investors that hold share capital, creditors ought not to be dealt so unfair a hand that they are discouraged from contributing. In this sense, creditors have an important role to play in sustaining economic growth, and their interests ought therefore to be protected for the good of the broader economy. Their role, however, must not be emphasised to the detriment of the interests of more vulnerable stakeholders and the promotion of socio-economic development in South Africa.

2 ‘Debtor in Possession’ versus ‘Management Displacement’

The administration regimes of both the United Kingdom and Australia have not followed the American Chapter 11 approach of ‘debtor-in-possession’, which allows for the bona fide management of the company to continue as if it were not under any form of administration. Instead, they have opted to place the property and affairs of the company in the hands of an independent practitioner.29

Whereas, under the Companies Act 1973, a provisional judicial management order30 would contain directions whereby any person, other than the judicial manager, vested with the management of the company’s affairs ‘shall from the date of the making of the order be divested thereof’,31 Chapter 6 does not provide for any such divestment, but instead confers broad powers on the business rescue practitioner, who has ‘full management control of the company in substitution for its board and pre-existing management’.32 It is not clear whether the words ‘in substitution’ imply a complete divestment.33 In Australia, the administrator is given effective control of the company during a voluntary arrangement procedure,34 and is entitled35 to appoint and remove directors and do ‘whatever else is necessary’ for the administration of the company’s affairs with a view to executing a deed of company arrangement. Similarly, in the United Kingdom, the administrator may ‘do anything necessary or expedient for the management of the affairs, business

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29 Omar op cit note 10 at 112 and McCormack op cit note 14 at 126.
31 Section 428(2)(a).
32 Section 140(1)(a).
and property of the company’ and does so as the company’s agent. Although there is no similar ‘catch all’ power conferred on the practitioner in Chapter 6, it is submitted that ‘full management control of the company in substitution for its board and pre-existing management’ ought to fulfil the same role.

The South African Chapter 6 also provides that the practitioner, during rescue proceedings, 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’ as well as remove these persons from office. This would imply that, although management may remain in place to be merely overseen by the practitioner, the practitioner is the one with ultimate control over the management of the business.

The choice between a ‘management-displacement’ approach and a ‘debtor-in-possession’ approach is not an ‘either/or’ consideration, for there may be varying degrees to which the management is displaced. The above provisions of the Companies Act 2008 indicate a definite shift away from the management-displacement approach under the Companies Act 1973, but a company under the Chapter 6 rescue is still far from being a debtor in possession (where reorganisation would be marked by valuation and asset sales) since Chapter 6 places limits on the company’s dealings with its own property.

The location of a rescue regime on this spectrum affects creditors in broadly two ways. Firstly, and generally speaking, the greater the displacement of management, the more interested creditors would be in the scope of powers exercisable by the practitioner as well as his business rescuing abilities. Secondly, ‘risk averse management may become less motivated to work hard under a strictly enforcing regime which not only removes them from office upon business distress but also severely penalizes them as a bonus if they are later found to have effectively resigned too late’. Following this logic, it is submitted that the creditors’ interests are better served in principle by placing more control in the hands of the directors of a company. Paragraph 3 below will focus on the business rescue practitioner, whose conduct will have a direct effect on the extent of the displacement of a company’s existing management and the effectiveness of a rescue in protecting the interests of the various stakeholders.

36 Schedule B1 par 59(1) of the UK Insolvency Act.
37 Schedule B1 par 69 of the UK Insolvency Act.
38 Section 140(1)(a).
39 Section 140(1)(b).
40 Section 140(1)(c)(i).
41 McCormack op cit note 49 at 152.
42 McCormack op cit note 49 at 152.
43 McCormack op cit note 14 at 137.
44 Section 134 of the Companies Act 2008.
3 The Business Rescue Practitioner

The Report of the Insolvency Law Review Committee on *Insolvency Law and Practice* in the United Kingdom (‘Cork Report’) acknowledged that ‘the success of an insolvency regime was heavily dependent on those who administer it’.\(^\text{46}\) For this reason, the functions and terms of appointment of such a practitioner will be a pertinent consideration in assessing the merits of a corporate rescue regime. Apart from a general concern for creditors that the appointment be likely to serve their interests, given that these creditors would also have an interest in the rescue being successful, this interest will naturally then also extend to seeing a person appointed as practitioner who will be able to effect a successful rescue.

