

ALLEN & OVERY



# Restructuring across borders

South Africa

Corporate restructuring and  
insolvency procedures | January 2022



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# Overview

Under South African law, when a corporate borrower faces financial difficulties, there are a variety of restructuring and insolvency options available. South African law allows for both formal and informal restructurings as well as formal insolvency procedures.

Informal restructurings are governed by South African common law and require an agreement between the company and all such creditors of the company whose rights might be affected, to achieve the desired result. In practice, an informal restructuring is only viable where the company has a small number of manageable creditors with whom it can negotiate and obtain the unanimous consent required to bind all creditors, and give effect to the agreement reached.

Formal restructurings, on the other hand, are regulated by the Companies Act, 2008 and can take the form of either business rescue (**Business Rescue**) or compromise (**Compromise**) proceedings.

Business Rescue under Chapter 6 of the Companies Act, 2008 is available to a company that is: (i) financially distressed (essentially, the company is facing severe liquidity issues); and (ii) has a reasonable prospect of being rescued. The concept of 'rescue' in this context includes the

restructuring of the company or its business to restore it as a going concern. Alternatively, if this is not possible, 'rescue' includes achieving a better return for creditors or shareholders than would otherwise result from immediate liquidation.

The Compromise procedure is available under section 155 of the Companies Act, 2008, and can be used as an alternative to Business Rescue with similar effect. It can be proposed at any stage, including when a company has commenced liquidation proceedings but excluding when it has commenced Business Rescue proceedings. The company is not required to be financially distressed, as is the case with Business Rescue.

A Compromise is only possible between a company and its creditors; not between a company and its members. To the extent a company has any obligations under securities that are not debt instruments, such as preference shares, the company would need to separately

consider and satisfy the provisions of section 114 of the Companies Act, 2008 relating to a scheme of arrangement (**Scheme of Arrangement**).

If a company is no longer able to trade as a consequence of it being insolvent, however, it may be more appropriate to put the company into liquidation, the formal dissolution procedure for South African companies.

A corporate borrower can initiate any of the above proceedings. A lender, on the other hand, can only initiate Business Rescue proceedings in accordance with the applicable provisions of the Companies Act, 2008 or apply for the winding-up of the company in accordance with the applicable procedure set out in the previous Companies Act, 1973 which continue to apply to involuntary insolvency proceedings.

The choice of procedure requires a thorough analysis of the company's financial obligations (including the nature of the obligations and whether any security has been granted for any of its obligations). It will depend largely on whether there is a reasonable prospect of rescue of the company, or which procedure will achieve a better return for the lender.

**This note considers the following corporate restructuring and insolvency procedures in further detail:**

- Business Rescue proceedings;
- Compromise and Schemes of Arrangement; and liquidation (also known as winding-up).



# Business Rescue proceedings

A South African company that is financially distressed and that has a reasonable prospect of rescue may reorganise or restructure the company or its business using the Business Rescue procedure provided for in Chapter 6 of the Companies Act, 2008. The Business Rescue procedure is akin to the administration process in England and Wales, and Chapter 11 proceedings in the United States of America.

The primary aim of Business Rescue is to restore the company as a going concern or, alternatively, if this is not possible, to achieve a better return for creditors or shareholders than would otherwise result from immediate liquidation.

A company is financially distressed if it appears to be reasonably unlikely that it will be able to pay all of its debts as they become due and payable within the immediately ensuing six months or if it is reasonably likely that it will become insolvent (that is, its liabilities exceed its assets) within the immediately ensuing six months. This is not equivalent to factual or commercial insolvency but rather is indicative that a company is experiencing liquidity problems.

Business Rescue proceedings are commenced by either a resolution of the board of directors of the company (**Voluntary Business Rescue**) or by court

order (**Compulsory Business Rescue**).

A board of directors may only resolve to commence Voluntary Business Rescue proceedings if it has reasonable grounds to believe that: (i) the company is financially distressed; and (ii) there is a reasonable prospect of rescuing the company. South African courts have been clear that Business Rescue cannot be used to simply effect an informal winding-up of the company or to delay the inevitable liquidation of the company to the detriment of the creditors.

A court may grant an order placing a company under supervision and commencing Business Rescue proceedings on application by an affected person (being a shareholder, creditor, employee or a registered trade union representing employees of the company), if the court is satisfied:

- that:
  - the company is financially distressed;
  - the company has failed to pay any amount under an obligation or public regulation or contract relating to employment related matters; or
  - it is otherwise just and equitable to do so for financial reasons; and
- there is a reasonable prospect for rescuing the company.





