AN EVALUATION OF THE STRENGTHS AND WEAKNESSES OF SOUTH AFRICA'S CORPORATE RESCUE REGIME AS A POTENTIAL BENCHMARK FOR UGANDA

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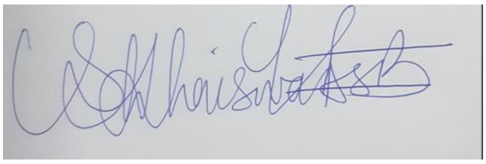

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SUMMARY

This thesis evaluates the strengths and weaknesses of the legal framework on corporate rescue in South Africa and Uganda. Although corporate rescue was initially not one of the objectives of insolvency law, it has now become the focus of modern insolvency law. South Africa became the first country to recognise the need to create a legal framework for rehabilitating financially distressed companies when it incorporated judicial management in the Companies Act of 1926. Judicial management was, however, not successful as a corporate rescue procedure. The South African policy makers however continued to explore ways through which financially distressed but viable companies could be saved from collapsing. This culminated into the introduction of business rescue in Chapter 6 of the Companies Act 71 of 2008.

The study presents a detailed analysis of the strengths and weaknesses of the South African business rescue framework. It posits that unlike the Ugandan system, the South Africa legal regime reflects the principles of a modern and effective corporate rescue system.

Whereas the government of Uganda attempted to embrace corporate rescue through the introduction of administration in the Insolvency Act 2011, the law is devoid of the internationally recognised features of a modern and effective business rescue framework. Administration has remained a white elephant in Uganda's insolvency system, with liquidation continuing to be the predominant procedure used by both creditors and financially distressed companies. It is recommended that Uganda's policy makers should benchmark the South African system to reform Uganda's corporate rescue framework.

This thesis is based on the law as at 31st of May 2022, found in the sources available in South Africa and Uganda.

Key terms:

Administration, business rescue, corporate insolvency, corporate rescue, corporate insolvency law, insolvency, judicial management, provisional administration, moratorium, rescue finance.

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LIST OF ABBREVIATIONS

A	Appellate Division Reports
AC	Appeal Cases
ACLC	Australian Company Law Cases
ACLR	Australian Company Law Reports
ALL ER	All England Law Reports
ALL SA	All South African Law Reports
ALR	Australian Law Reports
BCC	British Company Cases (1990–date)
BCC	British Company Law Cases (1983–1989)
BCCA	British Columbia Court of Appeal
BLR	Business Law Reports
BOU	Bank of Uganda
C	Cape Provincial Division
CC	Constitutional Court
CIPC	Companies and Intellectual Property Commission
Ch. D	Law Reports, Chancery Division
CPR	Civil Procedure Rules of Uganda
D	Durban and Coast Local Division
EBOLR	European Business Organisation Law Review
EBRD	European Bank for Reconstruction and Development
ECG	Eastern Cape High Court, Grahamstown
ER	English Reports
EWCA Civ	Court of Appeal (Civil Division)

EWHC	England and Wales High Court
FB	Free State High Court, Bloemfontein
FCA	Federal Court of Australia
FCR	Federal Court Reports, Australia
GJ	Gauteng Local Division, Johannesburg
GN	Government Notice
GNP	North Gauteng High Court, Pretoria
GP	Gauteng Division, Pretoria
GSJ	South Gauteng High Court, Johannesburg
HCCA	High Court Civil Application
HCMA	High Court Miscellaneous Application
HCCS	High Court Civil Suit
HL	House of Lords, English and Irish Appeals (1866–1875)
IMF	International Monetary Fund
IRA	Insurance Regulatory Authority
JCCL&P	Journal of Corporate and Commercial Law and Practice
JDR	Juta's Daily Reporter
JEFS	Journal of Economic and Financial Sciences
JOL	Judgments Online (LexisNexis)
KZD	KwaZulu-Natal High Court, Durban
NIBLeJ	Nottingham Insolvency and Business Law eJournal
NSWCA	New South Wales Court of Appeal
NSWLR	New South Wales Law Reports (Period 1971–date)
NSWR	New South Wales Reports (Period 1960–1970)

NSWSC	New South Wales Supreme Court
NZLR	New Zealand Law Reports
PC	Privy Council
PER/PELJ	Potchefstroom Electronic Law Journal
PLCJR	Plymouth Law and Criminal Justice Review
QB	Law Reports, Queen’s Bench
SA Merc LJ	South African Mercantile Law Journal
SA	South African Law Reports (1947–date)
SAJESBM	South African Journal of Entrepreneurship and Small Business Management
SALJ	South African Law Journal
SARIPA	South African Restructuring and Insolvency Practitioner’s Association
SC	Supreme/Superior Court
SCCA	Supreme Court Civil Appeal
SI	Statutory Instruments
SLR	Singapore Law Review
Stell LR	Stellenbosch Law Review
T	Transvaal Provincial Division
UKHL	United Kingdom House of Lords
UKPC	United Kingdom Privy Council
UKSC	United Kingdom Supreme Court.
ULRC	Uganda Law Reform Commission
UNCITRAL	United Nations Commission on International Trade Law
URSB	Uganda Registration Services Bureau
VSC	Victoria Supreme Court

W	Witwatersrand Local Division
WCC	Western Cape High Court, Cape Town
WL	Westlaw Transcripts
WLR	Weekly Law Reports
ZAECGHC	South Africa: Eastern Cape High Court, Grahamstown
ZAGPJHC	South Africa: South Gauteng High Court, Johannesburg
ZAGPPHC	South Africa: North Gauteng High Court, Pretoria
ZAWCHC	South Africa: Western Cape High Court Cape Town

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CHAPTER ONE

INTRODUCTION

1.1 Introduction and Background

Protection of businesses from failure has become one of the key objectives of any progressive government.[1] Indeed, corporate rescue has increasingly become a popular topic on many countries' legislative agenda.[2] Companies are now recognised as an integral part of the community in which they operate, with a direct impact on the economic and social well-being of the entire community.[3] Failure of any business enterprise often affects a wide range of stakeholders, including creditors, company managers, employees and shareholders.[4]

When a company fails, the consequences of its exit from the market are more dire in developing economies, where a few companies participate in active business. It is dangerous for a developing economy to allow companies, which comprise its industries and commercial enterprises to be dissolved due to temporary liquidity setbacks where, if granted a moratorium, those companies could overcome their difficulties, discharge their debts, and become successful concerns.[5]

Unfortunately, in market-based economies like Uganda and South Africa, corporate failure is generally acknowledged as inevitable.[6] The risk of business failure is often seen as an essential concomitant of entrepreneurial activity.[7] In a capitalist economy, a certain level of corporate failure is both inevitable and necessary for the efficient functioning of the market.[8] Companies falling by the wayside is seen as one of the principal characteristics of a market economy.[9]

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1 Godwin 2012 *Sydney LR* 163.
2 Calitz and Freebody 2016 *De Jure* 266.
3 Mongalo *Modern Company Law* 114.
4 Goode *Principles of Corporate Insolvency Law* 68.
5 Cilliers and others, *Companies and Other Business Structures in SA*: 478.
6 Reuven https://www.frbsf.org/economic-research/files/el2002-18.pdf (Date of use: 10 July 2018).
7 Goode *Principles of Corporate Insolvency Law*.
8 Argenti *Corporate Collapse: The Causes and Symptoms* 170.
9 McCormack *Corporate Rescue Law: An Anglo-American perspective* 6.

Finding a structured approach by means of which business failure may be either minimised or better managed remains a daunting task for policy makers.[10] Increasingly, different stakeholders are looking to insolvency law as a possible answer to corporate failure.[11] Regrettably, insolvency law has not provided a convincing solution to corporate failure.[12] Insolvency law is primarily centered around post-crisis liquidation of the debtor's assets and the allocation of the sale proceeds among creditors of an individual legal entity.[13]

Leading scholars of insolvency law[14] have over the years maintained that insolvency proceedings are just a collective debt collection mechanism through which a debtor's assets are pooled together for the benefit of all creditors.[15] Proponents of this view argue that the problems brought about by business failures are not bankruptcy problems. Consequently, insolvency proceedings should not be used to implement policies which society does not enforce outside of the insolvency regime.[16] However, other scholars[17] question this narrow view of insolvency law, while some acknowledge that other interests should be considered apart from those of creditors.[18] In their view, to concentrate exclusively on maximising returns for creditors is a dangerous oversimplification of the nature and purpose of the bankruptcy process.[19]

It is argued that the aims of a good modern insolvency law should include recognition of the fact that the effects of insolvency are not limited to the private interests of the insolvent business and its creditors. Other groups in society are vitally affected by the insolvency of a business. Consequently, corporate rescue measures are gradually being appreciated as a means for the preservation of viable commercial enterprises

10 Anderson 2016 *PLCJR* 20
11 Ssekaana M "Analysing the Role of the Court in Balancing Stakeholder Interest in Insolvency and Restructuring Proceedings in Developing Economies- a Ugandan Perspective." (Paper delivered at the Debt and Insolvency law in Africa Conference 6-8 July 2022 Abuja Nigeria) 1.
12 Kokorin 2021 *EBOLR* 782.
13 *ibid.*
14 Jackson and Baird 1984 *University of Chicago LR* 97; Scott 1989 *Virginia LR* 155.
15 Goode *Principles of Corporate Insolvency Law* 70); Kilborn and Walters (2012) Chicago-Kent College of Law Research Paper 1.
16 Jackson and Baird 1984 *University of Chicago LR* 102.
17 Nyombi 2015 IJLM 1.
18 Warren 1987 *University of Chicago LR* 800.
19 Warren 1987 *University of Chicago LR* 800.

capable of making a useful contribution to the economic life of the country.[20] This paradigm shift is prompting policy makers across the globe[21]to wonder whether it is best to tear the insolvent business apart because of a liquidation sale or resort to measures that can potentially remodel the financial and organisational structure of the business so as to permit the recovery and continued existence of the enterprise or business as the case may be.[22]

Many jurisdictions have reformed the focus of their insolvency laws from the dogmatic creditor-focused approach to a more balanced pathway towards building a rescue culture.[23] It was observed in the English Cork Report[24] that the concern for the livelihood and wellbeing of those dependent upon an enterprise, which may well be the lifeblood of a whole town or even a region, is a legitimate factor to which a modern law of insolvency must adhere to.[25] The effects on any given failure can potentially be so disastrous to creditors, employees and the community that it must not be overlooked.[26]

In many countries such as the United States of America, United Kingdom, Australia, South Africa,[27] and Uganda,[28] the focus of insolvency law is increasingly shifting to building a strong and vibrant business rescue culture that promotes the preservation of enterprises as opposed to rushing to dismantle them through liquidation sales.[29]

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20 Insolvency Law and Practice, Report of the (Cork) Review Committee (Cmnd.8558, 1982) para 198.

21 Ucheckukwu 'Rethinking Business Rescue in Nigeria: Borrowing Virtues from the Chapter 11 of the US Bankruptcy Code' 22.

22 Bridge 2013 *Law in Transition* 39.

23 Calitz and Freebody 2016 *De Jure* 1; Bridge 2013 *Law in Transition* 29.

24 The Cork Report is a report of the Review Committee on Insolvency Law and Practice (1982) Cmnd 8558. The Report summarises the outcome of the investigation and the recommendations that the Committee found necessary to reform UK Insolvency law. The Committee was chaired by Kenneth Cork and was commissioned by the Labour Government in 1977.

25 The Insolvency Law and Practice, Report of the (Cork) Review Committee (Cmnd.8558, 1982) para. 204.

26 *ibid*.

27 Calitz and Freebody 2016 *De Jure* 266.

28 Report on Insolvency Law by the Uganda Law Reform Commission, Law Pub. No. 13 of 2004 available at http://www.ulrc.go.ug/sites/defaulr/files/ulrcresources/insolvency%20law%20body0.pdf (Date of use: 12 July 2018).

29 Bo *Comparative Insolvency Law: The Pre-pack Approach in corporate rescue* 3 Available at www.elgaronline.com (Date of use: 30 May 2018).

1.2 South Africa's rescue framework

In 2008, the government of South Africa enacted the Companies Act 71, of 2008 (the Companies Act 2008) which introduced Chapter 6 on business rescue and gave force of law to the many internationally recognised rescue procedures in South Africa.[30] The preamble and section 7 of the Companies Act 2008 indicate that one of the purposes of the legislation is to promote the development of the South African economy by encouraging entrepreneurship and enterprise efficiency.[31] The Companies Act 2008 aims to reaffirm the perception that companies are a means of achieving economic and social benefit,[32] and to encourage the efficient and responsible management of companies.[33] Another relevant purpose is to provide for the efficient rescue and recovery of financially distressed companies in a manner that caters for the rights and interests of all relevant stakeholders.[34] The legislature dedicated a whole chapter in the Companies Act 2008 to business rescue.[35] In it, specific provisions on some of the intentionally recognised measures for a successful rescue system[36] are recognised:

(a) Section 133 provides that a company under business rescue enjoys an automatic general moratorium against all legal proceedings, including enforcement action against the company. This measure resonates with the World Bank principles for effective Creditor/Debtor Rights systems, which emphasise that commencement of insolvency proceedings, including corporate rescue procedures, should prohibit the unauthorised disposition of the debtor's assets and suspend actions by creditors to enforce their rights or remedies against the debtor's assets until after the objectives of the insolvency proceedings are achieved.[37]

(b) Section 134 protects the property interests of a company while it is placed under business rescue by restricting the circumstances under which the company's

30 Loubser 2013 *SA Merc LJ* 438; Burdett 2004 *SA Merc LJ* 241–262.
31 Section 7*(b)*(i) of the Companies Act 2008.
32 Section 7*(d)* of the Companies Act 2008.
33 Section 7*(j)* of the Companies Act 2008.
34 Section 7*(k)* of the Companies Act 2008.
35 Chapter 6 of the Companies Act 2008 is entitled 'Business Rescue and Compromise to Creditors'.
36 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 79.
37 Principle C5 of the World Bank Principles for Effective Creditor/Debtor Rights Systems (May 2015).

assets may be disposed of. It goes on to limit the rights of other parties to exercise their contractual and/or legal rights in respect of property in lawful possession of the company except with explicit written consent of the insolvency practitioner appointed to rescue the company.

(c) Section 135 provides for post-commencement finance. This provision makes it possible for the company to obtain critical financing to fund rescue strategies, and the funds obtained acquire statutory preference over other pre–commencement debts, including secured and unsecured business debts. This provision makes it attractive for lenders to fund rescue operations.

(d) Furthermore, Section 136(2) gives the insolvency practitioner a legal right to cancel or suspend entirely, partially, or conditionally, any agreement (other than an employment agreement) to which the company is a party at the commencement of the business rescue period. This allows the rescue team the flexibility to choose which contracts to retain, amend or even cancel in order to achieve the desired rescue strategy. This provision allows the practitioner to safely jump out of onerous contracts that could otherwise frustrate the rescue strategies.

(e) Section 137 grants the insolvency practitioner control over the company shareholders and directors, including imposing an obligation on company directors to comply with all requests for information by the practitioner and the right to cause the removal of any company director who may be impeding or otherwise frustrating the rescue processes.

The above measures are very critical ingredients of an efficient corporate rescue system.

This commitment to corporate rescue in South Africa did not just stop in Parliament. In the case of *Koen v Wedgewood Village Golf and Country Estate (Pty) Ltd*[38] Binns-Ward J, of the Western Cape High Court observed:

[38] 2012 (2) SA 378 (WCC).

> It is clear that the legislature has recognised that the liquidation of companies more frequently than not occasions significant collateral damage, both economically and socially, with attendant destruction of wealth and livelihoods. It is obvious that it is in the public interest that the incidence of such adverse socio-economic consequences should be avoided where reasonably possible. Business rescue is intended to serve that public interest by providing a remedy directed at avoiding the deleterious consequences of liquidations in cases in which there is a reasonable prospect of salvaging the business of a company in financial distress, or of securing a better return to creditors than would probably be achieved in an immediate liquidation.[39]

1.3 State of Uganda's corporate rescue regime

In 2011, the Parliament of Uganda enacted the Insolvency Act 14 of 2011 (Uganda's Insolvency Act). This Act aimed at improving the corporate rescue system in Uganda among other things.[40] Uganda's Insolvency Act was modelled on the English Insolvency Act of 1986. However, subsequent changes that the English have made to the 1986 Insolvency law over the years, such as the abolishment of administrative receiverships and removal of crown preferences, were not taken into consideration while enacting Uganda's Insolvency Act.[41] Thus, the provisions of Uganda's Insolvency Act on corporate rescue have several shortcomings.

A number of internationally recognised corporate rescue procedures are not fully reflected in Uganda's Insolvency Act. Uganda's Insolvency Act provides for two broad routes to corporate rescue: administration and voluntary arrangements. The procedure for implementation of either of these mechanisms is however riddled with several procedural roadblocks. For instance, before a company may commence administration, the company's shareholders must first consent by means of a special resolution to reach a settlement with the company creditors.[42] Thereafter, a petition must be made to court for an interim protective order.[43] An interim protective order is an order that is granted by the High Court after being satisfied by the company that it intends to make arrangements with its creditors.[44] Once the interim protective order is

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39 *Koen v Wedgewood Village Golf and Country Estate (Pty) Ltd* 2012 (2) SA 378 (WCC) para 14.
40 Nyombi 2015 *IJLM* 1.
41 The English Insolvency Act of 1986 was amended in 2000, 2002 and in 2015, and reports show that more changes are still being considered by the UK Government.
42 Section139(3) of Uganda's Insolvency Act 14 of 2011.
43 Section139(4) of Uganda's Insolvency Act 14 of 2011.
44 Deox Tibeingana v Vijay Reddy HC Misc. Cause No.286 of 2019 2.

issued, it operates as a stay of execution against the company and its assets.[45] Provisional administration is only deemed to commence after the court has granted an interim protective order.[46]

Uganda does not, however, have specialised insolvency courts. This means that an application for the interim protective order is made to the ordinary courts,[47] which are already burdened by case backlogs.[48] It may take several months before an application for the interim protective order is heard and determined by Court to authorise the placement of a financially distressed company into administration. For a company that is in critical financial distress, a delay of this nature could further jeopardise any hope for rescue. To make matters worse, section 145 of Uganda's Insolvency Act provides that provisional administration terminates when the period specified in the interim order lapses. This period is only thirty days.[49] This presupposes that this period is sufficient for the provisional administrator to diagnose the company and be ready to make an acceptable rescue proposal[50] to the creditors before they can approve an administration deed.[51] Failure to do so automatically pushes the company into liquidation[52] with all its associated negative effects. Although this period is extendable, the provisional administrator must first apply to court for such extension and prove existence of exceptional circumstances to warrant extension of time beyond the default thirty days.[53]

Uganda's Insolvency Act is also silent on certain critical corporate rescue measures, including post-commencement finance, which would enable a company under rescue to obtain priority credit from lenders to fund critical rescue strategies.[54] Post-

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45 Deox Tibeingana v Vijay Reddy HC Misc. Cause No.286 of 2019 p. 3.

46 Section142(1) of Uganda's Insolvency Act.

47 According to section 2 of Uganda's Insolvency Act, a court means the High Court or a court presided over by a chief magistrate. However, section 254(1) of the Insolvency Act goes further to specify that only the High Court shall have jurisdiction over all matters concerning companies.

48 According to a report by the Case Backlog Reduction Committee that was released on 27 March 2017, there were more than 155,400 cases pending at all levels of courts as of January 2017, out of which 7,837 had been pending in the court system for at least two years. See www.judiciary.go.ug/data/news/backlog%20releases%20report.ht (Date of use: 04 of August 2018).

49 Section 145(1)(a) of Uganda's Insolvency Act 14 of 2011.

50 Section 147 of Uganda's Insolvency Act 14 of 2011.

51 Sections149 and 150 of Uganda's Insolvency Act 14 of 2011.

52 Section 152(1)*(b)* of Uganda's Insolvency Act 14 of 2011.

53 Section 145(3) of the Uganda's Insolvency Act 14 of 2011.

54 Sarra 2011 *Penn State Int LR* 582.

commencement finance is widely recognised as an important mechanism for the facilitation of effective corporate rescue.[55] An effective corporate rescue regime ought to facilitate and provide incentives for post-commencement finance where it is determined that such finance is necessary for the continued operation or survival of the business of the debtor or the preservation or enhancement of value of the estate.[56]

The moratorium accorded to a company during administration in Uganda is so frail that it does not provide a substantive veil for distressed companies. For example, section 165(3) of Uganda's Insolvency Act provides that execution of an administration deed shall not prevent a secured creditor from enforcing a claim against company property. This position was recently upheld by Justice Stephen Mubiru in *Uganda Telecom Limited (in Administration) v Ondoma Samuel t/a Alaka and Company Advocates,*[57] when he ruled that:

> 'Unless a Court makes an order to the contrary, an administration deed does not prevent a secured creditor from realizing or otherwise dealing with its security'.[58]

Uganda's Insolvency Act also allows continued exercise of power of enforcement of a charge over a company property where the enforcement process had commenced before the start of the provisional administration.[59] This is made worse by the fact under the Ugandan insolvency regime, the threshold for eligibility of a creditor to commence liquidation proceedings against an insolvent company is so low that almost every trading company is exposed to the risk of being subjected to liquidation proceedings.[60] Virtually all trading enterprises are exposed to the risk of being prematurely liquidated merely because of having marginal symptoms of liquidity challenges. Moreover, a creditor has no legal obligation to first explore rescue measures before invoking liquidation and winding up proceedings.

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55 Ravi 2011 *ICR* 136–162.

56 See Recommendation 63 in the World Bank 'Principles for effective creditor rights and insolvency systems' revised in 2015. Available at: http://www.worldbank.org/en/topic/financialsector/brief/the-world-Bank-principles-for-effective-insolvency-and-creditor-rights (Date of use: 04 August 2018).

57 High Court Miscellaneous Civil Application No. 12 of 2018.

58 *Uganda Telecom Limited v Ondoma Samuel t/a Alaka and Company Advocates* HCMCA No.12 of 2018, 4.

59 Section143 (2) of Uganda's Insolvency Act 14 of 2011.

60 Under s 3 of the Uganda's Insolvency Act 14 of 2011, the threshold for inability to pay debts is only Two Million Ugandan Shillings.

There is laxity in enforcing the provisions of the Insolvency Act on the procedures for the appointment and qualifications of insolvency practitioners in Uganda. Whereas section 204 of the Act provides that a person is not qualified to be appointed or to act as an insolvency practitioner unless he or she is a lawyer, an accountant or a chartered secretary registered with the relevant professional body,[61] this provision is not yet being fully enforced. Until October 2017 when the Insolvency practitioner's regulations were promulgated, there was no clear procedure for registration and licensing of insolvency practitioners in Uganda.[62] However, it is still doubtful whether licensing of insolvency practitioners will, by itself, improve efficiency in the way insolvencies are managed. This is particularly so because the law does not include requirements to consider one's practical knowledge and management expertise before they are licensed to act as insolvency practitioners, especially in cases of corporate rescue.