According to David Hahn, the efficiency and fairness of a corporate reorganisation will turn on (among other things) ‘the professional qualification of the person controlling the reorganisation case’.\(^\text{49}\) Creditors will have an interest in preventing the appointment of a practitioner whose ability is doubtful and in removing a practitioner who proves to be incapable. Since provision is made for the removal and replacement of the practitioner in Chapter 6, the new Act offers some improvement to the comprehensiveness of the legislation itself in that the Companies Act 1973 provided for removing a liquidator from office\(^\text{50}\) but not a judicial manager.\(^\text{51}\)

Under the Companies Act 2008, the appointment may occur in one of two ways: in terms of either s 131(4)(a) by a court, after a successful application\(^\text{52}\) by an ‘affected person’\(^\text{53}\) for an order commencing business rescue proceedings, or s 129(3)(b) by the company itself when it enters business rescue proceedings by resolution.\(^\text{54}\) After the decision to rescue has been made, the primary concern for creditors will be the degree of influence that they will have in the decision about who should be appointed as practitioner.

As mentioned above, the practitioner is given extensive powers and control in the proceedings,\(^\text{55}\) with even the obligations of directors to exercise directors’ functions being made subject to the practitioner’s authority.\(^\text{56}\) For this reason, the person holding the office of practitioner will be of significant importance for all stakeholders, not least the creditors who – in the case of the company entering the Chapter 6 proceedings – will be hoping for a successful rescue to be carried out under that person’s supervision. This success will

\(^{46}\) Cmnd 8558 (1982).
\(^{47}\) In par 732.
\(^{49}\) Hahn op cit note 45 at 127.
\(^{50}\) In terms of s 379 of the Companies Act 1973, a liquidator could be removed from office by either the Master on the grounds set in s 379(1) or by the court in terms of s 279(2) for any ‘good cause’, including where the Master ought to have, but failed to do so.
\(^{52}\) In terms of s 131.
\(^{53}\) As defined in s 128(1) of the Companies Act 2008.
\(^{54}\) In terms of s 129(1).
\(^{55}\) In terms of s 137(2).
depend primarily on the ability of the practitioner, and this ability, in turn, will be influenced by his qualifications and also the legislative measures put in place to facilitate the full and proper exercise of his office.

3.1 Practitioner with Doubtful Ability Nominated

In the early stages of the rescue process, where a creditor or creditors believe that the practitioner nominated by the company or other affected person is insufficiently skilled to properly effect a rescue of the business in question, short of having recourse to expensive legal proceedings, extra-judicial remedies in this context may arise from either a legislatively prescribed procedure creating an effective ‘veto’ power, or specified requirements for being appointed to this office. In many instances, the latter may be preferable, being less expensive than recourse to courts and less susceptible to abuse in that they necessarily set an objective framework to operate in all cases, facilitating the appointment of an individual who is sufficiently competent with regard to his qualifications, experience and independence. The safeguards provided in Chapter 6 will be discussed below.

3.1.1 Legislative Safeguards in the Form of a ‘Veto’ Power

3.1.1.1 Appointment by an ‘Affected Person’

Where another ‘affected person’ nominates a practitioner that the general body of creditors suspect will be incapable of effectively conducting the rescue, this nomination is made subject to ratification at the first meeting of creditors, thus vesting an effective ‘veto’ in the hands of the body of creditors and enabling them to guard their interests sufficiently. Where creditors commence proceedings themselves, they may nominate their own practitioner.

The only real vulnerability here arises in respect of minority creditors without the power to block the choice of the body of creditors either to appoint a particular practitioner or to not exercise the veto power. However, it seems that when a rescue will serve the interests of the creditors and there is a reasonable prospect of the rescue succeeding, a choice to rescue will necessarily serve the interests of all creditors (unlike, eg, the choice to liquidate the company).