## Business Rescue proceedings (cont.)

Such an application may even be brought and a court order made if a company is under liquidation (ie the liquidation proceedings are converted into Business Rescue proceedings).

Once commenced, Business Rescue is effected through:

- the temporary supervision of the business and affairs of the company by a business rescue practitioner (ie the business rescue practitioner appointed to the company is vested with full management and control of the company in substitution for its board and pre-existing management);
- an automatic moratorium on claims and legal proceedings (including enforcement action) against the company. The moratorium runs for the duration of the Business

Rescue proceedings; and

- the development and implementation of a business rescue plan compiled by the appointed business rescue practitioner with input from creditors and other affected persons. The business rescue plan must be supported by holders holding at least 75% of the creditors' voting interests (50% of which must be constituted by independent creditors' voting interests) for it to have been adopted. If adopted, the business rescue plan is binding on the company and all of the company's creditors, irrespective of whether or not the creditors were present at the meeting of creditors, and irrespective of whether the creditors present at the meeting of creditors voted in favour or against the plan or abstained from voting.

The Companies Act, 2008 intends for Business Rescue proceedings to last for only three months. In practice, however, Business Rescue proceedings are often extended in accordance with the provisions of the Companies Act, 2008 and can take up to two years, depending on the complexity of the business.

If successful, Business Rescue proceedings terminate when a business rescue plan has been adopted and the business rescue practitioner files a notice of substantial implementation of the plan with the Companies and Intellectual Property Commission (**CIPC**). Ideally, the company should emerge from the process as a going concern.

Alternatively, Business Rescue proceedings terminate if the practitioner files a notice of termination of Business Rescue proceedings with CIPC or a business rescue plan has been proposed but rejected and no affected person has extended the proceedings in the manners contemplated by the Companies Act, 2008. A court may also set aside the resolution or order commencing Business Rescue or convert the Business Rescue to liquidation proceedings.

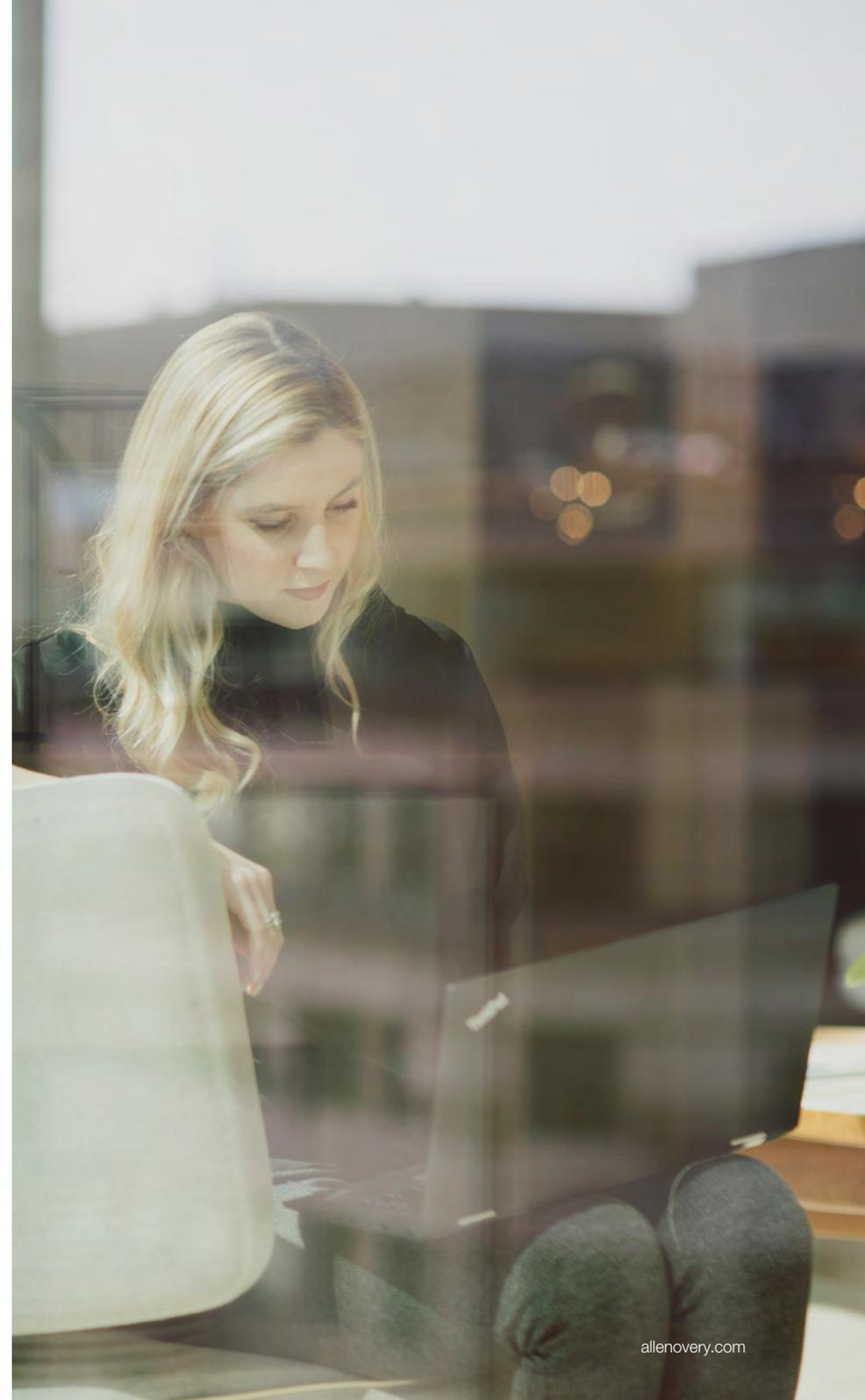
# Compromise proceedings and Schemes of Arrangement