Absence of a structured and well enforced procedure for appointment of office bearers in insolvency processes is a very serious loophole in Uganda's insolvency regime because turning around a company from financial distress to financial normalcy requires much more than just academic qualifications. Practical management experience, impeccable integrity, and the ability to negotiate and mediate between parties with differing interests are required. As was noted by McCormack,[63] specialised professionals whose main expertise is in financial analysis of corporate performance, or even legal advice and litigation hardly seem the worthiest candidates for the managerial roles assumed by the insolvency practitioner.[64]

The foregoing weaknesses in Uganda's insolvency framework expose distressed companies that have potential to recover from their financial woes to the risk of disruptive procedures. Such procedures include liquidation, traditional receiverships[65]

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61 Section 204(1)*(a)* of Uganda's Insolvency Act 14 of 2011.

62 The Insolvency Practitioner's Regulations, Statutory Instrument No.55 of 2017 were published in the Uganda Gazette No.59 Volume CX of 20 October 2017.

63 McCormack *Corporate Rescue Law: An Anglo-American perspective* 135.

64 *ibid.*

65 Receivership is a long-established method by which a secured creditor can enforce his or her security. The procedure involves the appointment of a person to act as a receiver, by either the creditor, pursuant to a right reserved under the security instrument, or by court. The person appointed as a receiver assumes the right to take over possession of the property that is subject of a charge and he or she is authorised to deal with it primarily for the benefit of the holder of the charge; see Finch, *Corporate Insolvency Law; Perspective and Principles* 272-300.

and other distress proceedings like arrests and committal to civil prison of company directors (on account of guarantees provided for loans advanced to companies). These measures often lead financially distressed companies to collapse before they are taken through any objective diagnostic and rescue measures.[66]

1.4 Problem statement

This research undertakes a comparative analysis of the law and practice on corporate rescue in South Africa and Uganda, with specific focus on identifying the strengths in the South African legal regime as a potential benchmark for addressing the weaknesses in the Uganda legal system.

The study notes that whereas there is global consensus that modern insolvency law should facilitate the diagnosis and treatment of imminent insolvencies at an early rather than late stage and provide means for the preservation of viable commercial enterprises, and only liquidate those that are irredeemable, this has not yet trickled down to the insolvency legal regime in Uganda. The general perception and practice in Uganda is that insolvency law only focuses on facilitating the orderly closure of the insolvent. Insolvency proceedings are predominantly used by creditors to wind up the insolvent debtor's business and sometimes, by the debtors themselves to escape from creditors' pressure to repay debts.

It is argued that whereas the government of Uganda attempted to embrace corporate rescue through the introduction of administration in the Insolvency Act 2011, the law is devoid of the internationally recognised features of a modern and effective rescue framework. As has already been observed,[67] provisional administration and administration, which are the primary formal rescue procedures under the Insolvency Act are heavily dependent on court. Uganda does not however have special insolvency courts. Parties interested in pursuing rescue measures have to file their petitions and applications before the ordinary courts, which are already overburdened by other civil and criminal cases.

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66 Kainombwisho 'Rescuing Financially Distressed Business' URSB–The Registry Newsletter, October–December 2016, Issue 7, Vol.7 10.

67 See discussion under 1.3.

This has rendered administration to be a rare procedure in Uganda's insolvency system, with liquidation remaining the predominant procedure used by both creditors and financially distressed companies. In addition, placing insolvent debtors under receivership by floating and fixed charge holders still occurs, and a number of stakeholders have not yet adequately appreciated the fact that procedures such as administration entitle a debtor to a moratorium against disruptive pressure from individual creditors. There is limited effort by the government of Uganda to breed the corporate rescue culture and few people appreciate that having a good corporate rescue regime can foster economic growth in the country. This is exposing many companies to the risk of liquidation and informal business closures, all of which end up hurting the economy.

Unlike Uganda, the situation in South Africa is remarkably different. In 2008, the government of South Africa enacted the Companies Act 2008, wherein a whole chapter 6 is dedicated to business rescue, and the procedure has since been embraced and used to rescue a number of financially distressed companies.[68] Although there is seemingly low success rate for business rescue in South Africa,[69] it is acknowledged that reformation of the law on business rescue has contributed to a general reduction in the number of liquidations, which is probably as a result of more financially distressed companies utilizing business rescue procedures before it is too late.[70]

In view of the fact that South Africa has had the recue regime for over ten years,[71] the premise of the study is that Uganda can learn from the South African experience and identify policy and legislative interventions that may be undertaken to cause a change in thinking towards building a robust rescue system. Specific recommendations are made in Chapter 8 for improving Uganda's corporate rescue system.

This research, therefore, answers the following questions:

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68 Conradie and Lamprecht 2018 *SAJEMS* 21.
69 Naidoo, Patel and Padia 2018 *JEFS* 11, 1.
70 Hubbard J 2013 *Finweek*, 22–23.
71 The Companies Act 2008 came into force on 1 May 2011, following publication of a *Government Gazette Notice* 34239 of 26 April 2011.

(a) To what extent does corporate insolvency law promote the rescue of financially distressed businesses and companies?

(b) To what extent has the inclusion of chapter 6 on business rescue and compromises with creditors in the South African Companies Act of 2008 improved the efficacy of the legal and regulatory framework on business rescue in South Africa?

(c) To what extent does Uganda's Insolvency Act of 2011 reflect the key features of a modern and effective corporate rescue framework?

(d) Has the Insolvency Act of 2011 improved the legal and regulatory framework on corporate rescue in Uganda?

(e) What lessons are to be learnt by both Uganda and South Africa from the legal frameworks in the UK and US on corporate rescue, as well as the recommendations from expert international organisations like IMF, World Bank, UNCITRAL and EBRD to improve their business rescue systems?

(f) Drawing from the strengths in the South African, UK and US frameworks, are there any specific legislative and administrative measures which Uganda can deliberately institute to address the identified gaps in its corporate rescue framework?

1.5 Aim and objectives

The aims and objectives of this research are to:

1.5.1 Examine the modern role of insolvency law in promoting the rescue of financially distressed businesses and companies.

1.5.2 Identify the strengths and weaknesses of the corporate rescue system in South Africa as compared to the internationally recognised rescue models and comparatively examine the potential benefits that could be derived from building an efficient corporate rescue system in Uganda.

1.5.3 Examine the adequacy of the Insolvency Act of Uganda in fostering the growth of a rescue culture in Uganda.

1.5.4 Recommend specific legislative and administrative measures through which the gaps in Uganda's corporate rescue framework can be addressed to further engender the rescue culture in the country.

1.6 Scope of the study

This study begins with a discussion of the normative principles of corporate insolvency law as well as the history of insolvency law in South Africa and Uganda. This is followed by a thematic discussion of the concepts of corporate and business rescue, including an examination of the common causes of financial distress. The study analyses the law and practice on corporate rescue in South Africa and Uganda, with a specific focus on identifying and evaluating the strengths and weaknesses of the South African corporate rescue system in facilitating recovery of financially ailing companies and businesses. The research comprises of an analysis of chapter 6 of the Companies Act 2008 and consideration of how the provisions contained therein have improved the processes for corporate and business rescue in the Republic of South Africa.

Literature and data from the respective agencies involved in business rescue processes in South Africa is reviewed. These include the Companies and Intellectual Property Commission (CIPC), which is the government agency in charge of licensing business rescue practitioners in South Africa, the Master of the High Court,[72] the office charged with supervisory mandate over insolvency practice in South Africa[73] and the reports published by the South African Restructuring and Insolvency practitioners' Association (SARIPA). The South African data, law and practice is compared to the law and practice in selected economies of United Kingdom and the United States of America to evaluate whether South Africa's rescue regime is aligned with corporate rescue practices in these jurisdictions.

72 The Insolvency Act 24 of 1936 and the partly repealed Companies Act 61 of 1973 and the Companies Act 2008 create the Office of the Master of the High Court as the regulator of insolvency practice in South Africa.

73 Calitz 2011 *De Jure* 296.

The study identifies extant gaps and weaknesses in the South African insolvency regime that are hindering the effective turnaround of financially distressed companies in South Africa. Similarly, Uganda's corporate rescue system is compared to the frameworks used in South Africa, the United Kingdom (UK) and the United States (US) models. Reference to the UK and US regimes is limited to guiding the researcher on the international best practice in the developed economies, but the focus of the discussion is primarily on the South African system as a potential benchmark for Ugandan corporate rescue regime.

The comparative evaluation of both the Ugandan and South African rescue systems is conducted using data and literature contained in official reports published by the Uganda Registration Service Bureau (URSB), the government agency with supervisory powers over insolvency practice in Uganda. These are evaluated along with the statistics obtained from South Africa, UK, and the US. The research also draws guidance from reports published by leading international bodies on insolvency matters such as INSOL international,[74] International Insolvency Institute[75] and UNICTRAL.[76] The study is further guided by library study on the doctrinal aspects of corporate rescue as well as judgments delivered by courts in Uganda, South Africa, UK and the US.

The findings of this study will provide a good reference point and foundation for reforming Uganda's corporate rescue system. This research reveals the benefits of using business rescue measures before the traditional liquidation approach; thus, it

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74 INSOL International is the International Association of Restructuring, Insolvency and Bankruptcy Professionals. It is a world-wide federation of national associations for accountants and lawyers who specialise in turnaround and insolvency. There are currently 44 Member Associations world-wide with over 10,500 professionals participating as Members of INSOL International. See: https://www.insol.org.

75 The International Insolvency Institute is a non-profit, limited membership organisation, based in the USA. It is dedicated to improving international cooperation in the insolvency field and focuses on promoting greater international cooperation and coordination through improvement in the law and legal procedures. See: https://www.iiiglobal.org.

76 UNCITRAL is the United Nations Commission on International Trade Law. It was established by the United Nations General Assembly through Resolution 2205 (XXI) on the 17th of December 1966 to reduce or remove the obstacles to trade created by disparities between the national laws governing international trade. UNCITRAL plays an active role in developing a framework to harmonise and modernize the law of international trade, including insolvency law. See: https://www.unictral.org.

will potentially guide subsequent policy and legislative interventions on how to diagnose and treat imminent insolvencies at an early stage and provide means for the preservation of the insolvent but still viable commercial enterprises that can be rescued from the jaws of liquidation.

1.7 Framework of the thesis

The thesis has eight thematic chapters.

1.7.1 Chapter 1: Introduction and Chapter Overview

The chapter presents the background to the research problem and explains the main questions which the study seeks to answer. It also sets out the methodology and an overview of all the subsequent chapters. The chapter contains a brief explanation and rationale for the focus on South Africa. This entails a discussion on why the researcher believes that Uganda could benefit if it considered the positive points from the South African legal regime on corporate rescue as it seeks to improve its own system.

1.7.2 Chapter 2: Development of Corporate Insolvency Law in South Africa

This chapter examines the development of corporate insolvency law in South Africa. It begins with a discussion on the meaning of insolvency and corporate insolvency generally as well as the history of corporate insolvency law in South Africa, noting that the current corpus of insolvency law in South Africa has its roots in the Roman-Dutch and the English legal systems. The objectives of corporate insolvency law are also examined. The chapter concludes with a discussion on the meaning of inability to pay debts, which is the primary determinant of one's insolvency in South Africa.

1.7.3 Chapter 3: Development of Corporate Insolvency Law in Uganda

This chapter focuses on the development of corporate insolvency law in Uganda. It argues that just like South Africa, Uganda's current legal framework on insolvency law is a replica of the English legal system. The chapter examines the state of Uganda's corporate insolvency law starting with a discussion on the law before the enactment of the Insolvency Act 2011 and the current framework. It also concludes with an exploration of the meaning of inability to pay debts as understood in Uganda.

1.7.4 Chapter 4: Corporate Rescue: The Concept, Nature and Purpose

The chapter explores the concept, nature and purpose of corporate rescue, which are at the core of this study. The meaning of corporate rescue is explored in detail. A distinction is drawn between the twin concepts of 'corporate rescue' and 'business rescue'. The chapter argues that corporate rescue is broadly used to include business rescue. The chapter also discusses the meaning and causes of financial distress, noting that financial distress is the primary trigger of rescue procedure. It also considers what constitutes a successful rescue attempt as well as the common barriers to corporate rescue. The chapter concludes with a discussion on the benefits of corporate rescue over liquidation.

1.7.5 Chapter 5: South Africa's Corporate Rescue Framework

This chapter examines South Africa's corporate rescue regime, with specific focus on the key concepts and provisions contained chapter 6 of the Companies Act 2008. The discussion touches on the eligibility criteria for entry into business rescue, the procedure through which a company enters business rescue and how long a company may stay under business rescue procedure. The key features of the Companies Act 2008 on business rescue are examined, including the nature of the moratorium extended to companies under rescue, how company property is protected during rescue, how company contracts are treated, how creditors, employees and other company contracts are treated as well as post-commencement finance. The chapter concludes with an analysis of the strengths and weaknesses of the South African rescue system and an evaluation of the extent to which the South African system compares with the internationally acceptable rescue standards.

1.7.6 Chapter 6: Analysis of Uganda's Corporate Rescue Regime

This chapter provides a detailed analysis of Uganda's corporate rescue regime. It is argued that although Uganda still has some residual provisions on informal corporate rescue under the Companies Act 2012, for insolvent companies, the primary rescue procedures are provisional administration and administration, which are provided under the Insolvency Act 2011. The chapter analyses the key features of provisional administration and administration as well as how these procedures can be commenced and terminated. It concludes with a discussion on the weaknesses of administration as a rescue procedure in Uganda.

1.7.7 Chapter 7: Corporate Rescue from an International Perspective

This chapter presents the international perspective on corporate rescue. The Chapter summarises the key principles and recommendations by the leading international bodies such as IMF, World Bank and UNCITRAL on how states can nurture corporate rescue. The chapter concludes with a comparative analysis of the corporate rescue systems in the UK and the US.

1.7.8 Chapter 8: Findings, Recommendations and General Conclusion

This chapter starts with a comparative analysis of South Africa’s rescue framework highlighting the key strengths and weaknesses of both the South African and Ugandan systems in comparison to the benchmarks from the UK and US systems. The chapter concludes with the specific proposals and recommendations which are considered necessary for improving Uganda’s corporate rescue system.

1.8 Description of the research methods

The study is based on library research. The researcher has relied on reports from primary sources of data available at offices working on insolvency and corporate rescue in South Africa, Uganda, UK and US.

The focus on South Africa and Uganda was influenced by the fact that both Uganda and South Africa share a number of commonalities. Uganda was a British protectorate and most of its laws are still modelled on the English Common Law system. Although South Africa is not strictly a common law country, the current South African legal regime mirrors a cocktail of both the modern common law and the civil law systems.

The researcher believes that the business environment in South Africa is relatively similar to societies like UK and US and provide a good benchmark for a developing country like Uganda. The examples and experiences drawn from South Africa and the developed jurisdictions of UK and US have provided a basis for the recommendations contained in Chapter Eight.

CHAPTER 2

DEVELOPMENT OF CORPORATE INSOLVENCY LAW IN SOUTH AFRICA

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2.1 Introduction

Corporate rescue is one of the goals of a modern insolvency system.[1] Consequently, to have a contextualised discussion on the topic of corporate rescue, one must have the requisite historical and normative appreciation of the wider principles and policy objectives of Corporate Insolvency Law. Therefore, this chapter begins by defining the concepts 'insolvency' and 'Corporate Insolvency Law'.[2] An account is given of how Corporate Insolvency Law has evolved in South Africa, noting that the current outlook of South African Insolvency Law bears features from both Roman-Dutch and English law systems.[3]

The discussion extends into a terse analysis of how the Roman-Dutch legal practices[4] and the developments in English Corporate Insolvency Law have influenced the development of Corporate Insolvency Law in South Africa.[5] However, considering that the English legal system has had more impact on South Africa,[6] it attracts a deeper analysis.[7]

The chapter also includes a brief discussion on the different theories and objectives of Corporate Insolvency Law.[8] It is argued that from a historical perspective, Insolvency Law emerged out of the need to address the challenges associated with diverse creditors enforcing their rights against the assets of the debtor. Consequently, the

1 Goode *Principles of Corporate Insolvency Law* 74–75; Insolvency Law and Practice, Report of the Cork Review Committee cmnd.8558.1982 para 198.
2 See the discussion under 2.2.
3 Burdette 'A framework for corporate insolvency law reform in South Africa' 78.
4 Wessels, *History of the Roman Dutch Law* 661; Thomas 'The Application of Roman law in Modern South Africa Law' (Paper presented at the University of Salerno on 30-09-2009 and at the University of Naples Federico II on 5-10-2009, Available at www.teoriaestoriadeldirittoprivato.com/media/rivista/2010/contributi/2010_Contributi_Thomas_SouthAfrican.pdf (20-03-2019).
5 Smith and Boraine, *Crossing Borders into South African Insolvency Law: From the Roman-Dutch Jurists to the UNCITRAL Model Law* 2002 ABI Law Review 140–143.
6 Burdette, 'A framework for corporate insolvency law reform in South Africa' 78.
7 See the discussion under 2.3.1.2.
8 See the discussion under 2.4.

legislation was more focused on creditor wealth maximisation.[9] However, the objectives of the modern Insolvency Law have expanded to include other objectives. These aims include the need to preserve viable commercial enterprises from collapsing and other community interests.[10]

The chapter concludes with a discussion on the meaning of 'inability to pay debts', which is the primary trigger for winding-up of insolvent companies.[11] Inability to pay debts also remains the main precursor to the commencement of corporate rescue proceedings.[12] The discussion consists of an analysis of the meaning of the term 'inability to pay debts', and the grounds upon which South African courts generally base their determination of a company's inability to pay debts.[13]

2.2 The Concept of 'Corporate Insolvency'

It is difficult to understand the scope and normative principles of Corporate Insolvency Law without first appreciating what 'insolvency' means. Therefore, I begin by defining 'insolvency' before zeroing in on the concept of 'corporate insolvency'.

2.2.1 **Insolvency**

'Insolvency' is more of an English concept than a legal one. It is actually surprising that although the term 'insolvency' is key to the understanding of Insolvency Law, legislation on insolvency in South Africa and jurisdictions such as Uganda and the United Kingdom do not expressly define what 'insolvency' means.[14]

In ordinary English, 'insolvency' is a noun used to refer to a condition of being unable to pay debts as they fall due or in the usual course of business.[15] 'Insolvency' in the context of a company can also be defined as the inability to pay the company's debts

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9 Jackson, *The Logic and Limits of Bankruptcy Law* Ch 1–2: Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 32–40.
10 Gross 1994 *Washington University Law Quarterly* 1031–1033.
11 Goode, *Principles of Corporate Insolvency Law* 161; s 344 of the Companies Act 61 of 1973.
12 Section 129(1)*(a)* of the Companies Act 2008.
13 Section 345 of the Companies Act 61 of 1973; *Boschport Ondernemings (Pty) Ltd v ABSA Bank Ltd* [2013] ZASCA 173.
14 Waiswa, *A Comparative Analysis of the Legitimacy of the Use of Insolvency Proceedings as a Debt Collection Tool in the UK and Uganda* 31.
15 Garner, *Black's Law Dictionary* 867.

either because of a lack of available cash to settle them as they become due, or because the company's total liabilities exceed its assets.[16] Clearly then insolvency is a situation where a company is unable to discharge its debts[17]as they fall due,[18] whether or not the liabilities of the company exceed its assets.[19]

In legal parlance, insolvency is not a 'deemed' condition.[20] Insolvency legislations often confine the scope of the term 'insolvency' to formal insolvency proceedings.[21] Instead of referring to 'insolvency', legislations opt to use the phrase, 'inability to pay debts'.[22] Therefore, in law, someone is considered to be insolvent if he or she is unable to pay his or her debts.[23]

The imprecision of the definition of insolvency is unfortunately not unique to just South Africa, UK and Uganda. Even in jurisdictions like Australia, where there have been legislative attempts[24] to define what insolvency means by providing for what constitutes solvency and insolvency in the law, ambiguity still exists.[25] For example, Section 95A of Australia's Corporations Act 2001 provides that a person is solvent only if he or she can pay all his or her debts as and when they become due and payable; if a person is not solvent, he or she is insolvent.[26]

A closer look at this statutory definition, however, still leaves a lot of debate as to what insolvency means. In the case of *Australian Securities and Investment Commission v Plymin, Elliott and Harrison (No.2),*[27] Mandie J of the Victorian Supreme court acknowledged the imprecision of the statutory definition and attempted to expound on what 'insolvency' entails. He listed fourteen indicators of insolvency, which one can rely on to assess whether a company is insolvent. The indicators include:

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16 Tolmie, *Corporate and personal insolvency law* 4.
17 Cassim and others*, Contemporary Company Law* 918.
18 Fletcher, *The Law of Insolvency* 1.
19 Madhuku 1995 Zimbabwe Law Review 85.
20 Goode, *Principles of Corporate Insolvency Law* 109.
21 *ibid*.
22 Sections 123, 222–224 and sch B1 para 11*(a)* of the Insolvency Act 45 of 1986 (UK); s 3 of the Insolvency Act 14 of 2011 (UG).
23 Finch, *Corporate Insolvency Law; Perspectives and Principles* 122.
24 Section 95A of the Corporations Act 2001 defines 'insolvency'.
25 Keay 1995 Monash University Law Review 12. See www.austlii.edu.au/journals/monashUlawRw/1995/12.pdf (18-12-2018).
26 Keay 1995 Monash University Law Review 12.
27 (2003) VSC 230, 21 ACLC 1237.

> (1) the company is experiencing continuing losses, (2) the company ratio is below 1, (3) the company is subject to overdue tax demands, (4) the company has evidence of poor relationship with its banks, (5) the company does not have access to alternative finance, (6) the company has an inability to raise further equity capital,(7) the company's suppliers place the company on cancellation of debt or are expressing unwillingness to continue supplying on credit, (8)the company's creditors are unpaid outside the trading terms, (9) issuing of post-dated cheques by the company, (10) issuing of dishonoured cheques by the company, (11) the company is required to enter into special arrangements with selected creditors, (12) the company becomes habitual recipient of demand letters from lawyers, summons and warrants issued against it, (13) payment to creditors of rounded sums not reconcilable to specific invoices and,(14) the company has an inability to produce timely and accurate financial information to display the company's trading performance and financial position.[28]

These indicators of insolvency, unfortunately, only serve to confirm that insolvency revolves around the central issue of inability to pay debts.[29]

2.2.2 Corporate insolvency

Corporate insolvency, as a natural deduction from the preceding discussion, is self-explanatory.[30] It is a condition that arises when a company or other juristic person[31] is unable to pay its debts.[32] Corporate Insolvency Law is the legal regime which regulates insolvent corporations.[33] The concept of Corporate Insolvency is what distinguishes inability to pay debts by companies from inability to pay debts by individuals, which is often referred to as bankruptcy.[34]

From a historical perspective however, the law relating to insolvency of companies developed separately from the law relating to the insolvency of individuals.[35] It is reported that by the 19th century, the Roman-Dutch legal system and the English common law system had developed two separate bodies of law on individual and corporate insolvency, with both regimes administered using different procedural rules and offering different substantive remedies.[36] However, even with this separation, a

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28 A*ustralian Securities and Investment Commission v Plymin, Elliott and Harrison (No.2)* (2003) VSC 230, 21 ACLC 1237 para 386.