3.1.1.2 Appointment by Company Resolution

Where entry to business rescue proceedings is by company resolution and the practitioner has been appointed by the company, this step is not made subject to ratification. Although Chapter 6 provides for an ‘affected person’ to apply either for the appointment to be set aside (s 130), or for the practitioner to be removed (s 139), this removal must be by court order. Where the practitioner is appointed by the company, it would, because of the expense

57 Section 131(5).
58 See ss 139(1) and 139(1)(b) read with s 139(2).
involved in obtaining a court order, be more satisfactory if this practitioner could be removed by resolution of the majority of independent creditors holding voting rights at a creditors’ meeting.\textsuperscript{60}

In the United Kingdom, a general security interest has ‘more or less an unfettered right to appoint an administrator to the company out of court’;\textsuperscript{61} yet in South Africa, recourse to the courts is mandatory for creditors, placing an undue financial burden on those who may, in many cases, have enabled the business to play a role in the economy in the first place. When it is the creditors’ money at stake, it is submitted that they ought not to be forced to spend more on legal fees simply to protect their interests that have been compromised through no fault of their own.

The Australian Corporations Act allows for the removal of an administrator at the first meeting of creditors,\textsuperscript{62} after which time an application\textsuperscript{63} will need to be made to court. This gives the creditors a reasonable opportunity to object, pursuant to which the costs of legal proceedings would serve to prevent unnecessary interruptions in the execution of the rescue procedure.

Since an absolute right on the part of the body of creditors would be open to abuse, it is submitted that the Australian position ought to be followed as a fair middle ground. Although the practitioner appointed would have to be investigated immediately, this would at least enable creditors to remove a practitioner who is insufficiently skilled and yet has met the requirements of appointment without recourse to the court.

A possible justification for treating appointments by an affected person differently from company appointments is that there is a greater likelihood that a company’s management will be co-operative with a practitioner that it has appointed itself and therefore it is in the best interests of all affected persons to encourage these voluntary appointments where possible. This ought to be a factor considered by creditors when deciding on whether to ratify the appointment. It is unlikely that creditors will object where the practitioner is sufficiently capable and independent, and is likely to co-operate well with the existing management. This option ought therefore to remain available to creditors, subject to qualification by limiting the grounds on which the power may be exercised and thereby restricting its availability to those cases where creditors have a legitimate concern.

Although s 130 does provide some protection for creditors, it is still costly for a creditor to protect his interests and, in order to avoid the burden of a court application, a creditor unwilling or unable to incur the necessary legal

\textsuperscript{59} Note that the grounds for removal differ from the grounds for setting aside an appointment. Despite some slight overlap, the factors considered for a practitioner’s removal in s 139(2) envisage circumstances in which a practitioner has failed to meet the expectations of his office, while s 130(b) would apply primarily to a defective appointment in terms of s 138.

\textsuperscript{60} Winer op cit note 33 at 19.

\textsuperscript{61} McCormack op cit note 14 at 118. In English law, this right to appoint an administrator does not refer to all secured creditors, but only to the holders of a floating charge who were previously allowed to appoint an administrative receiver.

\textsuperscript{62} Section 436E(4)(a) of the Corporations Act.

\textsuperscript{63} In terms of s 449B.
fees would have to rely on the legislative safeguards against appointing a practitioner who is not suitably qualified.

3.1.2 Legislative Safeguards for Appointment of a Sufficiently Qualified Practitioner

Once proceedings are underway, the creditors’ interests will be best served where the practitioner appointed is most likely to effect a successful business rescue. Qualifications required of a practitioner ought therefore to serve as some assurance of the practitioner’s ability in this regard, thereby protecting the interests of creditors. Accordingly, ‘qualifications’ should go to the practitioner’s competence as referring to ‘competence’ in the sense of the degree of impartiality, skill and ability appropriate for holding the office of practitioner and fulfilment of its associated functions.

At the time of the Cork Report, there were no specific qualifications required for insolvency practitioners\(^{64}\) and this was identified as a major shortcoming in the prevailing system at the time.\(^{65}\) Similarly, the lack of statutory regulation providing for the qualification, competence and suitability of the judicial manager was a problem with the old judicial management regime in South Africa.\(^{66}\) The Companies Act 2008 provides for certain broad qualifications to be required of practitioners,\(^{67}\) this being a highly satisfactory improvement on the largely unregulated position under the Companies Act 1973.