A corporate borrower in financial difficulty can seek to compromise (or arrange) its financial obligations with its creditors on an informal or formal basis. The former is less common as it requires the approval of all the creditors of the company to achieve the desired result. In practice, an informal compromise (or arrangement) is only viable where the company has a small number of manageable creditors with whom it can negotiate and obtain the unanimous consent required to bind all creditors and give effect to the agreement reached. During the negotiations of an informal compromise, a creditor is not prevented from initiating enforcement proceedings, including making an application for the winding-up of the company.

A formal compromise process is regulated by section 155 of the Companies Act, 2008. It can be used as an alternative to Business Rescue with similar effect and can be proposed at any stage, including when a company has commenced liquidation proceedings, but excluding when it has commenced business rescue proceedings.

The Compromise process offers the company and its creditors a fair amount of flexibility in restructuring the financial obligations of the company. It is not as stringently regulated or subject to as stringent an oversight by the Master of the High Court or CIPC as is the case with liquidation or Business Rescue proceedings under South African law.

A Compromise may be proposed by the board of directors of the company concerned or the liquidator of a company, if winding-up proceedings have commenced. The Compromise would be for the formal compromise or arrangement of the financial obligations of the company to all of the creditors or to all of the members of any class of the creditors of the company. A proposal setting out the relevant background information, the proposed plan as well as the assumptions and conditions must be delivered to all the creditors to whom the proposal has been made, together with a notice of the meeting for consideration of the proposal. Broadly speaking, the proposal must cover all the information that a creditor may reasonably require in its determination of the proposal.



# Compromise proceedings and Schemes of Arrangement (cont.)

While the Compromise process is underway, there is no protection from creditors unless a request for a debt moratorium is made in the proposal, and such request is expressly accepted by the creditors. In such circumstances, the debt moratorium would only extend to the debts of the consenting creditors. Any affected person may apply to court to place the company in Business Rescue, which would in turn halt the Compromise process. Any acceleration or commitment cancellations based on the Compromise during its negotiation period will also not be nullified.

The adoption of a proposal requires the support of the majority in number representing at least 75% in value of the creditors or class, as the case may be, present and voting in person or by proxy, at a meeting called for that purpose. If adopted, the company may apply to the court to sanction the Compromise. The court will exercise its discretion in granting the order or not, taking into consideration what is just and equitable in the circumstances. In making its determination, the court will have regard to the number of creditors of any affected

class of creditors who were present or represented at the meeting and who voted in favour of the proposal. A disgruntled dissenting creditor may seek to intervene in the proceedings and oppose the sanctioning. However, it must weigh up its chance of success and the costs involved in this regard, coupled with its already potentially compromised claim. Where the compromise finds favour with an overwhelming majority of creditors in value, it will be extremely difficult for such a disgruntled creditor to persuade the court to reject the compromise.

If sanctioned by the court and once that court order has been filed with CIPC, the Compromise is final and binding on all creditors of the company, or members of the relevant class of creditors, as applicable. This would include any foreign creditors of the company. Any payment under the Compromise will be determined and made in accordance with the terms of the Compromise.

As a consequence of the Compromise, no creditor (whether it voted in favour or against the proposal) will have any further

claims against the company for its specific debt, nor will it be able to institute any claims against officers and directors of the company for any contravention of the Companies Act, 2008. Creditors are also precluded from having any transactions which may be liable to be set aside as impeachable dispositions under South African insolvency law, investigated and set aside.