29 Goode, *Principles of Corporate Insolvency Law* 110.

30 Madhuku 1995 *Zimbabwe LR* 86.

31 Brumby, McTear, Wiliams and Border, *Personal Insolvency* 37.

32 Goode, *Principles of Corporate Insolvency Law* 1.

33 Smith, *The Law of Insolvency* 1; Madhuku 1995 *Zimbabwe LR* 85.

34 Goode, *Principles of Corporate Insolvency Law* 1.

35 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 12; Goode, *Principles of Corporate Insolvency Law* 1.

36 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 12.

degree of cross-influence between personal and corporate insolvency is discernible.[37] A number of principles and provisions on personal bankruptcy were incorporated into the English Corporate Insolvency Law.[38] The historical development of the Corporate Insolvency Law in South Africa is considered below.

2.3 Background to Corporate Insolvency Law in South Africa

Corporate Insolvency Law is a branch of Insolvency Law, which provides for the rules and principles relating to the ways in which companies and other juristic entities deal with the consequences of inability to pay debts.[39] Before the law recognised the possibility for individuals to create juristic entities like companies, there were laws dealing with the ways in which individuals were managing specific societal challenges.[40] Even for Insolvency Law, by the time laws were developed to provide for the management of debts by companies, there existed laws that were applicable to natural persons.[41] The law on personal insolvency preceded the development of Corporate Insolvency Law.[42]

This trend of events is also true for South Africa, where company law goes no further than the late nineteenth century.[43] South African Company Law was inherited from England.[44] The birth of English Company law can be traced back to 1844 when the English Parliament enacted the Joint Stock Companies Act of 1844.[45] This was the first piece of legislation that provided for the incorporation of companies as a separate legal entity.[46] By that time, personal Insolvency Law had already been developed.[47] Therefore, it is important to consider the history of personal Insolvency Law in South

37 Rajak, *Insolvency Law; Theory and Practice* 3.
38 *ibid.*
39 Goode, *Principles of Corporate Insolvency Law* 11; Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 11.
40 Orts, *Business Persons: A Legal Theory of the Firm* 22.
41 Goode, *Principles of Corporate Insolvency Law* 9–12. The birth of corporate insolvency law goes back no further than 1844 the year when the English Parliament enacted the Joint Stock Companies Act 1844.
42 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 9.
43 Burdette, 'A Framework for Corporate Insolvency Law Reform in South Africa' 20–40.
44 Burdette, 'A Framework for Corporate Insolvency Law Reform in South Africa'34.
45 7 and 8 Vict. C 110.
46 Goode, *Principles of Corporate Insolvency Law* 11.
47 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 11–12.

Africa and how it impacted and influenced the development of Corporate Insolvency Law.

2.3.1 The origin of Insolvency Law in South Africa

The Insolvency Law of South Africa is rooted in both Roman-Dutch law and English law.[48] The development of both Roman-Dutch Law and English was however highly influenced by the Roman law[49] contained in Table III of the Twelve Tables.[50] The Twelve Tables were a set of ancient Roman laws on execution of judgments.[51] To properly appreciate the history of South African Insolvency Law, it is necessary to look at the influence of Roman-Dutch and English legal systems on South Africa's Insolvency Law.

2.3.1.1 The influence of Roman-Dutch law

The Romans promulgated Table III of the Twelve Tables to provide for a structured procedure through which creditors could enforce their right of recovery against defaulting debtors.[52] This was done through a procedure referred to as *legis actio per manus iniectionem*, which was a form of execution that targeted both the estate of the debtor and his person.[53] This procedure would be used by a creditor after giving the debtor a grace period of thirty days from the date of judgment or, if the debt did not arise out of a court judgment, after the date when the debtor's liability was deemed uncontestable.[54] After the thirty-day grace period, the creditor would be entitled to take the debtor before the *praetor.*[55] A *praetor* was the equivalent of a present day magistrate entrusted with judicial powers to administer civil justice.[56]

Before the *praetor,* the creditor could start the enforcement process by placing his hand upon the debtor while reciting the prescribed words. In the absence of

48 Burdette, A Framework for Corporate Insolvency Law Reform in South Africa' 22.
49 Wessels, *History of the Roman Dutch Law* 663.
50 Burdette, A Framework for Corporate Insolvency Law Reform in South Africa' 22.
51 Mars, *The Law of Insolvency of South Africa* 1–2.
52 Burdette, A Framework for Corporate Insolvency Law Reform in South Africa' 22.
53 Graham, 'A Critical Analysis of Problem Areas in Respect of Assets of Insolvent Estates of Individuals' 22.
54 Twelve Tables 3.1; Graham, 'A Critical Analysis of Problem Areas in Respect of Assets of Insolvent Estates of Individuals' 22.
55 Burdette, 'A Framework for Corporate Insolvency Law Reform in South Africa' 21–23.
56 Olga, *Short History of Roman Law* 40.

intervention by a third party, referred to as a *vindex*, the creditor would be allowed to proceed with enforcement against the person of the debtor. The role of the *vindex* was to dispute the debtor's liability and the creditor's right of seizure.[57] If the *vindex* failed to prove his dispute to the creditor's right against the debtor, the *vindex* would be ordered to pay double the original amount.[58]

In the event that there was no *vindex* to intervene on behalf of the debtor, or where the *vindex* was not successful in his objection to the creditor's action against the debtor, the *praetor* would issue an order authorising the creditor to hold the debtor in private prison for a period of sixty days.[59] During the prison term, the creditor was required to bring the debtor before the *praetor* in the *comitium* on three consecutive market days on which the creditor would announce in public the amount of debt that he or she claimed from the debtor.[60] The purpose of the market public annoucement was to allow the debtor an opportunity to gain sympathy from members of the public to probably help him or her to settle the debt or secure his or her release from prison.[61] If the debtor failed to pay the debt, the creditor could, during the third market day, either kill the debtor or sell him or her into slavery.[62] If the same debtor was indebted to more than one creditor, all the claiming creditors were entitled to cut the debtor's body into pieces and share the body parts amongst themselves in proportions equal to the amount of money claimed by each of them against the debtor.[63]

The apparent viciousness of this procedure caused the Roman leadership to change this legal procedure around 325–356 BC; when a less severe law, *lex poetilia,*[64] was passed to abolish the fettering, imprisonment and putting to death of the debtor. The *Lex poetilia* introduced the *manus iniectio* procedure, through which the debtor was

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57 Kaser and Dannebring, *Roman Private Law* 338.
58 Graham, 'A Critical Analysis of Problem Areas in Respect of Assets of Insolvent Estates of Individuals' 22.
59 Visser 1980 *DJ* 42.
60 Burdette, A Framework for Corporate Insolvency Law Reform in South Africa' 23.
61 Graham, 'A Critical Analysis of Problem Areas in Respect of Assets of Insolvent Estates of Individuals' 22.
62 Visser 1980 *DJ* 44; Kaser and Dannebring, *Roman Private Law* 338.
63 Graham, 'A Critical Analysis of Problem Areas in Respect of Assets of Insolvent Estates of Individuals' 23.
64 *ibid*.

allowed to work off his debt as a debt-slave for the creditor[65] until after the value of the debt was fully recovered.[66]

The *manus iniectio* procedure in the *Lex poetilia* was followed by further legal innovations that led to the adoption of another procedure referred to as *missio in possessionem* which made it possible for the creditor to execute against the property of the debtor.[67] Through a *praetorian* order, the creditor could be authorised to take possession of the debtor's property, and if the debtor failed to pay after the prescribed period of attachment, a second *praetorian* order would be made to elect a *magister bonorum* to supervise the sale of the property.[68] If the debtor remained in default even after this second *praetorian* order, a third order would be made authorising the sale of the debtor's property to whoever offered the best price to the creditor(s).[69]

Under Roman Law, the execution procedures were generally focussed on protecting the interests of the creditor to recover his or her debt.[70] No attempt was made to protect the debtor against the consequences of inability or failure to pay debt.[71] This trend, however, changed around 17 AD when the *lex Iulia de bonis cedendis* was passed to allow a debtor to surrender his or her property to the creditor as an alternative to suffering execution against his or her person.[72]

The legal regime was not different in Holland. It is reported that the Roman legal procedure of *cessio bonorium* was introduced in Holland around the 15th and 16th centuries.[73] *Cessio bonorium,* which is latin for *a 'surrender of goods'*, was a debt relief procedure under Roman law through which a debtor whose inability to pay debt was not attributed to his or her own financial indiscretion or fault, could be allowed to enter into a vulunatry composition or arrangement with his or creditors.[74] Through this procedure, the innocent debtor would not be discharged from the debt unless the

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65 Graham, 'A Critical Analysis of Problem Areas in Respect of Assets of Insolvent Estates of Individuals' 24.
66 *ibid*.
67 Visser 1980 DJ 44; Kaser and Dannebring, *Roman Private Law* 45.
68 Burdette, 'A Framework for Corporate Insolvency Law Reform in South Africa' 24.
69 Visser 1980 DJ 44.
70 Graham, 'A Critical Analysis of Problem Areas in Respect of Assets of Insolvent Estates of Individuals' 24.
71 Burdette, 'A Framework for Corporate Insolvency Law Reform in South Africa' 25; Visser 1980 *DJ* 46.
72 Burdette, 'A Framework for Corporate Insolvency Law Reform in South Africa' 25.
73 Burdette, 'A Framework for Corporate Insolvency Law Reform in South Africa' 26.
74 Levinthal 1918 *University of Pennsylvania LR* 238.

property he surrendered to the creditors was sufficient to pay off all the creditors, but it would protect him or her against being arrested and imprisoned for the debt.[75] When the Dutch occupied the Cape in 1652, they brought with them the Dutch *cessio bonorum* procedure, which had been introduced in Holland as part of the Roman-Dutch law.[76]

The *cessio bonorum* remained the main system of Insolvency Law in the Cape from 1803[77] until 1829 when Ordinance no. 64 was introduced to regulate the administration of insolvent estates. The 1829 ordinance remained applicable up to 1843 when it was repealed and replaced by Ordinance 6 of 1843, which is considered the landmark in South African Insolvency Law.[78] Moreover, even in the other provinces like Natal and Transvaal, their insolvency legislation was modelled on the principles contained in Ordinance 6 of 1843. In Natal, its remodelled Insolvency Ordinance 24 of 1843 was later repealed by the Insolvency Law 47 of 1887. This piece of legislation was substantially the same as the Cape Ordinance no. 6 of 1843.[79] In the Transvaal, the Cape Ordinance influenced the making of Ordinance 21 of 1880, which was later replaced with *Insolventiewet* 13 of 1895.[80]

These pieces of legislation were used to regulate insolvency matters in the respective provinces of South Africa until the Union of South Africa was formed and eventually culminated into the passing of the Insolvency Act 32 of 1916, which was a unified Act applicable to the entire Republic.[81]

The Insolvency Act 32 of 1916 was later repealed and replaced by the Insolvency Act 24 of 1936, which is still the basic law on personal insolvency in South Africa.

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75 Levinthal 1919 *University of Pennsylvania LR* 238.
76 Wessels, *History of the Roman Dutch law* 661.
77 Graham, 'A Critical Analysis of Problem Areas in Respect of Assets of Insolvent Estates of Individuals' 49.
78 Wessels, *History of the Roman Dutch law* 661; Graham, 'A critical analysis of problem areas in respect of assets of insolvent estates of individuals' 50.
79 Graham, 'A Critical Analysis of Problem Areas in Respect of Assets of Insolvent Estates of Individuals' 50.
80 Buchanan, *Buchanan's Decisions in Insolvency* 239.
81 Graham, 'A Critical Analysis of Problem Areas in Respect of Assets of Insolvent Estates of Individuals' 50.

2.3.1.2 The influence of English law

English Insolvency Law developed along more or less the same principles as those contained in the *cessio bonorum* procedure of Roman-Dutch law.[82] Similar to the Roman-Dutch legal regime, English Bankruptcy law was primarily developed as an official formal procedure to facilitate the orderly collection and realisation of the debtor's estate for distribution among his or her creditors.[83]

The initial English insolvency legislation focused on enabling creditors to attach the person and later the property of defaulting debtors.[84] The first formal bankruptcy statute in England was introduced in 1542 during the reign of Henry VIII, with the objective of denouncing the practice of debtors defrauding their creditors.[85] The Bankruptcy Acts 34 and 35 of 1542 provided for the sale and rateable distribution of the debtor's property amongst creditors, and is said to have marked the birth of the *pari passu* principle[86] in English Insolvency Law.[87]

The preamble to and section 1 of the Bankruptcy Act 34 of 1542 summarised how the debtors of that time were looked at and the effects of being declared bankrupt.[88]

> Where divers and sundry persons craftly obtaining into their hands great substance of other men's goods do suddenly flee to parts unknown or keep their houses, not minding to pay or restore to any of their creditors their debts and duties, for their own pleasure consume the substance obtained by credit of other men, for their own pleasure and delicate living, against all reason, equity and good conscience…the Lord Chancellor shall have power and authority by virtue of this Act to take… imprisonment of their bodies or otherwise, as also with their real and personal property however held and to make sale of the said real or personal property however held for true satisfaction and payment of the said creditors, that is to say to every of the said creditors a portion, rate and rate alike, according to the quantity of their debt.[89]

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82 Goode, *Principles of Corporate Insolvency Law* 10.

83 *ibid.*

84 Burdette, 'A Framework for Corporate Insolvency Law Reform in South Africa' 27.

85 Goode, *Principles of Corporate Insolvency Law* 10.

86 *Pari passu* is a latin phrase which means 'with an equal step' or 'on equal footing', and is recognised as a fundamental rule of corporate insolvency law. The rules provides that in a winding up, unsecured creditors shall share rateably in the assets of the insolvent company that are available for residual distribution amongst all qualified creditors. See Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 511; Goode, *Principles of Corporate Insolvency Law* 235–248.

87 Tolmie, *Corporate and Personal Insolvency Law* 8.

88 Jordan, 1991 *Am. Bankr LJ* 325.

89 34 and 35 Hen. VIII, C.4 (1542).

The Bankruptcy Act 34 of 1542 was repealed and replaced during the reign of Queen Elizabeth when Parliament passed what is referred to as the second of the English Bankruptcy Acts 13 of 1570,[90] which is said to have been a more comprehensive statute on Insolvency Law.[91] Among other things, this piece of legislation limited the scope of bankruptcy law to traders and merchants only.[92] 'Traders' were defined as persons who earned a living through selling and buying merchandise.[93] At that time, the English bankruptcy regime believed in the theory that whereas traders might become insolvent through accident or misfortunes such as loss of a ship or genuine failure of business, the insolvency of a private individual (non–trader) was almost invariably due to their profligacy.[94] Consequently non–traders deserved no legal sympathy or protection. It was believed that

> Traders are generally speaking the only persons liable to accidental losses and to an inability of paying their debts without any fault of their own. If persons in other situations of life run into debt without the power of payment, they must take the consequences of their indiscretion. The law holds it to be an unjustifiable practice for any person but a trader to encumber himself with debt of any considerable value.[95]

This resulted into the creation of two insolvency systems to cater for the bankruptcy of traders and non–traders.[96] Insolvent individuals, or non–traders, continued to be subjected to harsh enforcement actions such as imprisonment and even death. Traders on the other hand enjoyed the protection of statutes such as the Lord Redesdale Act 53 of 1813, which established a special court for the relief of insolvent debtors.[97]

The Bankruptcy Act of 1570 was amended in 1604[98] by the law entitled 'An Act for the Better Relief of the Creditors Against such as Shall Become Bankrupt',[99] which among other things, increased the powers of the Commissioner to investigate frauds

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90 Leibell, 1940 *Fordham Law Review* 381. Available at: http//ir.lawnet.fordham. ed/flr/vol9/iss3/5 (04-05-2019).
91 Tolmie, *Corporate and Personal Insolvency Law* 8; Leibell, 1940 *Fordham Law Review* 381.
92 Tolmie, *Corporate and Personal Insolvency Law* 8.
93 Section 6 of the English Bankruptcy Acts 13 Eliz Ch.7 1570.
94 Goode, *Principles of Corporate Insolvency Law* 10.
95 Langbein, *Sir William Blackstone's Commentaries of laws of England* 581. Available at http://files.libertyfund.org/files/2140/Blackstone_138701_EBk_v6.0.pdf (11–05–2019).
96 Goode, *Principles of Corporate Insolvency Law* 11.
97 Goode, *Principles of Corporate Insolvency Law* 11.
98 1 Jac. 1, C.15 of 1604.
99 The Bankruptcy Act C.15 of 1604.

committed by the bankrupt, and to depose persons thought to be in possession of the bankrupt individual's assets.[100] The Commissioners were the wise, honest and discrete persons that were appointed by the Lord Chancellor, from amongst the creditors, to manage the bankrupt's property and affairs for the benefit of all his or her creditors.[101]

Several other statutes were introduced to empower creditors to imprison debtors for non–payment of debts.[102] For instance, whereas the statutes of Henry VIII and Elizabeth generally treated the bankrupt as a criminal who cheated honest men of their debts and was liable to imprisonment,[103] Parliament enacted Act 21 of 1623 to provide that pillory and the loss of an ear should be the penalty imposed upon a debtor who failed to prove that his or her bankruptcy was solely caused by misfortune.[104] The aim of these pieces of legislation was to punish rather than to rehabilitate the debtor.[105]

With time, the apparent unfairness of the bankrupcty regime, especially to non–trader debtors, generated pressure for reform.[106] At that time, non–traders were still subject to the severities of non–collective common law enforcement procedures involving seizures and impounding of property and persons, which often resulted into debtors being imprisoned at the behest of single creditors without regard to the interests of others.[107]

This saw the enactment of the Bankruptcy Act of 1861 which, among other things, abolished the long standing distinction between the law applicable to traders and non–traders.[108] In turn, the Debtors Act 1869 abolished[109] imprisonment of any person, including traders and non–traders for debt.[110]

As changes continued to occur in society, even English Insolvency Law kept changing; indeed, during the nineteenth century, English Insolvency Law was subjected to a

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100 1. Jac. I, C.15 sec. V; Edward, *The Origin, Progress and present practice of the Bankruptcy Law in England and Ireland* 27.
101 Leventhal 1919 *University of Pennsylvania Law Review* 17.
102 Burdette, A Framework for Corporate Insolvency Law Reform in South Africa' 27.
103 Leventhal 1919 *University of Pennsylvania Law Review* 17.
104 Leventhal 1919 *University of Pennsylvania Law Review* 17.
105 Goode, *Principles of Corporate Insolvency Law* 10.
106 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 11.
107 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 11.
108 Section 69 of the Bankruptcy Act 1861; Goode, *Principles of Corporate Insolvency Law* 11.
109 Section 4 of the Debtors Act 1869.
110 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 11.

series of reforms.[111] Nearly fifty pieces of insolvency legislation were introduced.[112] The most relevant was the Joint Stock Companies Act 1844, which introduced, for the first time in English law, provision for the incorporation of a company as a distinct legal entity.[113] Around the same time, the Joint Stock Companies Winding-Up Acts of 1844 and 1849 were passed to provide for the management of company insolvencies. Moreover, the Joint Stock Companies Winding-up Act of 1849 conferred general winding–up jurisdiction on the Court of the Chancery.[114]

The Bankruptcy Act of 1861 was also subsequently amended in 1869.[115] It was again amended in 1883 and later replaced by the Bankrupcty Act of 1914, which was amended in 1926 and 1976, and remained in operation, regulating personal insolvency in England until 1986 when the Insolvency Act was enacted.[116]

These developments in English Insolvency Law invariably influenced the development of South African law.[117] It is a widely acknowledged fact that the statutory provisions in the Insolvency Act 24 of 1936 contain strong elements of English law.[118] Indeed, in *Pearl Assurance Company v Union Government*,[119] Lord Tomlin of the Privy Council stated that the development of law, including Insolvency Law, in South Africa has been affected appreciably by the English law.[120]

2.3.2 Corporate Insolvency Law in South Africa

The concept of corporate legal personality was first introduced in the Cape during the pre-union era, through the Joint Stock Companies Limited liability Act 23 of 1861.[121]This piece of legislation was a replica of the English Joint Stock Companies

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111 Burdette, 'A Framework for Corporate Insolvency Law Reform in South Africa' 29.
112 Burdette, A Framework for Corporate Insolvency Law Reform in South Africa' 29.
113 Goode, *Principles of Corporate Insolvency Law* 11; Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 11.
114 Goode, *Principles of Corporate Insolvency Law* 11.
115 The Bankruptcy Act of 1869 was enacted, and most notably, repealed voluntary surrender of a debtor's estate.
116 Burdette, 'A Framework for Corporate Insolvency Law Reform in South Africa' 32.
117 Burdette, A Framework for Corporate Insolvency Law Reform in South Africa' 34.
118 *ibid.*
119 (1934) AD 560 (PC) 563; (1934) AC 570, 578.
120 Schreiner, *The contribution of English law to South African law and the Rule of law in South Africa* The Hamlyn Lectures 19th Series (Juta Cape Town 1967) 16. Available at https://socialsciences.exeter.ac.uk/media/universityofexeter/schoolofhumanitiesandsocialsciences/law/pdfs/The_Contribution_of_English_Law_to_South_African_Law.pdf (21-03-2019).
121 Burdette, A Framework for Corporate Insolvency Law Reform in South Africa' 38.

Act of 1844[122] and the Limited Liability Act of 1855.[123] The same English legislation was used to model the Corporate Insolvency Law that was applied in Natal, Transvaal and the Orange Free State.[124]

Following the unionisation of the South African states in 1910, the union government enacted the Companies Act 46 of 1926, the first statute on companies in post-Union South Africa.[125] The Companies Act 46 of 1926 was based on the Transvaal Companies Act 31 of 1909, which was also copied from the English Companies (Consolidation) Act of 1908.[126]

South Africa inherited most of the English Company Law principles, so much so that when the English Companies (Consolidation) Act of 1908 was amended and replaced by the English Companies Act of 1929, and later the Companies Act of 1948, the South Africa legislature continuously reviewed the Companies Act 46 of 1926 to reflect the same changes. It was, in fact, due to the changes in the English Company Law, that the South African government appointed the Lansdown Commission to see to the enactment of the Companies Amendment Act 23 of 1939, and later the Companies Amendment Act 46 of 1952 in accordance with the recommendations of the Millin Commission.[127]

As changes continued to take place, especially in the English Company Law, the Van Wyk de Vries Commission of enquiry was appointed on 14 October 1963, to review and make recommendations for the improvement of the South African Companies Act.[128]

In its report of 1970, the Van Wyk de Vries Commission recommended the repeal and replacement of the Companies Act 46 of 1926.[129] In 1973, the Companies Act 61 of 1973 (the 1973 Companies Act) was enacted. This legislation, among other things, introduced chapter XIV, which specifically provides for the winding-up of companies,[130] and Chapter XV regulating judicial management of financially distressed companies.