Under the Companies Act 2008, a person may be appointed as the practitioner of a company only if that person satisfies certain criteria.\(^{68}\) The person must be a member in good standing of a profession subject to regulation by a regulatory authority prescribed\(^{69}\) by the Minister and must not be subject to an order\(^{70}\) of probation. Further, appointment may only be in respect of a person who would not be disqualified\(^{71}\) from acting as a director of the company, does not have any other relationship with the company such that would lead a reasonable and informed third party to conclude that the integrity, impartiality or objectivity of that person is compromised by that relationship, and nor may the practitioner be related to any person with such relationship to the company.\(^{72}\)

While the latter four requirements deal broadly with the integrity of the person appointed, what is of most interest for the purposes of this discussion is the requirement that the person be a member in good standing of a ‘profession subject to regulation by a regulatory authority prescribed by the

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64 Keay & Walton op cit note 48 at 35.
65 Cork Report op cit note 46 in par 735.
67 Section 138.
68 Contained in s 138(1).
69 In terms of s 138(2).
70 In terms of s 162(7), this provision falling outside Chapter 6.
71 In terms of s 69(8), also falling outside Chapter 6.
72 The requirements as set out here closely follow the wording of s 138(1).
Minister’. Legislation in the United Kingdom also provides, as a minimum qualification of insolvency practitioners, that these practitioners be members of professional bodies that would be able to regulate and discipline their members, the aim being to ensure an independent insolvency profession that is not only qualified and independent, but also marked by integrity. In the United Kingdom, two examples of such professional bodies that have been identified are the Law Society of England and Wales and the Institute of Chartered Accountants in England and Wales. Although many solicitors therefore qualify to hold the office of insolvency practitioners, most practitioners are accountants who would take advice from specialist insolvency lawyers. However, as noted by Gerard McCormack, ‘[s]pecialised professionals whose main expertise is in financial analysis of corporate performance or even legal advice and litigation hardly seem the most worthy candidates for these managerial tasks’.

It is submitted that the qualification required by s 138(1)(a) of the Companies Act 2008 is neither here nor there in that ‘membership in good standing’ can hardly be equated to an ability to effect a successful rescue, unless such membership necessarily attests to such an ability. Furthermore, creditors cannot rely on such membership to conclude that a practitioner is able to effect what is in their best interests without further details about a practitioner’s personal qualifications. A person qualified in terms of the Act may still lack the necessary skills or experience for the job. Being ‘qualified’ in terms of the Act would serve mainly, if not solely, to reassure a creditor of the practitioner’s trustworthiness and the unlikelihood of a conflict of interests.

If the provisions of Chapter 6 that set out the necessary qualifications of a practitioner prove inadequate in providing assurance as to the competence of a practitioner to hold office, in the case of commencement by company resolution, the creditors’ primary remedy in cases where an incompetent practitioner has been appointed would lie in their ability to make applications to court. It may be argued that the legal costs involved in making such applications would serve as a deterrent for meddling committees of creditors that would obstruct the practitioner in the fulfilment of his function, but to the extent that creditors are denied protection for the sake of avoiding frustration of the rescue, protection should be provided elsewhere – and there does not

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73 Section 138(1)(a).
74 UK Insolvency Act 1986.
75 Keay & Walton op cit note 48 at 35.
76 In terms of the Insolvency Practitioners (Recognised Professional Bodies) Order 1986 (SI 1986/1764).
77 Keay & Walton op cit note 48 at 35.
78 Idem at 37.
79 McCormack op cit note 14 at 135.
80 Winer makes this point in his paper (op cit note 33 at 18).
81 Section 138(1)(b) and (c).
82 Section 138(1)(d) and (e).
seem to be any reason why more conclusive protection should not be provided in the context of s 138 and the corresponding regulations in terms of s 223.