For these reasons, a creditor must carefully consider the information provided to it in the proposal. A creditor should determine whether it is in its best interests to:

- support a proposal;
- reject the proposal and apply to court for the company to be placed in Business Rescue; or
- if the facts indicate that the company is unable to pay its debts, for the company to be wound-up.

It is important to note that the formal Compromise procedure under section 155 may not be used for restructuring any obligations of the company under securities that are not debt instruments, such as for example, preference shares.

In these instances, the company would need to consider a Scheme of Arrangement with the holders of any class of its securities.

A Scheme of Arrangement is subject to compliance with the provisions of section 114 of the Companies Act, 2008. These include: (i) the appointment of an independent expert to produce a report assessing the effect of the arrangement on the value of the securities; (ii) shareholder approval by way of special resolution (the threshold of which is typically 75% of all shareholders present and voting, subject to quorum requirements being met); and (iii) the appraisal rights of minority dissenting holders in terms of section 164 of the Companies Act, 2008 to require the company purchase their shares at fair value (which can be determined by a court if the parties cannot agree).<sup>1</sup> The additional approvals and independent expert report required under section 114 for a Scheme of Arrangement may make this option for restructuring a company in financial difficulty less attractive to lenders and perhaps even the company itself.

<sup>1</sup> A dissenting minority shareholder must comply with the requirements of section 164 of the Companies Act, 2008 in exercising this right.

# Liquidation

If a company is no longer able to trade as a consequence of it being insolvent (whether factually or commercially), it should be placed into liquidation, the formal dissolution procedure for South African companies (**Liquidation**).

Liquidation (also referred to as the winding-up) of a company essentially entails the disposal of the assets of the company whereby the proceeds from the disposal are applied towards covering the costs and expenses incurred in the liquidation process and where possible, paying a dividend to the creditors of the company. If any residue remains, the company may pay a distribution to its shareholders in accordance with their rights and interests in the company.

Generally, Liquidation is applied when:

- (i) it is foreseeable that a company will not be able to pay its debts as they fall due in the ensuing six months;
- (ii) a company has unsuccessfully undertaken a Business Rescue or Compromise procedure and rehabilitation of the company is not possible;
- or (iii) in the case of a solvent company, the shareholders determine to wind-up the company.

The Liquidation of an insolvent company is still regulated by the provisions of Chapter 14 of the previous Companies Act, 1973 which remain in place notwithstanding the repeal of this Act by the Companies Act, 2008<sup>2</sup> until such time as South Africa's insolvency laws are overhauled and consolidated. The process can be initiated by the board of directors adopting a resolution placing the company in Liquidation, or by the company itself, its shareholders, or one or more of the company's creditors applying to the court for the winding-up of the company. In the former instance, winding-up commences only when the adopted resolution is filed and registered with CIPC. For a compulsory liquidation initiated by court application, winding-up is deemed to have commenced on the court granting an order of final liquidation at the time of presentation of the application for winding-up.

A solvent company, on the other hand, may be voluntarily wound-up by the shareholders of the company passing a special resolution that is filed and registered with CIPC or by a court order.

Once the company is placed into liquidation, any contracts concluded with the company will remain in effect in the

absence of any statutory provisions to the contrary. The liquidator appointed to the company and responsible for the administration of the estate and supervision of the winding-up process will then decide whether to terminate or continue with any executory contracts. Any civil proceedings and the execution of any judgment against the company are suspended.

The duration of the liquidation/winding-up procedure depends on the size of the estate, the complexity of the company's transactions, the realisation of assets, any delays in the lodging and approval of the liquidation and distribution accounts by the Master of the High Court. It is therefore important that a director can be held personally liable under the Companies Act, 2008 for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having knowingly allowed the company to trade under insolvent circumstances (ie carried on its business recklessly).

Once liquidation/winding-up proceedings are concluded, the company will be dissolved and its name will be removed from the companies register.

<sup>2</sup> Schedule 5, Item 9 of the Companies Act, 2008 provides that despite the repeal of the Companies Act, 1973, Chapter 14 of the Act continues to apply with respect of the winding-up of insolvent companies until a date determined by the Minister of Trade and Industry and Competition, as if that Act had not been repealed.



# Key contacts

If you require advice on any of the matters raised in this document, please contact any of our partners or your usual contact at Allen & Overy, or email [rab@allenoverly.com](mailto:rab@allenoverly.com)

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# Further information

Developed by Allen & Overy's market-leading Global Restructuring Group, "**Restructuring Across Borders**" is a free and easy-to-use website that provides information and guidance on all key practical aspects of restructuring and insolvency in Europe, the Middle East, Asia and the U.S.

To access this resource, please [click here](#).



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