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122 7 and 8 Victoria Ch 110.
123 18 and 19 Victoria Ch 133.
124 Burdette, A Framework for Corporate Insolvency Law Reform in South Africa' 38.
125 *ibid.*
126 Burdette, A Framework for Corporate Insolvency Law Reform in South Africa' 38.
127 Burdette, A Framework for Corporate Insolvency Law Reform in South Africa' 39.
128 Benade 1970 *The Comparative and International Law Journal of Southern Africa* 277–308.
129 *ibid.*
130 Benade 1970 *The Comparative and International Law Journal of Southern Africa* 277–308.

Although the Van Wyk de Vries Commission had endeavoured to be innovative in the manner in which the new company law was directed more appropriately for South Africa, the 1973 Companies Act remained much in the mould of the English law.[131]

Despite the inclusion of winding-up provision in chapter XIV, the 1973 Companies Act failed to proscribe the import of section 339. This section provided for the application of the law on insolvency to the administration of insolvent companies. The result was that the duality of statutes regulating matters concerning the winding-up of companies that were unable to pay their debts was entrenched.[132] Moreover, the procedures for winding up of companies was complicated. One had to first juggle through different legal provisions in the 1973 Companies Act and the Insolvency Act 24 of 1936 to determine the right course of action before commencing a winding-up process.[133] Chapter XV of the 1973 Companies Act also provided for judicial management as an alternative remedy for financially distressed companies. However, judicial management was not an effective rescue measure for companies in financial distress.[134]

Later on, in 1984, the government of South Africa introduced the Close Corporations Act 69 of 1984 (the Close Corporations Act) to provide a simple inexpensive business entity offering limited liability for a single person enterprise or those involving not more than ten persons.[135] Part IX of the Close Corporations Act provides for winding-up of close corporations, and goes on in section 66 to allow for the application of the 1973 Companies Act to the winding-up of close corporations. The intention of government might have been good insofar as the Close Corporations Act created an easier procedure for small entrepreneurs to formalise their businesses by creating a purportedly special winding-up procedure for close corporations in the Close Corporations Act. However, allowing the application of the 1973 Companies Act to close corporations worsened the confusion surrounding the procedures for winding-up of insolvent companies in South Africa.[136]

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131 The Department of Trade and Industry *South African Company law for the 21st Century: Guidelines for Corporate Law Reform 2004* 13.

132 Burdette, A Framework for Corporate Insolvency Law Reform in South Africa' 71.

133 *ibid*.

134 Loubser, 'Some Comparative Aspects of Corporate Rescue in South African Company Law' 3.

135 The Department of Trade and Industry *South African Company law for the 21st Century: Guidelines for Corporate Law Reform 2004* 13.

136 Burdett, 'A Framework for Corporate Insolvency Law Reform in South Africa' 142.

In 2004, the South African Department of Trade and Industry undertook a comprehensive review of South African company law.[137] The purpose was to ensure that the regulatory framework within which enterprises operate promotes entrepreneurship, economic growth, investment and international competitiveness, coupled with efficiency, adoptability and good corporate governance principles.[138] This culminated into the enactment of the Companies Act 71 of 2008 (the Companies Act 2008), which contains elaborate procedures on corporate insolvency and a whole chapter 6 dedicated to business rescue. Chapter 6 of the Companies Act 2008 replaced chapter XV of the 1973 Companies Act, which provided for placing a distressed company under judicial management.[139]

2.4 Objectives of Corporate Insolvency Law

By its very nature, the law regulating corporate insolvency intrudes on an extensive diversity of interests and affects a wide range of parties that may have interests in the continued existence of the company or the business. These stakeholders include creditors, employees, and the community.[140] Since time immemorial, this has left policy makers, judges, practitioners, and scholars divided on the legitimate goals of Corporate Insolvency Law.[141]

Scholars from mainly the United States have dominated the debate about the true goal of insolvency law.[142] In the main, there are two theoretical standpoints: the traditionalists and the proceduralists.[143]

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137 Burdett, 'A Framework for Corporate Insolvency Law Reform in South Africa' 142.

138 Cassim and Cassim 2005 *International Company and Commercial Law Review* 1.

139 Loubser, 'Some Comparative Aspects of Corporate Rescue in South African Company Law' 3–7.

140 Ruzita, 'Theories, objectives and principles of corporate insolvency law: A comparative study between Malaysia and UK' Paper delivered at the 3rd International conference on management on 10–11 June 2013 Conference paper January 2013 668. Available at https://www.researchgate.net/publication/312091789_THEORIES_OBJECTIVES_AND_PRINCIPLES_OF_CORPORATE_INSOLVENCY_LAW_A_COMPARATIVE_STUDY_BETWEEN_MALAYSIA_AND_UK (8–07–2019).

141 Nsubuga 2016 *NIBLeJ* 4.

142 Goode, *Principles of Corporate Insolvency Law* 70.

143 Baird 1986 J LS 127, 133; Nsubuga 2016 *NIBLeJ* 4.

The proceduralists look at Insolvency Law chiefly as being concerned with providing a means for the maximisation of value for creditors.[144] They argue that the primary function of Insolvency Law is to respect pre-bankruptcy entitlements, and to organise a collective procedure to facilitate the attainment of the rights of the respective pre-insolvency creditors.[145] Sometimes referred to as the 'creditor wealth maximisation-approach' to Insolvency Law,[146] this theory reflects the fundamental assumption underlying Insolvency Law that the interests of individual creditors, and in particular their rights to collect the debts due to them using individual actions, must give way to the collective interests of the general body of creditors.[147] Proponents of the proceduralists theory contend that Insolvency Law should focus only on addressing issues that arise out of the insolvency processes, and that Insolvency Law should not protect non-insolvency claims or entitlements unless doing so would facilitate maximisation of value for creditors.[148]

The traditionalists; on the other hand, argue that Insolvency Law is an inclusive procedure that seeks to harmonise and ensure equal consideration of the interests of all parties involved or affected by the insolvency of a business.[149] Sometimes referred to as the 'broad-based contractarian approach' to Insolvency Law,[150] proponents of this theory fervently oppose the notion that Insolvency Law exists only to serve the interests of creditors.[151] This theory contends that Insolvency Law should encompass the principle of inclusion, which recognises all parties affected by financial distress of a company and allows them to press their demands. It advocates for the principle of rational planning, which seeks to ensure a fair determination of whether, and to what extent, all affected persons should be able to enforce their respective legal rights and exert leverage during the insolvency process.[152]

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144 Nsubuga 2016 *NIBLeJ* 4.
145 Goode, *Principles of Corporate Insolvency Law* 70.
146 Baird and Jackson 1984 *University of Chicago LR* 97.
147 Goode, *Principles of Corporate Insolvency Law* 61.
148 Mooney, 'A Normative Theory of Bankruptcy law: Bankruptcy Law As (is) Civil Procedure' (2003) Univ. of Penn. Law School, Institute for law and Economics, Research Paper no 03-27 02; Nsubuga 2016 *NIBLeJ* 2.
149 Nsubuga 2016 *NIBLeJ* 4.
150 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 33.
151 Korobkin 1993 *Tex. L. Review* 554.
152 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 34.

In addition to these traditional theories, some scholars have also propounded other theories such as the communitarian theory, which sees insolvency proceedings as intended to weigh the interests of a broad range of different constituents.[153] Promoters of this theory contend that Insolvency Law plays a communitarian role through its effect of allowing the redistribution of value by ensuring that upon insolvency, high priority claimants give way to others, including the community, during the sharing of value of an insolvent company.[154] The communitarian theory regards individuals as being interdependent of each other. These theorists contend that it is incumbent upon the different affected individuals to act in the best interests of their communities, even if doing so prejudices their own individual freedom.[155]

Others argue that Insolvency Law serves a series of values and interests that cannot be organised into neat priorities.[156] This 'eclectic approach' to Insolvency Law contends that Insolvency Law is a multi-value subject with unpredictable outcomes of a wide range of factors informed by multiple policy decisions incapable of precise definition.[157] These theorists view insolvency processes as intended to achieve diverse objectives such as distributing the consequences of financial failure amongst a wide range of actors, establishing priorities between creditors, protecting the interests of future claimants, offering opportunities for possible continuity, rehabilitating businesses,[158] as well as protecting the interests of other parties like employees, suppliers, neighbours and the wider public.[159]

Despite the absence of consensus regarding the normative outlook of Corporate Insolvency Law, there is wide recognition that it developed with the primary aim of replacing the free-for-all legal regime in which creditors' rights and remedies would be suspended. Instead, it is geared to provide a process for the orderly collection, realisation and fair distribution of the debtor's assets according to the creditors' claims.[160]

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153 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 35.
154 *ibid*.
155 Gross 1994 *Washington University Law Quarterly* 1031–33.
156 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 36.
157 Warren, 1987 *University of Chicago LR* 775–814.
158 Korobkin 1991 *Columbia LR* 717.
159 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 36.
160 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 1.

Arguably, right from the medieval Roman-Dutch, and later English times, Insolvency Law policies have largely been driven by three distinct but dominating objectives: to punish the bankrupts, to organise administration of the debtor's assets so that competing creditors are treated fairly and efficiently, and the hope that the insolvent debtor could be rehabilitated.[161] The policy objectives, although initially meant for personal or individual insolvency, have had a lot of influence on the development of Corporate Insolvency Law not only in England but also in South Africa.[162] This influence is visible even in the list of objectives of modern Insolvency Law as postulated by the Cork Committee.[163]

According to the English Cork Report,[164] modern Corporate Insolvency Law should focus on attaining the following objectives:

(a) To underpin the credit system and cope with its casualties;
(b) To diagnose and treat an imminent insolvency at an early stage;
(c) To prevent conflicts between individual creditors;
(d) To realise the assets of the insolvent to satisfy the debts with minimum delay and expense;
(e) To distribute the proceeds of the realisation amongst creditors fairly and equitably, returning any surplus to the debtor;
(f) To ensure that the processes of realisation and distribution are administered honestly and competently;
(g) To ascertain the causes of the insolvent's failure and if the conduct merits criticism or punishment, to decide what measures must be taken to address the failure;
(h) To recognise and safeguard the interests not merely of insolvents and their creditors but of society and other groups affected by the insolvency; and

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161 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 8.
162 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 27.
163 The Cork Committee was commissioned by the Labour government in 1977 to investigate and make recommendations on modernization and reform of UK insolvency Law. The Committee issues its report in 1982, which was followed by a White Paper in 1984, a Revised Framework for Insolvency Law (1984) Cmnd 9175, which resulted into the English Insolvency Acts of 1986.
164 Report of the Review Committee on Insolvency Law and Practice (Cmnd 8558, 1982).

(i) To preserve viable commercial enterprises capable of contributing usefully to national economic life.[165]

These objectives are summarised in three broad perspectives, sometimes described as the overriding objectives of Corporate Insolvency Law:[166]

1. to maximise returns for creditors;
2. to establish a fair and equitable system for the ranking of claims and distribution of assets amongst creditors; and
3. to provide a mechanism by which the causes of corporate failure are established and those found guilty of mismanagement punished for their omissions or actions, and where appropriate, deprived of the right to be involved in the management of other companies.[167]

These are the historical objectives of Corporate Insolvency Law, which underpin the normative philosophy of Corporate Insolvency Law across many jurisdictions.[168] Below, the three overarching motivations of Insolvency Law are discussed in more detail.

2.4.1 Maximising returns to creditors

This objective is mainly espoused by scholars in the law and economics research movement[169] from mostly the United States of America,[170] who argue that the proper function of Insolvency Law can be viewed in terms of a single objective: to maximise the collective return to creditors.[171] One of the leading proponents of this approach, Jackson, argues that Insolvency Law is merely a tool for debt collection in response

165 Report of the Review Committee on Insolvency Law and Practice Cmnd 8558 (London HSMO, 1982) para 198.
166 Goode, *Principles of Corporate Insolvency Law* 58.
167 Goode, *Principles of Corporate Insolvency Law* 58.
168 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 28.
169 Bhandari and Weiss, *Corporate Bankruptcy: Economic and Legal Perspectives* 308.
170 Baird 1986 *JLS* 127; Jackson and Scott 1989 *Va.L Review* 155.
171 Baird and Jackson 1984 *University of Chicago* 97.

to the problem of diverse owners enforcing their rights against the remaining pool of the debtor's assets.[172]

Proponents of the creditor-wealth maximisation objective contend that all policies and rules of Insolvency Law are and should be designed to ensure that the returns to creditors as a group are maximised.[173] This view is well received and has even been put into legislative effect in some jurisdictions, like Germany.[174] The German Bankruptcy Code of 1994 aims to establish a system that will enhance market exchange processes and rationalise debt collection rather than supersede market processes.[175]

It is contended that Insolvency Law focuses primarily on ensuring that creditors get maximum returns from the insolvent's estate through specific rules and procedures that ensure that the company assets are not removed from the reach of creditors.[176] This is done by emphasising rules such as anti-deprivation and *pari passu*, which were specifically designed to strike down arrangements and transactions that would otherwise have the effect of reducing the assets available for distributions to creditors.[177] These rules ensure that the interests of individual creditors, especially the right to collect their debts through other enforcement methods, are suspended to give way to the collective interests of the general body of creditors.[178]

However, the focus on creditor wealth maximisation and debt collection has been highly criticised for being insensitive to the interests of non-creditor stakeholders such as employees, the community and suppliers.[179] It is argued that treating insolvency as

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172 Jackson 1982 Yale LJ ch 1–2; Finch and Milman *Corporate Insolvency Law: Perspective and Principles* 32–40.

173 Ruzita A Theories, objectives and principles of corporate insolvency law: A comparative study between Malaysia and UK, Paper delivered at the 3rd International conference on management on 10 -11 June 2013 Conference paper January 2013 668. Available at https://www.researchgate.net/publication/312091789_THEORIES_OBJECTIVES_AND_PRINCIPLES_OF_CORPORATE_INSOLVENCY_LAW_A_COMPARATIVE_STUDY_BETWEEN_MALAYSIA_AND_UK (8-07-2019); Jackson 1982 Yale LJ ch 1–2; Goode, *Principles of Corporate Insolvency Law* 58.

174 Balz 1997 *Brooklyn Journal of International Law* 170–171.

175 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 29.

176 Goode, *Principles of Corporate Insolvency Law* 58.

177 Niven 2017 Insolv LJ 5. Available athttps://www.buddlefindlay.com/media/2101/peter–.–niven-insolv-lj-v25-pt1.pdf (10-07-2019).

178 Goode, *Principles of Corporate Insolvency Law* 518.

179 Jackson TH, *The Logic and Limits of Bankruptcy Law 1-2.*

a mere boot sale of assets for the benefit of creditors undermines the view that insolvency is a problem of business failure, which must be used to assist companies to continue in operation to avoid liquidation.[180] It also undermines policy arguments that Insolvency Law can facilitate the creation of a moratorium to allow a company to reorganise itself through measures such as schemes of arrangement to preserve jobs which would benefit employees and the community.[181]

For many years, the policy objective to maximise creditor returns dominated the focus of English Insolvency Law.[182] It is unsurprising that the same pro-creditor philosophical focus was transposed onto the South African insolvency system.[183] Through the principle of *concursus creditorum*, which is the foundation of South African Insolvency Law,[184] once a business or company becomes insolvent, the collective rights of creditors as a group are preferred to the rights of individual creditors.[185]

This policy objective has long been recognised as a major influencer of South African Insolvency Law.[186] Several commentators recognise that South African Insolvency Law was developed for the benefit of creditors and not for the relief of the harassed debtors.[187]

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180 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 29.

181 Korobkin 1991 *Columbia LR* 717; Dworkin 1980 *Journal of Legal Studies* 191.

182 Kilborn and Walters, 'Involuntary Bankruptcy as Debt Collection: Multi-Jurisdictional Lessons in Choosing the Right Tool for the Job' (5-11-2012) Chicago-Kent College of Law Research Paper no 2012-.–15 2. Available at SSRN: https://ssrn.com/abstract=2171441 or http://dx.doi.org/10.2139/ssrn.2171441 (17-06-2019).

183 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 27–28.

184 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 27–28.

185 In *The body corporate of Empire Gardens v Nobuhle Gloria Sithole* [2017] ZASCA 28 paras 9–11 the court emphasised that the purpose and effect of the sequestration process is to bring about a convergence of the claims in an insolvent estate to ensure that is wound up in an orderly fashion and that the creditors are treated equally.

186 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 32.

187 *R v Meer and Oandthers* 1957 (3) SA 614, 619; Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 32.

2.4.2 Establishing a system for fair distribution

One of the most prevalent phenomena in virtually all insolvencies is the scramble for priority to payments amongst the different groups or classes of creditors.[188] Insolvency Law seeks to provide a mechanism through which creditors' claims are paid fairly and equitably. Payments are deemed to be made equitably when creditors with similar legal rights are treated fairly, and their claims are paid in accordance with their relative ranking and interests.[189]

Corporate Insolvency Law must balance divergent interests. It must provide for mechanisms for the fair distribution of the proceeds from realisation of the distressed company's estate amongst both the high priority claimants, like the fixed and floating charge holders, and the low priority claimants, such as the community.[190] This is sometimes referred to as the 'communitarian approach' to Insolvency Law.[191] It sees insolvency processes as weighing the interests of a broad range of differing constituents, and advocates for the distribution of values so that on insolvency, 'high-priority claimants may, to some extent, give way to others, including the community in sharing the value of the insolvent entity.'[192]

Whereas English Corporate Insolvency Law approaches the subject from the general view that pre-insolvency rights ought to be respected, it also recognises and plays a redistributive role through rules of subordination and avoidance.[193] This aim should not be seen as a deviation from the protection of creditor's rights, but as a core and unavoidable function of Insolvency Law.[194]

The 'communitarian vision', however, is highly opposed by the credit maximisation proponents. They view the 'communitarian vision' as clouding Insolvency Law with diversionary considerations such as employment security and environmental

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188 Baird 2017 *University of Pennsylvania LR* 785, 789; Waiswa, 'A Comparative Analysis of the Legitimacy of the Use of Insolvency Proceedings as a Debt Collection Tool in the UK and Uganda'23.

189 UNCITRAL Legislative Guide on Insolvency Law Parts One and Two (2004) 11.

190 Warren 1993 *Michigan LR* 336–87. Available at: www.jstor.org/stable/1289668 (25–03–2019).

191 *ibid.*

192 Warren 1993 *Michigan LR* 336–87*.*

193 Goode, *Principles of Corporate Insolvency Law* 62.

194 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 36.

protection, which are ordinarily out of the realm of corporate management.[195] Schermer[196] argues that it is impossible to delineate the community and an infinite number of interests that are at stake in each bankruptcy, making the boundaries almost limitless. Almost anyone ranging from employees to distant suppliers can claim to have suffered some form of loss because of the failure of a once viable local business.[197] Therefore, Insolvency Law ought to ensure fair distribution of the proceeds of the estate of the insolvent to creditors within the defined rules and principles. Pre-insolvency rights should be respected while implementing the redistribution rules of subordination and avoidance.[198]

However, what is evident from the evolving legislation is that the aims of sound modern Insolvency Law must include a recognition that the effects of insolvency are not limited to the private interests of the insolvent and the creditors alone.[199] Other interests of society and stakeholders affected by the insolvency and its outcome, and the public interest, must also be recognised and safeguarded.[200]

2.4.3 Identifying the causes of company failure and sanctioning of culpable directors

To mitigate incidents of corporate failures by preventing similar mistakes in businesses in future, one of the central objectives of modern insolvency is to investigate the causes of the corporate failure.[201] Insolvency legislation empowers liquidators to investigate the causes of failure, and where possible, recommend imposition of criminal and/or civil liability for anyone found culpable.[202]

The United Kingdom's Insolvency Act 1986, the South African Companies Act 2008 and the 1973 Companies Act as well as the Ugandan Insolvency Act of 2011, all vest

195 Waiswa, 'A Comparative Analysis of the Legitimacy of the Use of Insolvency Proceedings as a Debt Collection Tool in the UK and Uganda' 24.
196 Schermer 1994 *Washington University Law Quarterly* 1049, 1051.
197 *ibid*.
198 Goode, *Principles of Corporate Insolvency Law* 62.
199 Waiswa, 'A Comparative Analysis of the Legitimacy of the Use of Insolvency Proceedings as a Debt Collection Tool in the UK and Uganda' 25.
200 Law Commission, 'Insolvency Law and Practice' Report of the (Cork) Review Committee (Comnd.8558, 1982) para 198.
201 Goode, *Principles of Corporate Insolvency Law* 62; Waiswa, 'A Comparative Analysis of the Legitimacy of the Use of Insolvency Proceedings as a Debt Collection Tool in the UK and Uganda' 25.
202 Goode, *Principles of Corporate Insolvency Law* 62.

powers on the insolvency practitioners to, among other things, investigate and examine relevant documents and the conduct of the company directors.[203] The purpose of the investigative power is to allow the insolvency practitioner to investigate the pre-insolvency conduct of the company affairs and gain insight so as to provide lessons and guidance to future company directors about the probable causes of business failure.[204]

Unfortunately, the extent to which investigations are conducted is largely dependent on the liquidator's financial and technical capacity to execute his duties.[205] In most cases, the liquidator's and insolvency practitioner's focus is on reducing expenses to retain enough money for distribution to creditors.[206] Allocating funds for investigation of the causes of corporate failure may not be a strategic priority, thereby rendering this objective one of the least practical, since in most cases, insolvency practitioners just do not focus on it and only rush to sell the company assets for the benefit of the creditors.[207]

With the current wave towards developing robust corporate rescue systems, insolvency practitioners must focus more on this objective. It provides a mechanism for profiling the common causes of corporate failure, which can be very handy for other companies.[208]

2.4.4 Other objectives

In addition to the above main objectives of corporate insolvency law, it has been argued[209] that a modern insolvency system should also focus on the following objectives:

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203 Section 213 and 214 of the UK Insolvency Act of 1986; part 29 of the Companies Act 2006 (UK); Sections 105–106 of the Insolvency Act 14 of 2011 of Uganda provide for a mechanism by means of which the affairs of the company and causes of failure of the company may be investigated.

204 Goode, *Principles of Corporate Insolvency Law* 62.

205 Waiswa, 'A Comparative Analysis of the Legitimacy of the Use of Insolvency Proceedings as a Debt Collection Tool in the UK and Uganda' 26.

206 *ibid.*

207 Waiswa, 'A Comparative Analysis of the Legitimacy of the Use of Insolvency Proceedings as a Debt Collection Tool in the UK and Uganda' 26.