3.1.3 Legislative Safeguards in the Draft Companies Regulations

The South African Draft Companies Regulations\footnote{Published in terms of s 223 of the Companies Act 2008 for public comment in Government Notice 1664 Government Gazette 32832 of 22 December 2009 by the Minister of Trade and Industry, to be effective from date of publication until 1 March 2010.} provide slightly more detail regarding the formal qualifications of business rescue practitioners. The draft regulations also establish what is referred to as a ‘Business Rescue Practice Regulatory Board’\footnote{Draft reg 129.} consisting of various professionals, and delegates the determination of minimum qualifications for practitioners entirely to this board, which is required\footnote{In terms of draft reg 133(1), the board is given two years from the effective date to make recommendations.} to make recommendations to the Minister in this regard. There is, however, a list of minimum requirements for the appointment of practitioners to be effective until these requirements are promulgated by regulation.\footnote{Draft reg 133(2).} It may be worthwhile to consider both these interim requirements and, briefly, the board itself.

3.1.3.1 The Business Rescue Practice Regulatory Board

In terms of the draft regulations, the functions\footnote{Draft reg 132(1).} of the Business Rescue Practice Regulatory Board are to advise the Minister on the qualifications to be required of business rescue practitioners, to manage the accreditation and keep a register of such persons, to establish ‘standards and codes of good practice for the conduct of business rescue proceedings’,\footnote{Draft reg 132(1)(d).} to deal with complaints concerning the conduct of business rescue practitioners, and to perform any other functions ‘necessary or ancillary’\footnote{Draft reg 132(1)(f).} to those specified.

This body comprises eighteen appointments: ten appointed for a three-year term by the Minister\footnote{Draft reg 130(1)(a).} (including a chair and deputy chair), and eight designated by independent bodies\footnote{Draft reg 130(1)(b).} to serve ‘until a new person is designated by the relevant entity that made the designation’.\footnote{Draft reg 130(2).} To further ensure independence, the regulations\footnote{Draft reg 130(3)(b).} restrict eligibility for appointment (or designation) to the board by subjecting membership to the same requirements as those provided for mutatis mutandis in relation to members of the Companies Tribunal, the Panel, or the Council as set out in Part E\footnote{Section 205.} of the Companies Act 2008. Similar provision is
made\textsuperscript{95} for conflicting interests, resignations, removals from office and vacancies by reference to Part E of the Act.

3.1.3.2 Minimum Requirements for Accreditation as Practitioner

In terms of the draft regulations, the Board has been entrusted with the task of deciding what the practitioner’s minimum qualifications ought to be. The fact that this highly specialised and qualified body is given two years to make this decision seems to attest to the weight of its consequences. It is submitted that the office of the practitioner is the most important area for regulation because his decisions have a direct influence on the success of the rescue at his command, and an indirect effect on the financial interests and livelihoods of those involved with the business being rescued – not least the creditors, who may in many instances prefer the certainty offered by a liquidation.

The interim requirements for the appointment of business rescue practitioners seem rather broad: essentially, the practitioner may be\textsuperscript{96} (i) an attorney, (ii) an accountant, (iii) a liquidator or business turn-around practitioner, or (iv) a person holding a degree in law, commerce or business management who has experience in conducting business rescue proceedings.\textsuperscript{97} Depending on the type of company\textsuperscript{98} involved, either five or ten years’ experience is required.\textsuperscript{99}

These requirements, listed in the alternative, do not seem to address the problem identified by Gerard McCormack (mentioned in par 3.1.2 above): namely the managerial nature of the role performed by the practitioner, and the irrelevance of a professional’s experience in a closely related, but entirely different area of expertise. The suggestion that an axe-wielding liquidator would be suitable is particularly worrisome – to appoint a liquidator as a business rescue practitioner may be compared, for the sake of argument, to appointing an executioner to act as a nurse or paramedic. Since the failure of judicial management has been attributed\textsuperscript{100} to the appointment of liquidators as judicial managers, the draft provision for liquidators to be appointed as practitioners should be carefully reassessed. It is submitted that managerial ability ought to be more prominent a requirement generally.