208 Joubert and Calitz '2014 *PER/PELJ* 926.

209 Law Commission 'Insolvency law and Practice' Report of the (Cork) Review Committee (Comnd.8558, 1982) paras 197–98.

2.4.4.1 Restoring the company to profitable trading

A sound modern insolvency system is expected, as part of its grand objective, to provide a means for the preservation of viable commercial enterprises capable of making a useful contribution to the economic life of the country.[210] In the opinion of Lord Browne-Wilkinson,[211] the modern Insolvency Law outlook seeks to preserve viable businesses, which is fundamental to the development of a rescue culture.[212]

In choosing an appropriate insolvency procedure, an insolvency practitioner must weigh up the various options and settle on a procedure that promises a better chance to rescue the ailing entity from the jaws of liquidation and its associated negative ramifications.[213]This objective is not one of the historical objectives of Insolvency Law. Insolvency Law developed mainly as a means for punishing or forcing defaulters to pay their debts.[214] However, modern experience has shown that insolvency has far reaching consequences on many stakeholders than just the creditors, which justifies the need to, whenever possible, consider salvaging the companies[215] before considering liquidation. This has necessitated many jurisdictions to include procedures that provide moratoriums to the distressed company to make it possible for them to be rescued.[216]

Sadly, this objective is achieved in only a small percentage of cases. This usually comes about because of a company's voluntary arrangement or a contractually agreed upon reorganisation which may take a variety of forms, including conversion of the debt into equity so that the loans to the company are extinguished and the lenders become shareholders.[217]

210 Law Commission n 189 para 198.
211 *Powdrill v Watson* (1995) 2 AC394 (HL).
212 Chow 2014 *The Student Journal of Law* 6.
213 Omar and Gant 2016 *Insolvency Law Journal* 24, 60.
214 Discussed under 2.3.1.
215 Mugambwa and Amankwah, *Commercial and Business Organisations Law in Papa New Guinea* 563.
216 The Voluntary administration procedure in the UK and Austria and ch11 of the Bankruptcy procedures in the US are all intended to achieve this. Ch 6 of the South Africa's Companies Act 2008 is dedicated to Business rescue and Parts V and VI of Uganda's Insolvency Act, 2011 are dedicated to administration in respect of both individuals and companies.
217 Goode, *Principles of Corporate Insolvency Law* 62.

There is, however, hope that with the current shift of attention towards corporate rescue,[218] it is possible that sooner than later, this objective will become one of the primary objectives during insolvency.

2.4.4.2 Enhancing commercial morality and protecting the credit system

This objective is a corollary of the previous objective.[219] It is premised on the idea that insolvency or bankruptcy is not simply a private matter between creditors and debtors, but a subject where there are legitimate matters of public interest at stake.[220] Insolvency Law seeks to protect commercial morality by preventing fraudulent debtors from abusing the credit system. It provides rules that guard against abuse of the insolvency system by debtors, creditors and insolvency practitioners.[221]

In *Shields v Peak*,[222] the Supreme Court of Canada stated that although one of the objects of bankruptcy law is to secure a speedy and equitable distribution of the bankrupt's assets, it is not confined to this purpose alone.[223] It also aims to prevent fraud and bad faith. It acts as a preventive procedure to fraud and collusion on the one hand, but as an encouragement to honest and cautious trading on the other.[224]

In South Africa for instance, section 141 of the Companies Act 2008 empowers the practitioner[225] to investigate the affairs of the company and to take appropriate corrective measures. The provision vests the practitioner with wide powers to investigate and report any suspected violations of the law by the company and/or its management. If any mismanagement or other mischievous dealings are discovered, the practitioner may direct the company's management to take any appropriate corrective measures within specific timelines. If the violation is criminal in nature, the

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218 Bo, *Comparative Insolvency law: The Pre-–packs Approach to Corporate Rescue* 1; Loubser 2013 *SA Merc Law J* 437–57.

219 Waiswa, 'A Comparative Analysis of the Legitimacy of the Use of Insolvency Proceedings as a Debt Collection Tool in the UK and Uganda' 28.

220 Law Commission 'Insolvency law and Practice' Report of the (Cork) Review Committee (Comnd. 8558, 1982) paras 62–63.

221 Finch 1997 *Oxford Journal of Legal Studies* 227.

222 (1883) 8 *S.C.R* 579.

223 Waiswa, 'A Comparative Analysis of the Legitimacy of the Use of Insolvency Proceedings as a Debt Collection Tool in the UK and Uganda' 29.

224 *Shields v Peak* (1883) 8 SCR 579 per Ritchie CJ.

225 Section 128(1)*(d)* of the Companies Act 2008 defines a practitioner or 'business rescue practitioner' as a person or persons appointed to oversee a company during business rescue proceedings.

practitioner may forward the evidence obtained to any appropriate authorities for further investigations and possible prosecution.[226] Similarly, investigating offences and exposing wrongs committed by company directors is one of the statutory duties of a liquidator in South Africa in accordance with section 400 of the 1973 Companies Act. Findings by the liquidator could trigger an application for the disqualification of a mischievous director.[227]

The Master or the official receiver, as the case may be, may also investigate complaints against role players in the insolvency legal system, including the debtor, creditors and the insolvency practitioners.[228] Moreover, creditors can recover value that has been transferred by the debtor to third parties to defeat the interests of the creditors.[229] Section 424(1) of the 1973 Companies Act empowers the Master, Liquidator or any creditor of the company to apply to court for a declaration that any director or member of the company that is being wound up or undergoing liquidation or judicial management was reckless or fraudulent in the way he/she managed the company before commencement of the insolvency proceedings. The court may order such company officer to be personally liable to the creditors. Procedures are also provided for avoiding preferential transactions.[230] This further facilitate the equitable distribution of the insolvent company's estate amongst the creditors in a fair and statutorily regulated manner.

Insolvency Law is indeed a multifaceted legal regime, with divergent but inter-related objectives.[231] From whichever angle one approaches it, it is indisputable that the underlying policy objective of corporate insolvency law is to ensure efficiency in the management of a company's inability to pay debts to avert the consequential negative effects of insolvency. This is the central thread in most, if not all insolvency interventions.

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226 Section 141(2)*(c)* of the Companies Act 2008.
227 Section 401 of the 1973 Companies Act.
228 In South Africa, s 417 of the 1973 Companies Act empowers the Master to examine any person who may have committed any wrongs during the management of the company, or in the course of its being liquidated or wound up. In Uganda, comparable powers are vested in the Official Receiver by s 199 of the Insolvency Act of 2011.
229 *Burley Appliance Ltd v Patricia Anne Grobbelaar and 2 Others* Case No. 3029/2001.
230 Section 340 of the 1973 Companies Act.
231 Waiswa, 'A Comparative analysis of the legitimacy of the use of insolvency proceedings as a debt collection tool in the UK and Uganda' 29.

2.5 Inability to pay debts as a determinant for insolvency

As noted earlier, a number of legal regimes use the term 'insolvency' and/or 'insolvent' when referring to the formal insolvency proceedings.[232] However, the phrase 'unable to pay debts' is often preferred when referring to a state of insolvency.[233] Moreover, many pieces of insolvency legislation also provide that a company is 'deemed to be insolvent' when it is 'unable to pay its debts'.[234] Nevertheless, these pieces of legislation are silent on what it means for a company to be 'unable to pay [its] debts'.

The phrase 'unable to pay debts' is not new to Insolvency Law. Since the early days of personal Insolvency Law in England and under the Roman-Dutch systems, it has been the main ground upon which debtors could be declared bankrupt.[235]

It is reported[236] that by the early 1840s, the list of acts of bankruptcy upon which one could be declared bankrupt revolved around financial deliquency,[237] including failure to pay, to secure or compound a judgment debt, or to settle a decree.[238]

Insolvency Law emerged out of a general desire to establish a formal procedure through which creditors could collectively and inexpensively collect their debts.[239] Even after the enactment of the Joint Stock Companies Act 1844 in England, which introduced the possibility ofincorporating companies as a form of business enterprise, and the Joint Stock Companies Winding Up Act 1844, which introduced the grounds and procedure for winding up of companies, a number of principles applicable to personal Insolvency Law were transposed into Corporate Insolvency Law. For instance, the Joint Stock Companies Winding Up Act 1844 reiterated the acts of bankruptcy applicable to natural persons as the grounds for winding-up of companies.[240]

232 Goode, *Principles of Corporate Insolvency Law* 110. See also the discussion under 2.2.2.
233 The UK Insolvency Act 1986 ss123, 222–224, s 3 of the Uganda Insolvency Act 2011.
234 Goode, *Principles of Corporate Insolvency Law* 109.
235 Radin 1940 *University of Pennsylvania LR* 8.
236 Meng 2014 *The Law Quarterly Review* 8.
237 Section 20 of the Bankruptcy Act 1842 (5 and 6 Victoria, C 122).
238 Section 21 of the Bankruptcy Act 1842 (5 and 6 Victoria, C 122).
239 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 10–11.
240 Sections 4–8 of the Joint Stock Companies Winding up Act 1844 (7 and 8 Victoria, C111).

Inability to pay debts was the primary trigger for creditors to wind up companies even after the English Parliament modernised English Company Law through the enactment of the Joint Stock Companies Act 1856. This piece of legislation did not make reference to acts of bankruptcy with regard to the winding-up of companies. Instead, it stated that if a company was 'unable to pay debts', this would be one of the grounds upon which the court could make an order to wind-up a company.[241] It appears that right from the early days of Corporate Insolvency Law, inability to pay debts has always been one of the primary grounds for winding up companies.

It is worth stating that whereas the laws have over the years maintained inability to pay debts as one of the grounds for winding up of companies, the law makers have avoided ascribing a definitive statutory meaning to this important phrase. The laws[242] only describe inability to pay debts as one of the grounds for winding up or commencing insolvency proceedings and only list a number of tests or scenarios which a court may rely on to deem a company to be unable to pay debts.[243] This lack of conceptual certainty has created ambiguity and endless debates amongst legal scholars[244] and judges[245] over the exact meaning of inability to pay debts.

It is probable that it is because of this lack of legal clarity that the South African parliament chose not to use this phrase in the Companies Act 2008. Instead, financial distress is stated as the primary trigger for corporate rescue proceedings.[246] However, even with this rather tactical attempt by the South African parliament to avoid the uncertainty surrounding the precise meaning of inability to pay debts under English law and by extension, most common law countries,[247] including Uganda, a deeper analysis of the meaning of financial distress as used in the Companies Act 2008 shows

241 Section 67 of the Joint Stock Companies Act 1856.

242 Sections 344*(f)* and 345(1) of the 1973 Companies Act; s 123 of the Insolvency Act 45 of 1986 (UK), s 3 of the Insolvency Act 14 of 2011 (UG).

243 Sections 344*(f)* and 345(1) of the 1973 Companies Act; s 123 of the Insolvency Act 45 of 1986 (UK), s 3 of the Insolvency Act 14 of 2011 (UG).

244 Keay and Walton, *Insolvency Law: Corporate and Personal* 16; Meng 2014 *The Law Quarterly Review* 130; Banister 2013 *Recovery* 11; Baird and Sidle 2008 *Insolvency Intelligence* 40.

245 Wilis JA in *Boschport Ondernemings (Pty) Limited v ABSA Bank Ltd* [2013] ZASCA 173; King AJ in *Standard Bank of South Africa v R–Bay Logistics* 2013 (2) SA 295; Lord Walker in *BNY Corporate Trustees Services Ltd and Others v Neuberger Berman Europe Ltd and Eurosail UK* (2013) UKSC 28; *Carman v Bucci* (2013) EWHC 2371; Briggs J in *Re Cheyne Finance Plc* (2008) BCC 199.

246 Section 129(1)*(a)* of the Companies Act 2008.

247 Nigeria, Ghana, Kenya, India, Singapore, Malaysia and Tanzania.

that in substance, this is a sugar-coated extension of the same dogmatic notion of inability to pay debts.

Section 128(1)*(f)* of the Companies Act 2008, defines a 'financially distressed' company as any company that appears to be reasonably unlikely to pay all of its debts as they fall due and payable within the immediately ensuing six months, or one that appears to be reasonably likely to become insolvent within the immediately ensuing six months. What is even more interesting is that inability to pay debts is still the key trigger for winding up of insolvent companies in South Africa.[248] Therefore, let me examine the meaning of the concept 'unable to pay debts' as used in the South African legal regime.

2.5.1 Meaning of 'unable to pay debts' in South Africa

Whereas one of the major themes of the South African Companies Act 2008 is the creation of a robust corporate rescue system that is appropriate to the needs of a modern South Africa,[249] there is still a recognition that not all companies in financial distress are eligible for rescue. Corporate rescue is only permissible in situations where there is reasonable hope that the symptoms and causes of financial distress of the company can be diagnosed and treated. Where the company is financially distressed beyond repair, rescue proceedings will not be appropriate.[250]

It is for this reason that amidst the global wave for the promotion of corporate rescue, item 9 of Schedule 5 of the Companies Act 2008 saved Chapter 14 of the 1973 Companies Act which regulates the winding-up and liquidation of insolvent companies. This is a subtle recognition that just like humans, the incurably sick companies die. It is necessary to retain procedures for their decent 'burial' through liquidation or winding up.

Section 344*(f)* of the 1973 Companies Act provides that one of the circumstances under which a company may be wound up by the court is if it is unable to pay its debts as described in section 345 of the 1973 Companies Act. As already stated herein

248 Cassim and others, *Contemporary Company Law* 918.
249 Cassim and others, *Contemporary Company Law* 861.
250 *Swart v Beagles Run Investment 25 (Pty) Ltd* 2011 (5) SA 422 (HC); Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 73–75.

above,[251] Chapter 14 of the Companies Act of 1973 was saved by item 9 of Schedule 5 of the Companies Act 2008 and it remains the law applicable to winding-up of insolvent companies in South Africa.[252]

Besides defining the concept, section 345 also provides a list of circumstances, which if proved, may be the basis for court to determine that a company is indeed 'unable to pay debts'. The provision is a deeming provision rather than a definition section.

Section 345 reads:

345 When company deemed unable to pay its debts

(1) A company or body corporate shall be deemed to be unable to pay its debts if-

(a) A creditor, by cession or otherwise, to whom the company is indebted in a sum not less than one hundred rand then due has served on the company, by leaving the same at its registered office, a demand requiring the company to pay the sum so due and the company or body corporate has for three weeks thereafter neglected to pay the sum, or to secure or compound for it to the reasonable satisfaction of the creditor; or

(b) Any process issued on a judgment, decree or order of any court in favour of a creditor of the company is returned by the sheriff or the messenger with an endorsement that he has not found sufficient disposable property to satisfy the judgment, decree or order or that any disposable property found did not upon sale satisfy such process; or

(c) It is proved to the satisfaction of the Court that the company is unable to pay its debts.

(2) In determining for the purpose of subsection (1) whether a company is unable to pay its debts, the court shall take into account the contingent and prospective liabilities of the company.

The circumstances under which a company may be deemed to be unable to pay its debts remain a subject of legal debate though they appear to be simple.[253]
Below, the different legal circumstances under which a company would be deemed to be unable to pay debts are explored.

2.5.1.1 Neglect or refusal to settle a statutory demand

[251] See page 54 above.

[252] *Wild & Marr (Pty) Ltd v Intratrek Properties (Pty)Ltd* [2019] ZAGPPHC 613 para 13.

[253] *Boschport Ondernemings (Pty) Limited v ABSA Bank Ltd* [2013] ZASCA 173; *Standard Bank of South Africa v R–Bay Logistics* 2013 (2) SA 295 (HC); Meng 2014 *The Law Quarterly Review* 8.

According to section 345(1) *(a)* of the 1973 Companies Act, a company is deemed to be unable to pay its debts if it neglects or fails to pay, or otherwise compounds a debt of not less than one hundred South African Rand, after three weeks of being served a demand notice.

For inability to pay debts to be proved under this limb of the law, a creditor must be able to prove to court that: (a) the company owes him or her an undisputed debt of no less than one hundred Rand; (b) that payment of the outstanding debt has been demanded; and (c) the company has failed or otherwise neglected to pay or compound the subject debt within a period of three weeks from the date of the demand.

It is trite law that for one to qualify to be a creditor for purposes of serving a statutory demand, his or her debt must not be genuinely disputed by the debtor.[254] Winding up proceedings are not to be used to enforce payment of a debt that is disputed on *bona fide* and reasonable grounds.[255] The Law of Insolvency aims to enforce rights, not to create rights.[256] This legal position is commonly referred to as the 'Badenhorst rule', which emerged from the decision in *Badenhorst v Northern Construction Enterprises (Pty) Ltd.*[257] The court held:

> A winding-up petition is not a legitimate means of seeking to enforce payment of a debt which is *bona fide* disputed by the company. A petition presented ostensibly for a winding-up order but really to exercise pressure will be dismissed and in some circumstances may be stigmatised as a scandalous abuse of the process of the Court. Some years ago, petitions founded on disputed debts were directed to stand over till the debt was established by action. If, however, there was no reason to believe that the debt, if established, would not be paid, the petition was dismissed. The modem practice has been to dismiss such petitions. But, of course, if the debt is not disputed on some substantial ground, the Court may decide it on the petition and make the order.[258]

It is also widely recognised that once a debtor's indebtedness is established, the evidential burden rests on the debtor to prove that the indebtedness is disputed on

254 *London and Global Ltd v Sahara Petroleum Ltd* (1998) Times 3 December C.A; Waiswa AS 'Insolvency proceedings: A double edged sword' *Euroflex* (2015) 4 Available at https://www.insol-europe.org/download/documents/885 (20-06-2019).

255 *Badenhorst v Northern Construction Enterprises (Pty) Ltd* 1956 (2) SA 346 (T).

256 Lord Hoffmann in *Cambridge Gas Transportation Corporation v Official Committee of unsecured creditors of Navigator Holdings Plc* (2007) 1 AC 508 para 15.

257 1956 (2) SA 346 (T).

258 *Badenhorst v Northern Construction Enterprises (Pty) Ltd* 1956 (2) SA 346 (T) 348A–C.

bona fide and reasonable grounds. The discretion of the court not to grant a winding-up order upon the application of unpaid creditor is narrow, not wide.[259]

Courts are *ad idem* that the evidential burden on the debtor company does not entail proving that it is not indebted to the creditor, but rather that the indebtedness is disputed on *bona fide* and reasonable grounds.[260] The test for proving that a debtor factually disputes his or her indebtedness, according to Brand J, in *Payslip Investment Holdings CC v Y2K Tec Ltd,*[261] is whether it appears on the documented evidence presented that the debtor's claim is disputed on reasonable and *bona fide* grounds. It is not sufficient that the creditor has made out a case on the probabilities.

In *Hulse-Reutter and Another v HEG Consulting Enterprises (Pty) Ltd (Lane and Fey NNO Intervening)*,[262] Thring J further noted:

> what the debtor must establish is no more or no less than the grounds on which they do so are reasonable. They do not have to establish, even on probabilities, that the company, under their direction, will, as a matter of fact, succeed in any action which might be brought against it by the creditor to enforce the disputed claim… They do not have to prove to the company's defense in any such proceedings. All that they have to satisfy court about is that the grounds which they advance for disputing the creditor's claims are not unreasonable'[263]

Therefore, whereas section 345(1) of the 1973 Companies Act is arguably the easiest window for proving a debtor's inability to pay its debts, the creditor must ensure that all the legal requirements set out above are satisfied.

2.5.1.2 Failure or refusal to satisfy a judgment debt

A company is deemed to be unable to pay its debts under this test if it is proved that a creditor obtained a judgment against the company for any amount and that execution proceedings have been commenced, but the company has failed or refused to satisfy the decree and execution proceedings. For a creditor who has obtained judgment

259 *Afrgri Operations Limited v Hamba Fleet (Pty) Ltd* [2017] ZASCA 24; *Kalil v Decotex (Pty) Ltd* 1988 (1) SA 943 (A).
260 *Freshvest Investments (Pty) Ltd v Marebeng (Pty) Ltd* [2016] ZASCA 168; *Re London and Paris Banking Corp* (1875) 19 Eq 444.
261 2001 (4) SA 781 (C) 783H–I.
262 1998 (2) SA 208 (HC).
263 *Hulse-Reutter and Another v HEG Consulting Enterprises (Pty) Ltd (Lane and Fey NNO Intervening)* 1998 (2) SA 208, 219E–220A.

against a company, section 345(1)*(b)* is probably the easier test that can be relied on to prove a company's inability to pay debts.

Evidence of failure or refusal to satisfy a court order is usually compelling proof of inability to pay debts. The general expectation is that a solvent company should find no difficulty in settling a judgment debt. Lord Hoffmann in *Re a Company 12209 of 1991*[264] observed that a company's non-compliance with a statutory demand, or non-satisfaction of execution of a judgment debt, are matters that can be proved quite simply, usually in a single short witness statement. If proved, each one of them independently establishes the court's authority to make a winding up order, even if the company can pay its debts.

The rationale for including these specific tests for deeming inability to pay debts and proving financial distress of a company was to make it easier for creditors to whom a company is genuinely indebted, to commence insolvency proceedings against the company with less difficulty.[265] The same reason is true for trade creditors from whom a company may incur unquestionable debt but chooses not to pay.[266]

2.5.1.3 Inability to pay debts

Section 345(1) *(c)* of the 1973 Companies Act is couched in very wide terms to encompass all situations where one can prove that a company is unable to pay its debts. This provision has, over the years, been interpreted by courts[267] to encompass two inter-linked forms of insolvency: factual insolvency and commercial insolvency. In *Boschport Ondernemings (Pty) Ltd v ABSA Bank Ltd*,[268] Willis JA stated that 'factual insolvency' is the situation where a company's liabilities exceed its assets while 'commercial insolvency' arises where a company is in such a state of illiquidity that it is unable to pay its debts even though its assets may exceed its liabilities.[269]

264 [1992] BCLC 865, 868.
265 Delport and Vorster, *Henochsberg on Companies Act 61 of 1973* (electronic version) 707.
266 Goode, *Principles of Corporate Insolvency Law* 117.
267 *Boschport Ondernemings (Pty) Ltd v ABSA Bank Ltd* [2013] ZASCA 173 para 16; *Johnson v Hirotec (Pty) Ltd* 2000 (4) SA 930 (SCA) para 6; *In re Carbon Development (Pty) Ltd (in liquidation)* 1993 (1) SA 493 (A) 502C–D.
268 (936/12) [2013] ZASCA 173.
269 *Boschport Ondernemings (Pty) Ltd v ABSA Bank Ltd* [2013] ZASCA 173 para 16.