Ideally, one may also prefer a practitioner to have expertise and experience in more than one of the areas outlined above, although it is unlikely, eg, that

\textsuperscript{95} Draft reg 130(3)(c).
\textsuperscript{96} In terms of draft reg 133(2)(a).
\textsuperscript{97} I have deliberately oversimplified these requirements to draw attention to what I regard as problematic in them.
\textsuperscript{98} The draft regulations seem to exclude businesses that are not companies in terms of the Companies Act 2008 from making use of the business rescue practitioner, even though ‘business’ is used throughout Chapter 6. Whether this is intentional would seem to be of little relevance, considering that smaller businesses would, in any case, struggle to pay the remuneration set out for the practitioner in draft reg 135.
\textsuperscript{99} Draft reg 133(2).
\textsuperscript{100} Identified by Olver op cit note 9 at 86, where the author points out that ‘the objectives and the duties of these two categories of persons are diametrically opposed’. Kloppers op cit note 2 at 426 concludes from Olver’s observations that the ‘main problems [with judicial management] lie with the persons appointed as judicial managers’.
an attorney of ten years with experience predominantly in commercial practice would also be a member of the International Federation of Accountants, and/or the holder of a degree in business management. The solution may lie in the provision for juristic persons or partnerships to act as practitioners, although the question of whether this would be feasible with regard to the further regulation and costs that would be involved is a separate issue. Alternatively, provision should be made for close co-operation between the practitioner and existing management to take full advantage of the latter’s knowledge and experience relating directly to the affairs of their particular company. In cases where such management is less than competent, however, mandatory co-operation would most likely be counter-productive – then it may be more appropriate for the practitioner to displace the management entirely, in which case the practitioner’s managerial ability in particular would again fall under the spotlight.

3.2 Incompetent Practitioner in Office

If a practitioner who has met the requirements for holding office is appointed and subsequently turns out to be incompetent in fulfilling his functions, the two remedies available to creditors in terms of Chapter 6 are removing him from office (and replacing him with a new practitioner) and holding him bound to act within his powers.

3.2.1 Procedure for Removal of Practitioner from Office

Section 139 provides for the removal of a practitioner upon request by an affected person on a number of grounds. The grounds specified include incompetence or failure to perform duties, failure to exercise the proper degree of care, engaging in illegal conduct, ceasing to be qualified in terms of the Act, conflict of interest, lack of independence, and becoming unable to perform the role of practitioner over a prolonged period. Since these grounds are wide, it should not be difficult to remove an incompetent practitioner at that stage, given that there will, one assumes, be conduct on his part to support an application for his removal. The power to remove the practitioner in this context, however, is vested in the court and would, again, mean legal costs for a creditor seeking removal. The financial burden will therefore be the most significant factor weighing against an affected person’s applying for the practitioner’s removal.

3.2.2 Constraints on Exercise of Power by Practitioner

The powers conferred on the practitioner ought, like his qualifications, to act as some assurance of protection for creditors’ interests. The more power a

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102 Section 139(2).
103 In terms of s 138(1).
104 By ‘prolonged’ I mean a time that is not considered a ‘reasonable time’ (see s 139(2)(f)).
business rescue regime takes away from the company’s management, the more power it places at the practitioner’s disposal and the more important it becomes to have some measure of control over who the practitioner is. Chapter 6 has opted for an approach that places a large degree of control in the hands of the practitioner.

One particularly broad power is that contained in s 136(2) which allows the practitioner to ‘cancel or suspend entirely, partially or conditionally any provision of an agreement to which the company is a party at the commencement of the business rescue period, other than a contract of employment’. Paul Winer notes that not only could this lead to unnecessary litigation, but parties to contracts whose rights under those contracts are infringed by this power may be left worse off as a result of the business rescue than would have been the case on liquidation of the business.105 It is submitted that this power, in the broad and unqualified form in which it appears, is far too unwieldy and cause for concern.

The practitioner is made subject to the responsibilities, duties and liabilities of the company’s directors106 (as provided for in ss 75 to 77 of the 2008 Act), but is exempted from liability in terms of any other relevant law for conduct falling outside such responsibilities, etc when such conduct is ‘in good faith and in the course of the exercise of the powers and performance of the functions of practitioner’,107 unless the act or omission giving rise to such liability amounts to ‘gross negligence in the exercise of the powers and performance of the functions of practitioner’.108 It is submitted that, although the standard applied to directors is probably high enough, there does not seem to be any reason to have a threshold as high as gross negligence for any conduct falling outside that associated with the functions of a director. A lower threshold would remove any temptation on the part of the practitioner to take a ‘cowboy’109 approach to rescuing a business in any area where he may not be subject to the restrictions placed on directors – perhaps the benchmark should be the ordinary, skilled insolvency practitioner.110 If the practitioner is to be entrusted with broad and extensive powers to fulfill the functions of his office, his accountability for their exercise ought to be equally broad and extensive.