Fourie J, in *OBC Distribution Centre (Pty) Ltd t/a OBC Cold Storage v Paul Alexandre Andrade Correia and Evelina Chantele Correia*[270] held that one may seek to establish factual insolvency either directly or indirectly. Direct proof can be adduced of the debtor's liabilities and of the market value of his assets at the date of the application, or indirectly by providing evidence of circumstances indicative of the fact that the debtor has debts that have not been paid.[271]

Recently, in *Maralco Business Advisors CC t/a Maralco Plant Services v Glowax (Pty) Ltd*[272] Manamela AJ instructively held, amongst other things, that section 345(1) *(c)* of the 1973 Companies Act provides for unspecified or non-exhaustive possible instances under which a company may be found to be unable to pay debts.[273] A company's inability to pay debts may be proved in any manner, including providing evidence that a company has failed to pay known debts to its trade creditors, proof that the company has been sued by creditors for payment of outstanding debts, or that the company's negotiable instruments such as cheques have been dishonoured.[274]

In terms of the test, the creditor is provided with latitude to use any possible evidence to prove that the company cannot pay its debts. The mere fact that the value of the company's assets exceeds the amount of its liabilities does not preclude a finding that the company is unable to pay its debts and hence liable to be wound up.[275]

From this perspective, the fact that a company can pay all its debts over an extended period through perhaps the realisation of its assets, is irrelevant.[276] The test is satisfied if the creditor can prove that the company has in fact failed to pay its undisputed debt, irrespective of the value of its asset base. In *Boschport Ondernemings (Pty) Ltd v ABSA Bank Ltd*[277] *Willis JA* in the Supreme Court of Appeal unequivocally declared

270 [2014] ZAGPPHC 743 para 4.
271 *OBC Distribution Centre (Pty) Ltd t/a OBC Cold Storage v Paul Alexandre Andrade Correia and Evelina Chantele Correia* [2014] ZAGPPHC 743 para 4.
272 Case no: 17572/2018.
273 Manamela AJ in *Maralco Business Advisors CC t/a Maralco Plant Services v Glowax (Pty) Ltd* para 16.
274 Delport and Vorster, *Henochsberg on Companies Act 61 of 1973* (electronic version) 707.
275 Caney J in *Rosenbach and Co (Pty) Ltd v Singh's Bazaars (Pty) Ltd* 1962 (4) SA 593 (D) 597.
276 Meng 2014 *The Law Quarterly Review* 130.
277 [2013] ZASCA 173 para 17.

the rationale for the preference for commercial insolvency to factual or balance sheet insolvency. He held:

> 'That a company's commercial insolvency is a ground that will justify an order for its liquidation has been a reality of law which has served us well through the passage of time. The reasons are not hard to find; the valuation of assets, other than cash, is a notoriously elastic and often highly subjective one; the liquidity of assets is often more viscous than recalcitrant debtors would have a court believe; more often than not, creditors do not have knowledge of the assets of a company that owes them money- and cannot be expected to have; and courts are more comfortable with readily determinable and objective tests such as whether a company is able to meet its current liabilities than with abstruse economic exercises as to the valuation of a company's assets. Were the test for solvency in liquidation proceedings to be whether the assets exceed liabilities, this would undermine there being a predictable and therefore effective legal environment for the adjudication of the liquidation of companies, one of the purposes of the new Act, set out in section 7(i) thereof.'[278]

This position is consistent with several old English court decisions, most notably *Cornhill Insurance Plc v Improvement services Limited,*[279] in which the court was required to decide whether a company that was wealthy with a lot of assets but had stubbornly refused to settle an undisputed debt of a paltry 1,154 Pounds, should be wound up on the ground of being unable to pay its debts.

The brief facts of *Cornhill Insurance Plc v Improvement Services Limited*[280]are that the defendant, made a claim against the plaintiff under a fire insurance policy, which the defendants had obtained from the plaintiff to cover their property against the risk of damage by fire. When a fire subsequently broke out and the defendant's property got damaged, the defendant demanded for indemnification from the plaintiff. The plaintiff entered into an agreement committing to pay to the defendant a total of 1,154 Pounds, but later refused to honour their commitment despite several demands for payment by the defendant. The defendant threatened to commence winding up proceedings against the plaintiff on the ground of inability to pay debts. The plaintiff, a very rich insurance company with many assets, sought to restrain the defendant from presenting the petition for winding up, on the ground that the plaintiff was a solvent public company with many assets and that allowing the defendant to present the winding up petition would amount to an abuse of the court process.

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278 *Boschport Ondernemings (Pty) Ltd v ABSA Bank Ltd* [2013] ZASCA 173 para 17.
279 (1986) 1 WLR 1.
280 *ibid.*

The trial judge, Harman J, upheld the view that a company, however wealthy it may be, if it does not pay its debts as they fall due, may be deemed to be unable to pay its debts and be declared insolvent. He cited with approval the famous *dictum* by Vaisey J in *Re A company*[281] that 'rich men and rich companies who did not pay their debts had only themselves to blame if it were thought that they could not pay them.'[282]

Whichever way one looks at this provision, before a court can deem a company to be unable to pay its debts under section 345(1)*(c)* of the 1973 Companies Act, a clear debt must exist which can be readily ascertained. The debt must be due. It must also be proven that the company had failed or refused to settle the debt after a demand was issued. This test does not require the court to venture into ascertaining the value of the company's assets compared to the debts due, although this may be one of the many factors which the court may consider while exercising its discretion in deciding whether to grant the order for winding up.[283]

2.6 Conclusion

In this chapter, the meaning of the concept of insolvency, and how Corporate Insolvency Law has generally evolved to its current state in South Africa has been examined. Given South Africa's historical connections to both England and the Roman-Dutch legal systems, the current laws on insolvency in the Republic are a blend of the principles inherited from the English and Roman-Dutch legal systems.[284]

In both the English and the Roman-Dutch systems, personal insolvency law developed before the advent of the notion of juristic personality. The principles of personal insolvency law influenced the development of Corporate Insolvency Law in South Africa.[285]

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281 (94) SOLJ 369.
282 Re A company (94) SOLJ 369.
283 *ABSA Bank Ltd v Rhebokskloof (Pty) Ltd* 1993 (4) SA 436(C) 440F–441A.
284 See the discussion under in 2.3.1.2.
285 See the discussion under 2.3.2.

The consideration of the different theories and views concerning the normative objectives of Corporate Insolvency Law as fostered by legal scholars reveal that although Insolvency Law may seek to achieve many objectives, wide recognition remains for the approach that the need to maximise returns for creditors stands out as the most dominant objective of Corporate Insolvency Law.[286]

It was also observed that modern Insolvency Law is generally evolving towards wider recognition that a company's inability to pay its debts, if not well managed, can result into corporate failure, and since failure can potentially affect many more stakeholders than just creditors, there is need to widen the normative focus of Insolvency Law. Therefore, there has been a shift towards the promotion of corporate rehabilitation and rescue.

Finally, the chapter analysed the concept of inability to pay debts in South Africa and an overview of how courts have generally interpreted and applied section 345 of the 1973 Companies Act to determine whether or not a company is indeed unable to pay its debts, and therefore liable to be wound up.[287] The requisite context to the subject matter has been provided to create a firm foundation for the next chapter dealing with the development of Corporate Insolvency Law in Uganda.

[286] See the discussion under 2.4.2.
[287] Discussed in 2.5.

CHAPTER THREE
DEVELOPMENT OF CORPORATE INSOLVENCY LAW IN UGANDA

CHAPTER THREE
DEVELOPMENT OF CORPORATE INSOLVENCY LAW IN UGANDA

3.1 Introduction

This chapter presents a synopsis of the law regulating corporate insolvency in Uganda. The discussion opens with a historical overview of Corporate Insolvency Law in Uganda. Like South Africa, Uganda's legal system is largely structured along the theories and principles inherited from England.[1]

Uganda's pre-colonial economy was largely informal and of a subsistence nature. It was dominated by small-scale subsistence food crop growing, fishing and blacksmith, which were transacted mainly through barter trade.[2] This accounts for the conspicuous absence of an insolvency law regime during the pre-colonial era.

When the British declared Uganda a British protectorate in 1894, Uganda's economic gates were opened to the formal world economy.[3] To facilitate effective administration of the protectorate, the British colonial administrators introduced the Uganda Order in Council of 1902.[4] This Order in Council formalised colonial rule in Uganda and contained provisions that made British laws and practices applicable in Uganda.[5]

The adoption of the colonial system created a strategic window for the introduction of the British Bankruptcy Act of 1916 and the English Companies Act of 1894, which heralded the adoption of basic principles of English Corporate Law and Insolvency Law by Uganda.[6] Notably, even after its independence, Uganda continued to apply the colonial laws. To-date, the legal system is still influenced by the English common law and doctrines of equity.[7]

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1 Nyombi, Kibandama and Bakibinga 2014 *JBL* 652, 653.
2 Nyombi 2015 *International Journal of Law and Management* 2; Waiswa, 'A Comparative Analysis of the Legitimacy of the Use of Insolvency Proceedings as a Debt Collection Tool in the UK and Uganda' 17.
3 Byrnes, 'Uganda A Country Study' 1566–156. Available at http://www.africa.upenn.edu/NEH/ueconomy.htm (17–07–2019).
4 Waiswa, *A Concise Workbook on Fundamentals of Commercial Law in Uganda* 8.
5 *ibid*.
6 Bakibinga, *Companies Law in Uganda* 3.
7 Bakibinga 2004 *Uganda Living LJ* 31.

Since the normative principles and objectives of English Insolvency Law which were transposed into South Africa[8] also apply to Uganda, a discussion of the meaning and objectives of corporate insolvency law in Uganda would be superfluous because Uganda's insolvency regime is a direct replica of the English Insolvency Law principles.[9]

The chapter concludes with a discussion on the meaning of 'inability to pay debts' as stipulated in the Insolvency Act 14 of 2011 and of how courts in Uganda have generally interpreted and applied this concept.

3.2 Development of Corporate Insolvency Law in Uganda

When Uganda became a British protectorate in 1894, there was no formal insolvency system in Uganda.[10] Although some Ugandans are reported to have been involved in unstructured trade activities in ivory, slaves, animal hides and skins with Africa's east coast traders long before the arrival of the Europeans,[11] these trade activities were largely informal and on a negligible scale. Moreover, they were conducted through barter trade.[12] This informality meant that there were no formal credit or financial systems at that time to warrant the development of insolvency rules and procedures, since Insolvency Law developed out of necessity to resolve consequences of failure to pay debts.[13]

Following the declaration of Uganda as a British protectorate in 1894, Uganda's economy was opened to the world.[14] The British colonial administration began pursuing policies that drew Uganda further into the world economy, arguably to serve Britain's economic agenda.[15] Through their agents and local collaborators, the British persuaded Ugandan farmers, especially in central Uganda, to begin growing cotton

8 See the discussion in ch 2.
9 *ibid*; Uganda Law Reform Commission *A study Report on Insolvency Law* ULRC Publication 13 of 2004 4.
10 Nyombi, Kibandama and Bakibinga 2014 *JBL* 656.
11 Byrnes, 'Uganda A Country Study' 156.
12 Nyombi 2015 *International Journal of Law and Management* 2.
13 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 9; Leibell 1940 *Fordham LR* 380 1.
14 Byrnes, 'Uganda A Country Study' 156.
15 Onek, *Modes of British Imperial Control of Africa: A Case Study of Uganda 1890–1990* 40.

and coffee and other cash crops for export to Britain.[16] This eventually transformed Uganda's economy from a predominantly subsistence economy to a quasi-commercial society, which marked the beginning of a money economy in Uganda.[17]

To facilitate the effective administration and consolidation of power in the protectorate, on 11 August 1902, the British colonial administrators promulgated the Uganda Order in Council 1902,[18] which is regarded as the first constitution of the Ugandan Protectorate.[19] The Uganda Order in Council 1902 formalised colonial rule in Uganda and contained provisions that made British laws and practices applicable in Uganda.[20]

Article 17 of the Uganda Order in Council 1902, commonly referred to as the reception clause,[21] provided that all laws that were applicable in the UK before 1902 would become applicable to Uganda. Courts would henceforth rely on the English laws and practices in adjudicating disputes as long as the application of the English law was not repugnant to morality and good conscience.[22] The reception clause was a legal machinery deliberately crafted by the British to enable the English to carry with them English laws and liberties into any unoccupied country where they could settle.[23] The repugnancy clause[24] excluded all forms of local practices and customs that were deemed anathematic to justice, equity and good conscience.[25]The reception clause effectively anchored the colonial legal system in Uganda.[26]

The Uganda Order in Council created a legal window through which English laws, including those on insolvency, were exported into Uganda.[27] Even when the colonial administration enacted the Bankruptcy Act of 1931, which is recognised as the first

16 Sabune, 'The Cotton sector in Uganda: Progress made and recommendation for achieving further progress' Paper presented to 64th Plenary meeting of the ICAC, Liverpool, UK, 2005 2. Available at http://www.cdouga.org/wp-content/uploads/2013/10/ICAC2005.pdf.(23–09.–2019).
17 Taylor 1978 *International Journal of African Historical Studies* 3.
18 Mugambwa, 'The Evolution of British Authority in Uganda with Special Emphasis on Buganda 1890–1938' 63.
19 Kanyeihamba, *Constitutional and Political History of Uganda from 1894 to the Present* 5.
20 Waiswa, *A Concise Workbook on Fundamentals of commercial Law in Uganda* 8.
21 Waiswa, *A Concise Workbook on Fundamentals of commercial Law in Uganda* 9.
22 Article 20 of the Uganda Order in Council 1902.
23 Jenkyns, *British Rules and Jurisdiction beyond the Sea* 5.
24 Article 17(2) of the Uganda Order in Council 1902.
25 Ellett, *Pathways to Judicial Power* 35.
26 Ellett, *Pathways to Judicial Power* 34.
27 Mugambwa, 'The Evolution of British authority in Uganda with special emphasis on Buganda 1890–1938' 63.

law on insolvency in Uganda,[28] English rules and principles on personal insolvency continued to apply in Uganda.[29]

3.2.1 Influence of English Corporate Insolvency Law in Uganda

As noted above,[30] by the time that the Uganda Order in Council of 1902 was promulgated by the colonial administration, Uganda did not have any specific law on personal or corporate insolvency. Consequently, by virtue of the reception clause in the Uganda Order in Council, English laws, including those on corporate insolvency law became applicable in Uganda until such time that the colonial administration in Uganda enacted specific laws for Uganda.[31]

In the area of insolvency, the first intervention by the colonial administration was registered in 1931, in the form of the Bankruptcy Act 67 of 1931 (the Bankruptcy Act of 1931) and the Deed of Arrangements Act 75 of 1931 (the Deed of Arrangements Act of 1931).[32] These pieces of legislation were a direct replica of the British Bankruptcy Act of 1914 and the English Deed of Arrangements Act of 1914, respectively.[33]

On the face of it, the scope of the Bankruptcy Act of 1931 seemed sufficiently broad to cover all cases of inability to pay debts by both individuals and companies. In fact, some commentators have erroneously argued that this law was enacted to deal with both personal and corporate insolvencies.[34] However, section 116 of the Bankruptcy Act of 1931 specifically provided that a receiving order could not be made against any corporation or against any association or company registered under the Companies Act.[35] Section 4 of the same Bankruptcy Act of 1931 provided that, once a debtor was proved to have committed any act of bankruptcy, the only redress court could grant to the petitioner was issuing a receiving order in respect of the estate of the delinquent

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28 Nyombi, Kibandama and Bakibinga 2014 *JBL* 656.

29 Section 162 of the Bankruptcy Act of 1931 provided that until the Chief Justice of Uganda makes rules regarding insolvency in Uganda, the rules made under the English Bankruptcy Act of 1914 were declared applicable in Uganda.

30 See the discussion under 3.1.

31 Waiswa, *A Concise Workbook on Fundamentals of Commercial Law in Uganda* 9.

32 Uganda Law Reform Commission *'A study Report on Insolvency Law'* ULRC Publication 13 of 2004 4.

33 Nyombi, Kibandama and Bakibinga 2014 *JBL* 656.

34 *ibid.*

35 Section 116 of the Bankruptcy Act of 1931.

debtor. By necessary implication, therefore, the remedies and processes contained in the Bankruptcy Act of 1931, were only applicable to personal insolvency, and not corporate insolvency.[36] The position was the same under sections 126 and 3 of the English Bankruptcy Act 59 of 1914.[37]

The Deed of Arrangements Act of 1931, which was also copied from the English Deed of Arrangements Act of 1914, introduced into Uganda a formal procedure through which a debtor could negotiate an out of court settlement, composition, or extension, with his or her creditor[38] as an alternative to leaving such creditor to pursue bankruptcy proceedings against the debtor.[39]

In England, deeds of arrangement were generally developed in the 19th century to offer a viable alternative to bankruptcy.[40] Unfortunately, statistics showed that the impact of deeds of arrangement in England was minimal.[41] This is arguably because by their very nature, deeds of arrangement neither operated as a discharge of the debtor in bankruptcy, nor affected the rights and remedies of the creditor against the sureties of the debtor.[42] This was aggravated by the fact that execution of a deed of arrangement with one's creditors could, within the meaning of the Bankruptcy Act of 1914,[43] constitute evidence of the fact that the debtor had suspended or was about to suspend payment of his or her debts. This was recognised as one of the acts of bankruptcy, upon which the court could rely to issue a receiving order in respect of the debtor's estate.[44]

It is, therefore, unsurprising that even in Uganda, there is a dearth of statistics about the impact of the Deed of Arrangements Act of 1931. Some reports[45] even indicate

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36 Uganda Law Reform Commission *'A Study Report on Insolvency Law'* ULRC Publication 13 of 2004, 4.
37 Levi and Moore, 1937 *The University of Chicago Law Review* 8.
38 *ibid*.
39 Chitty J and others*, Chitty on Contracts* 1544.
40 Milman 2008 *SAcLJ* 441.
41 *ibid.*
42 Chitty J and others*, Chitty on Contracts* 1544; *Cole v Lynn* (1942) 1 KB 142.
43 Section 1*(h)* of the Bankruptcy Act 59 of 1914; s 2(1)*(a)* of the Bankruptcy Act 67 of 1931.
44 Uganda Law Reform Commission *'A Study Report on Insolvency Law'* ULRC Publication 13 of 2004, 43.
45 Uganda Law Reform Commission *'A Study Report on Insolvency Law'* ULRC Publication 13 of 2004,43.

that this piece of legislation remained in disuse until it was finally repealed by the Insolvency Act 14 of 2011.[46]

Regarding Corporate Insolvency Law, it is reported that before the introduction of English Company Law in Uganda, the Indian Companies Act of 1882 was recognised as the law applicable to companies in Uganda.[47] The Indian Companies Act of 1882 is said to have been a direct replica of the English Companies Act of 1862. Even after the promulgation of the Uganda Order in Council of 1902, the same principles of Company Law that were contained in the Indian Companies Act of 1882 continued to apply in Uganda.[48] Application of Indian law to Uganda was caused by the fact that by the time Uganda became a British protectorate after the 1885/1885 Berlin conference, England had long established its rule in India,[49] and rather than reinvent the wheel by writing new laws for Uganda, it was convenient for the British to extend the application of Indian laws to Uganda through the Uganda Order in council of 1902.[50]

The Indian Companies Act of 1882 remained applicable in Uganda until the colonial administration enacted the Companies Ordinance 6 of 1923 (the Companies Ordinance of 1923) as the first law on companies in Uganda.[51] The Companies Ordinance of 1923 was later repealed and replaced by the Companies Ordinance 12 of 1935, which remained operational until 1961 when the Companies Act 110 of 1961 (the Companies Act Cap 110) was enacted. The Companies Act Cap 110 was a re-enactment of the rules and principles of Company Law and Corporate Insolvency Law applicable in England[52] at that time as contained in the English Companies Act 38 of 1948.[53]

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46 Section 262 of the Insolvency Act 14 of 2011.

47 Uganda Law Reform Commission *'Study Report on Company Law'* ULRC Publication No.35 (2004) 7.

48 Article 17 of the Uganda Order in Council of 1902.

49 Rahman and others, 2018 *Peace and Conflict Studies* Vol. 25, No.1, Article 5,

50 Oloka 'An Overview of the Legal System in Uganda' 1.

51 Uganda Law Reform Commission *'A Study Report on Insolvency Law'* ULRC Publication 13 of 2004,7.

52 Bakibinga, *Companies Law in Uganda* 3.

53 Tumuheki, 'Towards Good Corporate Governance: An Analysis of Corporate Governance Reforms in Uganda' 17; Nyombi, Kibandama and Bakibinga 2014 *JBL* 656; Tarinyeba 'Corporate Governance in Uganda: The Role of Bank Finance' 26.

Through the Companies Act Cap 110, Uganda inherited and derived the benefit of all the developments that had been registered in English Company Law and Insolvency Law up to 1948.[54] The Companies Act Cap 110 remained in force for 50 years after independence. In 2012 it was finally repealed and replaced by the Companies Act 1 of 2012.[55]

3.2.2 Corporate Insolvency Law pre-2011

Since 1 January 1961, when the Companies Act Cap 110 became applicable in Uganda, all matters related to incorporation, management, insolvency and winding up of companies were subjected to similar rules as those that were contained in the English Companies Act of 1948.[56]This had many advantages, including standardisation of rules on incorporation and registration of companies, recognition of the rights of people to form and run businesses as companies, with separate legal personality from the shareholders, as well as capacity of companies to raise capital through issuance of shares to the public and borrowing through use of debt instruments such as debentures and charges.[57] All of these interventions were positive innovations that had a great impact on the corporate landscape of Uganda.

Inheritance of English law, however, also brought with it some negative effects, especially from the insolvency perspective. At that time, English insolvency law was largely focused on punishing rather than rehabilitating the perpetrators of financial indiscretion.[58] Likewise, corporate rescue and rehabilitation of financially distressed companies was not a priority in English law at that time.[59] Inability to pay debts was largely seen as a sign of failure in business, and not as a possible unavoidable consequence of any business venture. A company that was deemed to be unable to

54 Bakibinga, *Companies Law in Uganda* 3.
55 Section 298 of the Companies Act 1 of 2012.
56 Bakibinga 2004 *Uganda Living LJ* 31.
57 Bakibinga, *Companies Law in Uganda* 3.
58 Lubben 2013 *Western Reserve LR* 319–322. Available at https://scholarlycommons.law.case.edu/cgi/viewcontent.cgi?article=1126andcontext=caselrev (14–09–2019).
59 Levinthal 1919 *University of Pennsylvania Law Review* 1.–5. Available at https://scholarship.law.upenn.edu/cgi/viewcontent.cgi?article=7675andcontext=penn_law_review (14–09–2019).

pay debts would easily be condemned into winding-up or liquidation[60] without any formal legislative effort to give such ailing companies a second chance to recover.