The Business Rescue Practice Regulatory Board envisaged by the Draft Companies Regulations is responsible for ‘receiving and resolving complaints concerning the conduct of business rescue practitioners’111 and ‘any other

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105 Winer op cit note 33 at 15.
106 In terms of s 140(3)(b).
107 Section 140(3)(c)(i).
108 In terms of s 140(3)(c)(ii).
109 The problem of such individuals arising in practice is discussed by Keay & Walton op cit note 48 at 35 in the context of qualified insolvency practitioners.
110 This was the standard set at common law in England before the recent legislative amendments (see Re Charnley Davies Ltd [1990] BCC 605).
111 Draft reg 132(1)(e).
functions necessary or ancillary to [this function].' However, this should not enable any affected party to have recourse to the Board where Chapter 6 does not provide a remedy, and such complaints by affected parties would most likely have to relate to violations of the standards and codes of good practice established by the Board. These standards and codes should therefore serve to fill the gap left by the Act and restrict the practitioner, as comprehensively as possible, in the exercise of his powers.

Where the practitioner exercises his wide powers conservatively, allowing the debtor to remain in control, he promotes the objectives of reorganisation in that management is not penalised for having recourse to the rescue procedure and, further, is more likely to work harder towards achieving the same goal as that sought by creditors – ie, saving the company. It is submitted that there should perhaps be more restraints on the ‘overpowering’ of management by the practitioner to ensure co-operation by the previous management, although in certain cases, a defective management would certainly require a heavy-handed practitioner to correct the course of a business ailing as a result of its own internal defects.

The conferment of a wide range of powers, short of displacing management, is important for the success of any business rescue regime, and the accountability in Chapter 6 would most likely suffice in at least the majority of cases. Although the standards and codes of good practice (and related complaint procedures) may be of use in curtailing the practitioner’s discretion in the exercise of his powers, if these become a cheap and easily accessible alternative to court proceedings for affected parties to bring the practitioner to book whenever he steps out of line, then the benefit of the ‘cost barrier’ will be lost as a disincentive to parties that may merely wish to interfere with the proceedings. If the Business Rescue Practice Regulatory Board serves exclusively to ‘take in the leash’ where necessary to keep a practitioner on course during business rescue proceedings, leaving more substantial relief to be granted at the discretion of a court, this problem should not arise. The standards and codes would have to be accordingly formulated to restrict interference by the Board in the business rescue process itself, while facilitating co-operation between the practitioner and existing management, allowing the latter to retain a reasonable measure of control.

4 Conclusion

Academics have noted that a business rescue regime is far more likely to succeed if it operates in the context of a debtor-friendly system of insolvency. Although the Chapter 6 mechanism itself is highly debtor-
friendly, it does not act positively to the detriment of creditors. The fact that a company forms an integral part of the community in which it conducts business cannot be ignored, and by introducing legislation aimed at providing temporary protection to distressed businesses, the law in South Africa is clearly seeking to promote free enterprise in the interests of national economic development. The new business rescue procedure no longer suffers from judicial management’s flaw of dependence on the essentially static and expensive process associated with the practice of law, although there is still sufficient court involvement as oversight to protect interested parties.

One of the reasons for the failure of judicial management as a viable business rescue regime was the primary emphasis having been placed on the interests of creditors. Although Chapter 6 provides an even ‘spread’ of protection to all stakeholders, it also confers significant procedural benefits on the debtor business. This effectively causes an indirect prejudice to those who do not receive the same (particularly financial) benefits by virtue of the procedures made available to them in the Act. This would not be a problem if an impartial and capable individual is placed in control and effects a successful rescue of the business in question. The practitioner is therefore in a sense the ‘weakest link’ for creditors in that he would seem to be the most likely object of litigation where creditors are unhappy, in which case creditors will have to incur legal costs. A lack of legislative measures to ensure a sufficient degree of competence on the practitioner’s part creates the potential for litigation, which is a burden for creditors that is perpetuated by the inability of the person holding that office. Owing the the very generous protection afforded to the debtor business, the Act and regulations should seek to avoid any potential problems that may give rise to litigation, lest the result of the process be effectively disadvantageous to creditors. It ought not to be assumed that all cases will run smoothly, and the qualifications of the practitioner ought to serve as a safeguard against problems arising due to his inability.