This perception on Insolvency Law was transposed onto Uganda. In fact, section 222(5) of the Companies Act Cap 110 reproduced the wording of section 222*(e)* of the English Companies Act 38 of 1948 to provide that inability to pay debts was one of the grounds upon which a company may be wound up by court. Moreover, section 223 of the Ugandan Companies Act Cap 110, adopted the wording and meaning of the term 'inability to pay debts' as contained in section 223 of the English Companies Act of 1948, which listed the circumstances under which a company may be deemed to be unable to pay its debts.[61]

In *Regal Pharmaceuticals Ltd v Maria Assumpta Pharmaceuticals Ltd*[62] Christopher Madrama J of the High Court of Uganda (as he then was), while determining a petition for winding-up of a company under the Companies Act Cap 110, resoundingly emphasised the fact that the application of sections 222 and 223 of the Companies Act Cap 110 had to be made in accordance with the rules that had been historically established by English courts. He reasoned that these provisions are in *pari materia* with sections 222 and 223 of the English Companies Act of 1948.[63]

The Judge referred to the English case of *Re Tweed Garages Ltd,*[64] where, on a petition to wind up the company, Plowman J interpreted a provision in the 1948 Companies Act of Britain, which is in *pari materia* with sections 222*(e)* and 223*(a)* of the Ugandan Companies Act Cap 110 and held among others that where, what is in dispute was the amount of money owing and there was no doubt that the petitioners were creditors for amounts which would entitle them to a winding up order, Court could proceed to grant a winding up order. He noted that an answer to a petition which

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60 Section 222(5) of the Companies Act 1961 Cap 110.

61 Waiswa 'A Comparative Analysis of the Legitimacy of the Use of Insolvency Proceedings as a Debt Collection Tool in the United Kingdom and Uganda' 31.

62 High Court Company case no. 20 of 2010.

63 *Regal Pharmaceuticals Ltd v Maria Assumpta Pharmaceuticals Ltd High Court* company case no. 20 of 2010.

64 (1962) 2 Ch. 406.

disputes the exact amount owed to the petitioner is not sufficient to circumvent a winding-up order.[65]

Whereas the English Companies Act of 1948 underwent a number of reforms[66] and was later repealed and replaced in 2006,[67] its Ugandan copycat, the Companies Act Cap 110, remained largely unchanged until 2012 when it was finally repealed and replaced by the Companies Act 1 of 2012.[68]

With regard to insolvency matters, the deficiency in scope of the Companies Act Cap 110 generated justified domestic and international pressure on the government of Uganda to reform the country's commercial, banking and company laws, including Insolvency Law.[69] Part of the pressure resulted from the fact that whereas the English had carried out a number of insolvency reforms, such as the enactment of the Insolvency Act 1985 and its subsequent prompt repeal and replacement with the Insolvency Act of 1986,[70] Uganda continued to use the limited provisions on winding up and liquidation of companies as contained in the Companies Act Cap 110.[71] This prompted the government of Uganda, through the Uganda Law Reform Commission (ULRC), to carry out a comprehensive review of commercial laws in Uganda, including the Law on Insolvency.[72]

The efforts for reform were driven by four guiding points: the need for unification and formulation of a comprehensive insolvency law covering corporate and individual insolvency; updating the insolvency law in light of the ever-changing conditions of commerce; making provision for means of collecting property wherever found to settle debts and liabilities of insolvent debtors; and deregulation for private business.[73]

65 Per Plowman J in *Re Tweed Garages Ltd* (1962) 2 Ch 406, 410.
66 Uganda Law Reform Commission '*A Study Report on Insolvency Law'* ULRC Publication 13 of 2004,7.
67 Saleem, *A Guide to the Companies Act 2006* 17.
68 Section 298 of the Companies Act 1 of 2012.
69 Uganda Law Reform Commission (n47) 2.
70 Omar, *International Insolvency Law: Reforms and Challenges* 32.
71 Uganda Law Reform Commission *'A Study Report on Insolvency Law'* ULRC Publication 13 of 2004,7.
72 Uganda Law Reform Commission '*A Study Report on Insolvency Law'* ULRC Publication 13 of 2004, 2.
73 Uganda Law Reform Commission *A Study Report on Insolvency Law* ULRC Publication 13 of 2004 xv.

In line with these guiding principles, the reform process considered experiences in other jurisdictions, including the United Kingdom,[74] Australia[75] and Hong Kong[76] among others, where extensive studies had been conducted before reforming their respective insolvency laws.[77] The reform processes were aimed at enhancing creditor confidence in the recovery of their monies through insolvency proceedings while at the same time providing adequate protection to the insolvent against creditors. The reforms also aimed at creating an insolvency regime that enhances an insolvent's entrepreneurial spirit and potential after insolvency rather than reducing it.[78]

The review was commissioned in 1999.[79] A study report with specific recommendations was issued by the Uganda Law Reform Commission (ULRC) in 2004.[80] This eventually culminated into the drafting of the Insolvency Bill 2009. The main theme of the Bill was to provide for receiverships, administration, liquidation, arrangements, bankruptcy, and regulation of insolvency practitioners as well as cross-border insolvency. The main objective of the Bill was to consolidate insolvency laws into one statute, reform the different forms of insolvency procedure and introduce corporate rescue procedures.[81]

The Bill provided an overhaul of the entire body of Insolvency Law in Uganda. It amalgamated the various insolvency laws and introduced new insolvency procedures such as administration.[82] Furthermore, it strengthened the rights and duties of

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74 Report of the Review Committee on Insolvency Law and Practice (Cmmd 8558, 1982)

75 *General Insolvency Inquiry: A Report of the Law Reform Commission of Australia, September 1998* ('the Hammer Report' 2.

76 The Law Reform Commission of Hong Kong *Report on Corporate Rescue and Insolvent Trading*, October 1996 and the *Report on the Winding up Provision of the Companies Ordinance*, July 1999.

77 Uganda Law Reform Commission *A Study Report on Insolvency Law* ULRC Publication 13 of 2004 xv.

78 Uganda Law Reform Commission *A Study Report on Insolvency Law* ULRC Publication 13 of 2004 xv.

79 Nyombi, Kibandama and Bakibinga 2014 JBL 657.

80 Uganda Law Reform Commission: *A Study Report on Insolvency Law* ULRC Publication no.13 of 2004; Nyombi, Kibandama and Bakibinga 2014 JBL 657.

81 Uganda Law Reform Commission *A Study Report on Insolvency Law* ULRC Publication 13 of 2004 2–4.

82 Nyombi, Kibandama and Bakibinga 2014 *JBL* 658.

insolvency practitioners and introduced provisions to cater for areas such as cross-border insolvency.[83]

The ULRC recommendations produced several significant changes in Uganda's Corporate Insolvency Law. Today, The ULRC report[84] is considered as the foundation of modern corporate insolvency law in Uganda.[85] After six years of debate and consultations,[86] the Insolvency Bill 2009 was finally passed by the Parliament of Uganda as the Insolvency Act 14 of 2011 (the Act) to cover both corporate and personal insolvency.[87] The Act came into force on 1 July 2013[88] and is celebrated as the first insolvency law to be passed by the Parliament of Uganda since its independence in 1962.[89]

3.2.3 State of insolvency law in Uganda after 2011

The coming into force of the Act heralded a new dawn in the legal and regulatory trajectory of insolvency practice in Uganda.[90] Although the ULRC, the architect of this law has been criticized[91] for not providing a formal statement regarding the purpose and/or objectives of the Act, a reading of the provisions of this law leaves no doubt that it was highly influenced by the trends and developments in English Insolvency Law, particularly, the recommendations in the English Cork Report.[92] The framers of the Insolvency Act were guided by the desire to provide a statutory approach that would oblige companies to pay attention to their finances and diagnose financial difficulties at the earliest stage in order to avoid plunging into insolvency.[93]

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83 Nyombi 2018 *IJMA* 1.

84 Uganda Law Reform Commission *A Study Report on Insolvency Law* ULRC Publication 13 of 2004.

85 Nyombi, Kibandama and Bakibinga 2014 *JBL* 657.

86 Nyombi, Kibandama and Bakibinga 2014 *JBL* 657.

87 The long title of the Insolvency Act 2011 clearly provides that it applies both to personal and corporate insolvency. Part III of the Act is clearly marked as applicable to individual insolvency while IV is made applicable to corporate insolvency.

88 reg 2 of The Insolvency Act 2011 (Commencement) Instrument 25 of 2013.

89 Nyombi 2018 *IJMA* 1.

90 *ibid*.

91 Nyombi 2018 *IJMA* 2.

92 *ibid.*

93 Uganda Law Reform Commission *A Study Report on Insolvency Law* ULRC Publication 13 of 2004 2.

The Act introduced two broad branches of legal development. The first is the formal legal procedure for business rescue and the orderly realisation of and distribution of assets of the insolvent. The second was the introduction of strong statutory rules to prevent abuse of insolvency administration processes and commercial malpractice[94] amongst players in the administration of companies.

It is argued that one of the essential objectives of the Act was the establishment of a protective legal framework through which value of the assets of the insolvent is not diminished upon the commencement of insolvency proceedings.[95]

In terms of theoretical approach, it is argued that the Act is dynamic. Its framers attempted to balance the various theoretical approaches and developed a framework that transformed Uganda's Insolvency Law into a modern insolvency law system which fosters the values of efficiency, accountability, fairness, and expertise.[96] Below, some of the key features of the Act are discussed.

(a) It introduced a new regulatory regime for insolvency practitioners.[97]

Before the coming into force of the Act, both the Companies Act Cap 110 and the Bankruptcy Act Cap 67 never prescribed any specific rules regarding the qualifications and licensing requirements for insolvency practitioners.[98] The law did not provide any clear safeguards against malpractices committed by individuals who were appointed to act as insolvency practitioners.[99] Insolvency practitioners were perceived as unprofessional and often accused of conniving with the most powerful creditors, mostly

94 Nyombi, Kibandama and Bakibinga 2014 *JBL* 666.

95 Institute of Certified Public Accountants of Uganda 'Corporate Recovery and Insolvency Guidelines' (2017) 6. Available at https://www.icpau.co.ug/sites/default/files/Resources/Corporate_Recovery_Insolvency_Guidelines.pdf (05–08–2019).

96 Nyombi 2018 *IJMA* 15.

97 Sections 203–211 of the Insolvency Act 2011 provide the meaning, qualifications and mode of appointment and removal of insolvency practitioners. Section 205 criminalises acting as an insolvency practitioner without the required qualifications.

98 Uganda Law Reform Commission *A Study Report on Insolvency Law* ULRC Publication 13 of 2004, 26.

99 Uganda Law Reform Commission *A Study Report on Insolvency Law* ULRC Publication 13 of 2004 26.

banks, at the expense of other creditors, which resulted into insolvency being perceived as an automatic trigger for liquidation and winding up of companies.[100]

The ULRC recommended that insolvency practitioners in Uganda should be regulated and that the persons qualified to act as insolvency practitioners should be restricted to accountants, auditors and advocates recognised and regulated by their respective professional bodies.[101] It was hoped that this would go a long way in engendering transparency and cleanliness in insolvency practice in Uganda.[102]

The Parliament of Uganda addressed this problem by prescribing specific qualifications and disqualifications for insolvency practitioners in the Act, including the creation of criminal sanctions for any person who purports to act as an insolvency practitioner without qualifications.[103] Section 204 of the Act succinctly provides that a person is not qualified to be appointed or to act as an insolvency practitioner unless he or she is a lawyer, an accountant or a chartered secretary who is a registered member of the relevant professional body.[104] Moreover, the Act defines an 'insolvency practitioner' broadly to include any person who acts as a receiver, a provisional administrator, an administrator, a provisional liquidator, a liquidator, a proposed supervisor of a voluntary arrangement, or a supervisor of a voluntary arrangement or a trustee in bankruptcy.[105] Every person who plays any leadership/oversight role in a company during insolvency is covered by this definition and hence subjected to the same professional requirements.

To further guarantee integrity of the practitioners, the Act provides that a person, even if professionally qualified to be appointed, is not eligible for appointment as an insolvency practitioner unless he or she provides security or professional indemnity to the clients as a form of insurance against the risk of loss arising from unprofessionalism or negligence.[106] The Act also gives creditors greater voice when

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100 Nyombi, Kibandama and Bakibinga 2014 *JBL* 658.

101 Uganda Law Reform Commission *A Study Report on Insolvency Law* ULRC Publication 13 of 2004, 27.

102 Uganda Law Reform Commission *A Study Report on Insolvency Law* ULRC Publication 13 of 2004, recommendations 22 and 28.

103 Nyombi 2018 IJMA 1; ss 203–211 of the Act.

104 Section 204(1)*(a)* of the Act.

105 Section 203 of the Act.

106 Section 204(1)*(b)* of the Act.

selecting an insolvency practitioner,[107] so much so that even if an insolvency practitioner complies with the statutory requirements, the creditors can reject his or her appointment if they, for instance, feel unconvinced about the proposed practitioner's ethical commitment to uphold their interests during the insolvency proceedings.[108]

If these statutory standards are enforced, insolvency practitioners have no choice but to professionally execute their duties under the law and ensure efficiency and transparency in the management of affairs of the insolvents in Uganda.

(b) The Act consolidated the law on both corporate and personal insolvency.

The Act repealed both the Bankruptcy Act Cap 67, which used to deal with personal insolvency and parts of the Companies Act Cap 110, which used to regulate corporate insolvency.[109] The ULRC argued that consolidation of the law on both personal and corporate insolvency would save time for practitioners and promote efficiency in insolvency processes.[110] Incorporating all matters pertaining to insolvency of individuals and company was expected to make it easier for practitioners, students and the general public to access only one law as the source on all insolvency matters in the country.[111] Moreover, the consolidation also extended into merging both the statutory and common law rules on insolvency into one law.[112]

The Act effected these recommendations by consolidating the law on insolvency of both individuals and companies into one piece of legislation.[113] Moreover, section 264 of the Act provides that the rules of equity and common law applicable to corporate insolvency and bankruptcy of individuals and receiverships in England shall continue

107 Nyombi, Kibandama and Bakibinga 2014 *JBL* 658.
108 Section 146(4) of the Act; Nyombi, Kibandama and Bakibinga 2014 *JBL* 658.
109 Section 262 of the Act.
110 Uganda Law Reform Commission *A Study Report on Insolvency Law* ULRC Publication 13 of 2004, 11.
111 Uganda Law Reform Commission *Study Report on Company Law* ULRC Publication No.35 2004, 41.
112 Uganda Law Reform Commission *A Study Report on Insolvency Law* ULRC Publication 13 of 2004, 6.
113 Part III of the Insolvency Act 14 of 2011 is dedicated to individual insolvency while Part IV contains provision specifically for corporate insolvency.

in force except where they are inconsistent with the provisions of the Act. This was a critical step towards limiting protracted litigation on insolvency matters and simplification of the law and practice of insolvency in Uganda.[114] The framers of the law hoped that having a consolidated law for both personal and corporate insolvency would promote efficiency and save costs in the management of insolvencies in Uganda.[115]

Although the framers of the Act are credited for attempting to consolidate and harmonise all laws on the management of insolvencies in Uganda, it is apparent that the Act did not achieve full consolidation. The long title of the Act shows that the intention of Parliament was to consolidate all the laws relating to insolvency applicable to all of types of companies and persons in Uganda. However, this intention has not materialised.

In practice, the scope of the Act is limited to insolvency of individuals and companies other than financial institutions licensed under the Financial Institutions Act 2 of 2004 (the Financial Institutions Act) and the Insurance Act 6 of 2017 (the Insurance Act).

Parts X and XI of the Financial Institutions Act provide a special procedure through which financial institutions may be placed under receivership and liquidation. Moreover, section 133 of the Financial Institutions Act provides that for purposes of any matter concerning financial institutions, the Financial Institutions Act shall take precedence over any other enactment. In case of a conflict, the Financial Institutions Act shall take precedence over other laws.

This position was recently confirmed by Justice David Wangutsi of the High Court Commercial Division in *Sudhir Ruparelia and Meera Investments Limited v Crane Bank Limited (in receivership).*[116] The judge ruled, among other things, that on matters involving liquidation or insolvency of a financial institution, the Financial Institutions Act takes precedence over any other piece of legislation.[117] By necessary implication this

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114 Nyombi 2014 *JBL* 658.
115 Insolvency Bill 2009 Part IV and Sched 4.
116 Misc. Application no. 320 of 2019.
117 *Sudhir Ruparelia and Meera Investments Limited v Crane Bank Limited (in Receivership)* Misc. Application no. 320 of 2019 7.

makes the Act inferior to the law regulating the insolvency of banks and other financial institutions.

A similar approach is followed in the Insurance Act. This statute also extensively restricts the application of the Insolvency Act and the Companies Act to the winding up and liquidation of licensed providers of insurance services in Uganda.[118]

The reservation of special rules and procedures for the management of insolvency of banks and insurance companies may have been justified by the sensitivity of operators in such sectors to the financial stability of the entire economy. However, it is argued that the eligibility criteria for appointment of receivers and liquidators under the Financial Institutions Act, the Insurance Act or any other specialised laws should be the same as those applicable to other insolvency practitioners appointed under the Act. This is so especially because most banks and insurance companies are bigger than average companies, which means that management of liquidations and receiverships of such big operations requires extra skills, competency, and professionalism.

Persons appointed to discharge roles of insolvency practitioners under the Financial Institutions Act and the Insurance Act should ideally be subjected to even more stringent obligations than those prescribed under Part VIII of the Act. This will promote professionalism, accountability, and transparency in the management of distressed financial and insurance institutions as it is the case for other companies and insolvent individuals. This may further mitigate the risks that were recently reported regarding the manner in which the Bank of Uganda has been managing the affairs of insolvent banks in Uganda.[119]

118 Sections 125–31 of the Insurance Act 6 of 2017.

119 Report of the Parliament of Uganda Committee on Commissions, Statutory Authorities and State Enterprises (COSASE) on the Special Audit Report of the Auditor General on Defunct Banks February 2019 Available at https://www.parliament.go.ug/cmis/views/2b2ae8f774e94ad8ae77a2ff9897d092%253B1.0 (30/09/2019).

(c) The Act introduced corporate rescue.

This change was intended to increase the survival rate of companies in financial distress.[120] Before the enactment of the Act, the Companies Act Cap 110 was generally silent on corporate rescue.[121] Compromises and arrangements were the only possible alternative to winding up and liquidation of financially distressed companies.[122] Compromises and arrangements were a procedure copied from the English Companies Act of 1948 through which a company and its creditors could enter into an informal deed, agreement or compromise. The company could accordingly agree to pay its creditors portions of the debt over an agreed period of time.[123]

The procedure through which any proposed compromise or arrangement could be pursued under section 207 of the Companies Act Cap 110 was, however, riddled with several procedural roadblocks.[124] The procedure entailed an application being made in court by either the company, a member of the company, creditor or a liquidator.[125] Moreover, the court order authorising the compromise or arrangement would be of no effect until a certified copy thereof had been delivered to the registrar of companies for registration and a copy annexed to every copy of the company memorandum or any other instrument constituting the subject company.[126] The procedure was, by any standards, cumbersome for users and practitioners. In fact, compositions and arrangements were never used for a period exceeding 30 years to meaningfully rescue any company in Uganda.[127]

This was further worsened by the fact that arrangements and compositions under the Companies Act Cap 110 never provided for a moratorium on legal proceedings against

120 Nyombi, Kibandama and Bakibinga 2014 *JBL* 659.
121 *ibid*.
122 Section 207 of the Companies Act Cap 110 of 1961.
123 Omar and Gant 2016 *Insolvency Law Journal* 40–61.
124 Uganda Law Reform Commission *A Study Report on Insolvency Law* ULRC Publication 13 of 2004, 14.
125 Section 207(1) and (2) of the Companies Act Cap 110 of 1961; Uganda Law Reform Commission *A Study Report on Insolvency Law* ULRC Publication 13 of 2004, 14.
126 Section 207(3) of the Companies Act Cap 110 of 1961.
127 Uganda Law Reform Commission *A Study Report on Insolvency Law* ULRC Publication 13 of 2004,14.

a company in distress.[128] Any attempt by a company to enter into an arrangement, composition or reconstruction with creditors could easily trigger winding up proceedings against the company by other creditors.[129]

It is, therefore, difficult to argue that the pre-2011 insolvency legal regime in Uganda provided a realistic corporate rescue mechanism. The ULRC, therefore, sought to incorporate international principles on corporate rescue into the Insolvency Act, arguing that the process for review of the law relating to insolvency must go beyond merely amending and patching up the old law. Instead, deliberate provisions targeted at rehabilitation rather than punishing and stigmatisation of insolvency were opted for.[130] It was recommended that a balance should be struck to provide for adequate punishment of the insolvent, and to deter fraudulent company directors. At the same time, rehabilitation should be sought to allow the insolvent but viable companies to resume a productive role in the economy after overcoming insolvency.[131]

Accordingly, Parliament incorporated Administration into the Act[132]as a statutory alternative remedy to liquidation of insolvent companies in Uganda.[133] Administration was introduced as a procedure through which financially distressed companies could agree with their creditors to appoint an independent person(s) to reorganise, manage and operate the business of the company in a manner that can result into the survival of the company and the whole or any part of its undertaking as a going concern.[134] Alternatively, where this was not reasonably possible, a more advantageous realisation of the company's assets than would be effected in a liquidation would be pursued.[135]

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128 Uganda Law Reform Commission *A Study Report on Insolvency Law* ULRC Publication 13 of 2004,14.