Where creditors doubt the ability of a practitioner, they may refuse to ratify an appointment when it is made in terms of s 131, but in any other case, are forced to make applications to court. Once the practitioner has been appointed, s 139 does provide for the easy removal of one who is...

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117 Rajak & Henning op cit note 66 at 273.
118 Idem at 269.
119 See Oliver op cit note 9 at 89, where the author asserts, in relation to judicial management, that this procedure may be appropriate ‘where the concern serves the required need of the country as a whole’. Judicial management may be seen as a ‘special privilege’, the purpose of which was to protect large public companies ‘employing a large labour force and whose liquidation would have adverse effect on the economy and the community’. Cf the purposes of the Companies Act 2008 set out in s 7.
120 Loubser op cit note 6 at 162. The author explains that a successful rescue under the old Companies Act was one that enabled full payment of a company’s debts and nothing more, thus ignoring any potential benefit apart from that received by creditors.
incompetent, such removal being by court order. It is submitted that, at this juncture, court oversight is appropriate since the assessment of competence ought to be made objectively. Furthermore, remembering that South Africa has opted to follow global trends in the displacement of management, it is the practitioner who is placed in complete control of the company’s affairs. This means that, once in office, for other interested parties to decide on the practitioner’s removal would result in either a corporate coup d’état, or an internal stalemate between interested parties. For this reason, extra-judicial removal is not appropriate at this point and, if creditors are to be offered a less costly remedy (other than possible recourse to the Business Rescue Practice Regulatory Board), this protection ought to be afforded before the appointment is made official: by extending some form of the veto power applicable to s 131 appointments to all appointments, and/or by providing for more substantive qualifications for the practitioner.

With adequate statutory regulation, courts interpreting wide powers restrictively, and sufficiently skilled practitioners being used to oversee the rescue proceedings, the interests of creditors will be protected sufficiently fairly, considering the numerous other interests that also deserve protection. Creditors are for the most part protected, but will in many instances find themselves having to foot the bill for that protection.

It may be the case that the Chapter 6 mechanism promises to be an effective one, but it seems to assume smooth sailing as far as the practitioner’s role is concerned. The practitioner’s role permeates through the entire process and ought therefore to be more comprehensively governed. The broad powers and lack of extra-judicial accountability in the rescue procedure itself serve to reinforce the need for a sufficiently high degree of competence to be required of the person holding the office of practitioner, and the Draft Regulations do show promise in this regard. It would certainly be helpful to have a set of guidelines stipulating how a practitioner ought to go about informing his discretion to exercise or delegate his powers while the business rescue procedure is underway, but this may not be possible given the multitude of factors that may need to be considered in the specific circumstances of any particular company. The standards and codes provided for in draft reg 132(1)(d) are important in that they may offer the tightest reins to be had on the practitioner’s discretion.

In conclusion, the new business rescue provisions promote economic development in South Africa by nurturing the growth of emerging commercial endeavours and protecting companies in general from being effectively axed by liquidation, but the importance of adequate regulation of the practitioner ought not to be underestimated. The appointment of any ‘loose-cannon’ practitioners, particularly in the initial business rescues effected under the Companies Act 2008, would create the risk of fostering an impression of volatility in the Chapter 6 procedure and lead to creditors being unwilling to contribute finance needed to expand the company. The irony would be that overprotecting debtors would lead to harming them instead – their demise.
resulting from being ‘starved’ of credit rather than ‘executed’ by insolvency proceedings. Legislation that is debtor protectionist should be welcomed to the extent that it does not undermine the value of creditors in the equilibrium of a properly functioning marketplace in the totality of its social and financial context.