129 *ibid.*

130 Uganda Law Reform Commission *A Study Report on Insolvency Law* ULRC Publication 13 of 2004,9.

131 Uganda Law Reform Commission *A Study Report on Insolvency Law* ULRC Publication 13 of 2004, recommendation 1(a).

132 Sections 138–74 of the Act.

133 Nyombi, Kibandama and Bakibinga 2014 *JBL* 659.

134 Section 140*(b)*(i) of the Act.

135 Section 140*(b)*(iii) of the Act.

Administration entails a two-stage procedure,[136] kick-started by the appointment of a provisional administrator by court.[137]The provisional administrator's core mandate is to investigate the company's business, property, affairs, and financial circumstances and to assess whether there are reasonable prospects for the rescue of the company.[138] If rescuing the company appears to be a viable pursuit, an administration deed is prepared and presented to creditors for consideration. Provisional administration entails a preliminary diagnostic evaluation of the company and is expected to be concluded within only thirty (30) days.[139] The provisional administrator is required to present a proposal[140] to the creditors detailing how their respective debts will be paid. Once this proposal is approved, an administration deed is executed. In the administration deed, among other things, the creditors agree to place the company into full administration.[141]

The most important feature of administration is that it imposes a moratorium on creditors' actions and legal proceedings against the company.[142] This gives breathing space to the administrator to concentrate on achieving the purpose of administration without having to fend off court proceedings and enforcement actions by creditors and other parties.[143]

The introduction of administration was a big step towards nurturing a corporate rescue culture in Uganda. It breathed a ray of hope for the many financially distressed, but viable companies that were exposed to the risk of liquidation and asset stripping by aggressive creditors in Uganda.[144] Part VI of the Act has provided a helpful alternative procedure through which creditors and company directors can deal with financial distress.[145] Creditors and the company directors can agree to place the company into

136 Nyombi, Kibandama and Bakibinga 2014 *JBL* 660.
137 Section 139 of the Act.
138 Section 140(1)*(a)* of the Act.
139 Section 145 of the Act; Nyombi, Kibandama and Bakibinga 2014 *JBL* 660.
140 Section 148 of the Act.
141 Section 162 of the Act.
142 Nyombi, Kibandama and Bakibinga 2014 *JBL* 660.
143 Section 143 of the Act; Nyombi, Kibandama and Bakibinga 2014 *JBL* 660.
144 Nyombi, Kibandam and Bakibinga 2014 JBL 659.
145 Waiswa 2015 The East African (31 October 2015). Available at https://www.theeastafrican.co.ke/oped/comment/Urgent-insolvency-advice-for-Uchumi-management-/434750-2937456-acac5s/index.html (20 August 2019).

administration and monitor its potential for recovery before turning to liquidation and other disruptive debt enforcement procedures.[146]

(d) Introduced cross-border insolvency

Before the enactment of the Act, Uganda lacked a clear legal procedure for the management of insolvency of companies that were operating businesses in Uganda and elsewhere.[147] The only provision on cross-border insolvency was found in section 222*(g)* of the Companies Act Cap 110, which empowered a court in Uganda to wind up a company incorporated outside Uganda, but carrying on business in Uganda, if winding-up proceedings had been commenced against the company in its country of incorporation or in any country where it established a place of business. However, the law did not provide any further guidance regarding the manner in which affected parties could proceed with the management of the assets of such companies, let alone on how creditors in Uganda could enforce their claims against the parent company on the basis of the debts incurred by the Ugandan subsidiary.[148]

Due to the haze surrounding cross-border insolvency, no case was ever registered on cross-border insolvency for the over 50 years when the Companies Act Cap 110 was in force in Uganda.[149] This prompted the ULRC to recommend inclusion of clear provisions on cross-border insolvency and the procedure for reciprocal enforcement of insolvency orders made in Uganda in other countries and vice versa.[150] This proposal was adopted and incorporated in Part IX of the Act, which now allows any insolvency orders made in Uganda to be enforced in other countries with whom Uganda has reciprocal arrangement.[151] The Act also details the procedures through which orders made in foreign jurisdictions can be enforced in Uganda.[152]

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146 Section 139(3) and (4) of the Act.
147 Uganda Law Reform Commission *Study Report on Company Law* ULRC Publication No.35 2004, 22.
148 Uganda Law Reform Commission *A Study Report on Insolvency Law* ULRC Publication 13 of 2004, 47.
149 Uganda Law Reform Commission *Study Report on Company Law* ULRC Publication No.35 2004, 22.
150 Uganda Law Reform Commission *Study Report on Company Law* ULRC Publication No.35 2004,51.
151 Section 212 of the Act provides the procedures through which the Minister may declare reciprocating states, territories, and courts.
152 Nyombi, Kibandama and Bakibinga 2014 *JBL* 659.

(e) The Act clarified the roles of the official receiver as the default insolvency practitioner, licensor and regulator of all insolvency practitioners in Uganda

Prior to the coming into force of the Act, persons that were appointed to discharge roles of insolvency practitioners in Uganda were not professionally regulated.[153] Whereas the Companies Act Cap 110 provided for liquidation and winding up of companies, it exclusively vested the mandate to appoint liquidators and receivers of companies to creditors, where the company was undergoing a creditor's voluntary winding up,[154] or the court where the winding up arose out of a petition to court.[155] A company could also appoint a liquidator to wind up the company in cases of a member's voluntary winding-up.[156] Save for providing for a general disqualification of companies from acting as liquidators,[157] the Companies Act Cap 110 did not prescribe any other specific qualifications and/or requirement for one to have a license before being considered eligible for appointment by either the company, court or the creditors to discharge roles of an insolvency practitioner. This meant that any person could be appointed as a liquidator or receiver for a company in financial distress.

The Companies Act Cap 110 did not clearly circumscribe the role and powers of the Official Receiver over the operations of persons appointed to act as liquidators and receivers in respect of companies incorporated or registered in Uganda. It only provided that an aggrieved person, including a creditor, contributory or shareholder could apply to court for an appropriate order against the liquidator if they were aggrieved by the actions of the liquidator or the receiver.[158] This process was, however, weak in ensuring professionalism, accountability, and quality of service by those appointed to act as liquidators.[159]

The Act has, however, improved the situation by categorically providing in Part VIII for the powers and functions of the Official Receiver as the licensor and regulator of

153 Nyombi, Kibandama and Bakibinga 2014 *JBL* 658.
154 Section 292 of the Companies Act 110 of 1961.
155 Section 311 of the Companies Act 110 of 1961.
156 Section 283 of the Companies Act 110 of 1961.
157 Section 330 of the Companies Act 110 of 1961.
158 Sections 302 and 311 of the Companies Act 110 of 1961 provided for the right to apply to court for removal of a liquidator or resolution of any issues raised against the liquidator.
159 Nyombi, Kibandama and Bakibinga 2014 *JBL* 658.

insolvency practitioners in Uganda.[160] The Official Receiver is now statutorily mandated, amongst other things, to investigate the conduct of insolvency practitioners and to prosecute them for any offences committed.[161] The Act also prescribes the qualifications for one to act as an insolvency practitioner[162] and a requirement to register and obtain a license before one can be eligible for appointment as an insolvency practitioner in Uganda.[163] In addition, section 199*(e)* empowers the Official Receiver to act as the default practitioner whenever, for whatever reason, a vacancy arises during any insolvency proceedings. For instance, in case of sudden death or incapacitation of the appointed practitioner, the Official Receiver automatically assumes the roles of the practitioner until such a time that a new office holder is appointed by court, creditors or members. This protects the stakeholders against potential risk of loss arising out of a delay in filling the position of an insolvency practitioner to take charge of the company.

It is believed that these measures will go a long way in promoting professionalism and accountability amongst insolvency practitioners in Uganda, including those appointed under specialised laws such as the Financial Institutions Act and the Insurance Act.

(f) The Act differentiates between winding up and liquidation of companies in Uganda

Prior to the enactment of the Act, the procedures for winding-up and liquidation of companies in Uganda was all contained in the repealed Companies Act Cap 110.[164] Section 212 of the Companies Act used to provide that winding up of a company could either be commenced by the court,[165] initiated voluntarily by members or creditors[166] or conducted subject to the supervision of court.[167] The Act listed seven circumstances under which a company could be wound up by the court, to wit: where, the company, by special resolution resolved that the company be wound up by the court;[168] in the

160 Regulation 8 of the Insolvency Practitioner's Regulations SI 55 of 2017.
161 Section 199*(d)* of the Act.
162 Section 204 of the Act.
163 Regulation 8 of the Insolvency Practitioner's Regulations SI 55 of 2017.
164 Sections 212–348 of the Act.
165 Section 212(1)(*a)* of the Act.
166 Section 212(1)*(b)* of the Act.
167 Section 212(1)*(c)* of the Act.
168 Section 222(1) of the Act.

event of a failure to deliver a statutory report to the registrar of companies or to hold a statutory required meeting;[169] and where the company did not commence its business within a year from its incorporation.[170] Other circumstances included where the number of members of the company reduced, in case of a private company, to less than two, or in the case of any other company, to less than seven;[171] where the company was unable to pay its debts;[172] or where the court was of the opinion that it was just and equitable for the company to be wound up by court;[173] and in case of a company incorporated outside Uganda and carrying on business in Uganda, where winding up proceedings had been commenced against the company in any other country where it had established a place of business.[174]

It is evident from these provisions that a company could be wound up by the court because of a wide range of reasons, including insolvency and other non-debt related reasons. Even where a company was solvent and the members decided to voluntarily cease running of the business, for instance where the company had met the objectives for which it was incorporated or otherwise voluntarily for other strategic reasons not connected to inability to pay debts, the company would still endure liquidation processes.[175]

Liquidation and winding-up processes were generally understood and applied as one and same process.[176] Both procedures were governed by the same law, the Companies Act Cap 110.[177] In fact, in most jurisdictions, the terms winding-up and liquidation are used interchangeably to refer to the collective insolvency processes leading to the end of a company's life.[178]

169 Section 222(2) of the Act.
170 Section 222(3) of the Act.
171 Section 222(4) of the Act.
172 Section 222(5) of the Act.
173 Section 222(6) of the Act.
174 Section 222(7) of the Companies Act 110 of 1961.
175 Sections 276–307 of the Companies Act 110 of 1961.
176 Waiswa, *A Concise Workbook on Fundamentals of Commercial Law in Uganda* 319.
177 *ibid.*
178 Waiswa 2015 *Euroflex* 3. Available at https://www.insol-europe.org/download/documents/885 (20-06-2019); Goulding, *Company Law* 389.

From a conceptual perspective, however, winding up and liquidation are not the same. Winding up is a process through which the life and operations of a company are ended.[179] It may also be defined as the process of stopping the business of a company, realising its assets, discharging its liabilities, settling any questions of account or contribution between its members, distributing the surplus assets, if any, among the members and terminating the existence of the company by dissolution.[180]

Winding up may or may not involve the sale of the company assets. The primary purpose of winding up is to decently arrange for the orderly closure of the company,[181] by ensuring that its affairs, relations with third parties and rights are properly terminated. Where the company owned property, winding up may involve the sale of assets and distribution of the proceeds to creditors or members as the case may be. Hence, whereas winding-up may involve sale/liquidation of the company assets, this is not the primary objective of winding up processes.[182]

On the flipside, 'liquidation' is derived from the word 'liquidate', which in ordinary English parlance means to settle an obligation by payment or to convert into cash.[183] Liquidation is the process through which the assets of an insolvent company are collected, sold and the proceeds therefrom distributed to the company creditors and the residue to the members.[184] Liquidation is also sometimes defined as the act or process of converting assets into cash to settle debts.[185]

While explaining the jurisprudential meaning of liquidation, Pigeon J of the Supreme Court of Canada in *Dauphin Plains Credit Union Ltd v Xyloid Industries Ltd,*[186] stated:

> [I]f one searches dictionaries, it is not hard to find a definition of liquidation wide enough to include bankruptcy. In the Century Dictionary this is given: 'Liquidation: the act or operation of winding up the affairs of a firm or company by getting in the assets, settling with its debtors and creditors and apportioning the amount of each

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179 Madhuku 1995 *Zimbabwe Law Review* 6.

180 The *General Insolvency Inquiry: A Report of the Law Reform Commission of Australia, September 1998* ("the Hammer Report") para 128.

181 Goode, *Principles of Corporate Insolvency Law* 36.

182 Malescu Law 'Differences between Liquidation, Dissolution and Winding up' (Miami 10 July 2019).Available at https://malesculaw.com/difference-between-liquidation-dissolution-.–and-.–winding-up/ (28-10–2019).

183 Garner, *Black's Law Dictionary* 1015.

184 Waiswa, *A Concise Workbook on Fundamentals of Commercial Law in Uganda* 319.

185 Garner, *Black's Law Dictionary* 105.

186 [1980] 1 SCR 1182.

partner's or shareholder's profit or loss, etc.' Liquidate: Law and commerce: To ascertain and set out clearly the liabilities of (a company or firm) and to arrange the apportioning of the assets; to wind up'. In Corpus Juris, that mine of information, is this definition: 'Liquidation, a word of French origin, is not a technical term, and, therefore, can have no fixed legal meaning; but it has a fairly defined legal meaning and it is said to be a term of jurisprudence, of finance and of commerce. It is defined as the act of settling, adjusting debts or ascertaining their amounts or balance due; settlement or adjustment of an unsettled account…Applied to a partnership or company, the act or operation of winding up the affairs of a firm or company by getting in the assets, settling with its debtors and creditors and appropriating the amount of profit or loss.[187]

Primarily, liquidation is triggered by an inability to pay debts. Liquidation always results in the sale of the company assets to recover funds to settle the creditor's claims. Liquidation entails proceedings to sell and dispose of assets for distribution to creditors in accordance with the insolvency law.[188] Therefore, it is obvious that the primary objective of liquidation is the sale of the company assets to raise funds for distribution to the creditors.

Liquidation, unlike winding-up, is concerned more with the collection, sale of company assets and thereafter distribution of the proceeds to the creditors. Orderly closure of the company is not the primary focus of a liquidator appointed to undertake a liquidation. Dissolution of the company is only but a consequential outcome of liquidation, after the distribution of the proceeds of liquidation has been concluded.[189]

Before the coming into force of the Act, this conceptual distinction between winding-up and liquidation was blurred. However, through the Act, the Parliament of Uganda distinguished between liquidation and winding-up procedures by limiting liquidation procedure to only companies that are unable to pay their debts, as defined under the insolvency Act,[190] and winding up applicable to solvent companies under the general law on companies. This distinction was subsequently confirmed in the Companies Act 1 of 2012, Part IX of which is dedicated to voluntary winding up of solvent companies.

187 Pigeon J in *Dauphin Plains Credit Union Ltd v Xyloid Industries Ltd* [1980] 1 SCR 1182, 1203.

188 United Nations Commission on International Trade Law (UNCITRAL) Legislative Guide on Insolvency law (United Nations New York 2005) 5. Available at https://www.uncitral.org/pdf/english/texts/insolven/05-80722_Ebook.pd (28-10-2019).

189 Nyombi, Kibandama and Bakibinga 2014 *JBL* 663.

190 Sections 3 of the Act.

Part IV of the Act extensively provides for liquidation of insolvent companies in Uganda. It specifies that liquidation of a company may be done through court,[191] voluntarily by either the members or creditors,[192]or subject to the supervision of court.[193] Irrespective of the mode through which liquidation is commenced, the Act is now clear that liquidation of a company can only be commenced against or by a company that is unable to pay its debts.[194]

Winding up, on the other hand, is a voluntary step initiated by the company itself, with the primary objective of ending its life for whatever reason. So long as the company can confirm that it has financial capacity to settle all its debts within a period of twelve (12) months from the date of commencement of the winding-up processes, it is permissible.[195]

Section 271 of the Companies Act 1 of 2012 specifically provides that before a company can pass a resolution to voluntarily wind up, the company directors must first prepare and file with the registrar of companies a declaration of solvency which must contain a statement confirming that the company is in a position to pay all its liabilities within twelve (12) months from the date of passing the resolution to wind up the company.[196]

It is expected that with this distinction between liquidation and winding up being clearly spelt out in the Act and the Companies Act 1 of 2012, practitioners, students and the public are in a better position to make guided decisions about the procedures they may choose to undertake.

From the exposé above, it is evident that the Act set Uganda on the right path towards achieving a modern insolvency system. Although there is no official report detailing

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191 Section 57*(a)* of the Act.
192 Section 57*(b)* of the Act.
193 Section 57*(c)* of the Act.
194 Section 91(2) determines that the court may appoint a liquidator if it is satisfied that the company in respect to which the order is sought is unable to pay its debt as defined under s 3 of the Act. For voluntary liquidation, s 58(1) provides that a company may be liquidated voluntarily if the company passes a special resolution that it cannot, by reason of its liabilities continue its business.
195 Section 271 of the Companies Act 1 of 2012.
196 Waiswa, *A Concise Workbook on Fundamentals of Commercial Law in Uganda* 320.

the impact that this law has had so far on insolvency processes in Uganda, it is comforting that these measures are now part of the legal regime in Uganda. There is every reason to be hopeful that the Act will bring many benefits to insolvency practice in Uganda.

3.3 Meaning of inability to pay debts in Uganda

In a bid to create a self-contained legislation on insolvency and minimise room for any possible ambiguity in the application of the law, the framers of the Act deemed it necessary to statutorily define what 'inability to pay debts' means in the Act.[197] It was hoped that prescribing a statutory meaning to the phrase 'inability to pay debts' would give a clear indication of the various ways through which a company may be presumed to be unable to pay its debts and when it may be exposed to the risk of being subjected to insolvency proceedings.[198]

Unfortunately, as in many other countries,[199] the statutory definition in the Act is not a definition in a strict sense. It only provides a list of factors, which if proved, can form the basis for the court's decision to presume that one is indeed unable to pay his or her debts.

Section 3 of the Act[200] defines 'inability to pay debts' as follows:

> (1) Subject to subsection (2) and unless the contrary is proved, a debtor is presumed to be unable to pay the debtor's debts if-
> (a) The debtor has failed to comply with a statutory demand;
> (b) The execution issued against the debtor in respect of a judgment debt has been returned unsatisfied in whole or in part; or
> (c) All or substantially all the property of the debtor is in the possession or control of a receiver or some other person enforcing a charge over that property.
>
> (2) On a petition to the court for the liquidation of a company or bankruptcy order, evidence of failure to comply with a statutory demand by the creditor shall not be admissible as evidence of inability to pay debts unless the application is made within 30 working days after the last date for compliance with the demand.
>
> (3) Subsection (1) does not prevent proof of inability to pay debts by other means.

197 Nyombi, Kibandama and Bakibinga 2014 *JBL* 665.
198 *ibid.*
199 Meng 2014 *LQR* 1.
200 14 of 2011.

(4) In determining whether a debtor is unable to pay the debtor's debts, contingent or prospective debts may be taken into account.

(5) A petition to the court for the liquidation of a company or bankruptcy order on the ground of inability to pay debts, may be made by a contingent or prospective creditor only with the leave of the court; and the court may give such leave, with or without conditions, only if it is satisfied that a prima facie case of inability to pay debts has been made out.'

Although the wording of this section may appear clear, it is obvious that it does not provide an all-inclusive definition of what 'inability to pay debts' means. It only lists some of the circumstances under which a legal presumption of inability to pay debts may be made. Moreover, section 3(3) provides that subsection 1 does not prevent proving inability to pay debts in other ways. This means that other means may be used to prove inability to pay debts. Consequently, there are more ways than the three circumstances highlighted in section 3(1)*(a)* of the Act. A creditor can prove that a debtor is unable to pay his or her debts in any way possible so long as the evidence adduced can demonstrate and/or otherwise prove to the satisfaction of court on the balance of probabilities that the debtor is unable to pay his or her debts.

In fact, contrary to what Musa Ssekaana J of the High Court of Uganda recently stated *obiter dicta* in the personal insolvency case of *Deox Tibeingana v Numbers Finance and Investment Co Ltd,*[201] there is no *lacunae* in the law regarding what happens when an individual in his own admission in an affidavit or acknowledgement by letter, admits liability in writing or otherwise. The learned judge wondered whether a creditor should always first file a suit in court and obtain judgment before he or she can serve a statutory demand against a debtor before commencing insolvency proceedings against a debtor that has confessed to being unable to pay debts.

Contrary to what the learned judge stated[202] to be a lacuna in the law, where a debtor acknowledges a debt by letter or through an affidavit as the case may be, the creditor does not need to first file a suit in court to obtain judgment before he or she can commence insolvency proceedings against such a debtor. The creditor may prove inability to pay debts against the debtor based on the debtor's acknowledgement or admission of liability in accordance with section 3(3) of the Act, which unequivocally

201 High Court Misc. case no. 101 of 2019 8 (16 August 2019).
202 *Deox Tibeingana v Numbers Finance and Investment Co Ltd* Misc. case no. 101 of 2019, 6.

permits a creditor to prove a debtor's inability to pay debts in other ways than the circumstances listed under section 3(1)*(a)*, *(b)* and *(c)* of the Act.

The only difference is that where a creditor decides to commence insolvency proceedings against an individual debtor based on a debt not arising out of a judgment, the creditor should not attempt to serve a statutory demand against the debtor under section 3(1)*(a)* of the Act. This happened in *Deox Tibeingana v Numbers Finance and Investment Co Ltd.*[203] In that case, the respondent company served a statutory demand notice against the applicant, a renowned lawyer in Kampala, claiming for a debt of UGX 640,000,000 arising out of breach of a loan agreement. By the time the statutory demand was served on the applicant, the respondent had not obtained a judgment against the applicant for the debt in issue. This prompted the debtor to file an application to court seeking for orders to set aside the statutory demand in accordance with section 5 of the Act.

In granting the application, Musa Ssekaana J reiterated that the law on insolvency aims to enforce rights and not to establish rights. He proceeded:

> a statutory demand cannot issue against an individual without a judgment, or the debtor being found liable under a judgment. It was erroneous for the respondent to issue a statutory demand without a judgment.[204]

It is in this case that the learned Justice stated *obiter dicta*, that there seems to be a *lacuna* in the law regarding how creditors with claims against individual debtors should commence insolvency proceedings against non-judgment debtors.[205]

However, a creditor can commence insolvency proceedings against the debtor on the basis of such other evidence of inability to pay debts in accordance with section 3(3) of the Act. In such a case, the creditor's petition, and the affidavit in support thereof, should focus on proving and attaching the specific evidence from which court can infer inability to pay debts by the debtor. The creditor should not issue a statutory demand notice.

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203 Misc. case no. 101 of 2019.
204 Deox Tibeingana v Numbers Finance and Investment Co Ltd Misc. case no. 101 of 2019,6.
205 *Deox Tibeingana v Numbers Finance and Investment Co Ltd* Misc. case no. 101 of 2019, 8.

The foregoing notwithstanding, section 3(1) of the Act provides the first line of considerations that are normally relied upon in proving a debtor's inability to pay debts. Let us examine the import of each of the said statutory presumptions of inability to pay debts in Uganda.

(a) The debtor has failed to comply with a statutory demand.

The Act defines a statutory demand to mean a demand made in accordance with section 4 of the Act.[206] For ease of reference and to have a contextualised discussion on the import of this provision, it is important to reproduce section 4 of the Act hereunder.

> **4. Statutory demand**
>
> (1) A demand by a creditor in respect of a debt made in accordance with this section shall be a demand notice and shall constitute a statutory demand.
>
> (2) A statutory demand shall-
> (a) be made in respect of a debt that is not less than the prescribed amount and in the case of debt owed by-
> (i) an individual, is a judgment debtor; or
> (ii) a company, is an ascertained debt but need not be a judgment debt;
> (b) be in the prescribed form;
> (c) except where the debt is a judgment debt, be verified by a statutory declaration attached to the demand.
> (d) be served on the debtor; and
> (e) require the debtor, to pay the debt or compound with the creditor or give a charge over property to secure payment of the debt, to the reasonable satisfaction of the creditor within twenty working days after the date of service or a longer period as the court may order.

To further simplify the legislation for users, the Insolvency Regulations[207] provide that a statutory demand shall specify:[208]

(a) The amount of the debt owed and in the case of a debt arising out of a judgment or order of a court, the details of the judgment or order.[209]

(b) How the debtor may comply with the statutory demand.[210]

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206 Section 2 of the Act.
207 The Insolvency Regulations SI 36 of 2013.
208 Regulation 4(2).
209 Regulation 4(2)*(a)*.
210 Regulation 4(2)*(b)*.

(c) Where the debt is secured, the nature of the security.[211]

(d) Whether and how the debtor may compound the debt or give a charge over property to secure the debt.[212]

(e) That, if the debtor does not comply with the demand within the time specified in section 4(2)*(e)* of the Act, insolvency proceedings may be commenced against the debtor;[213] and

(f) The right of the debtor to apply to court to set aside the statutory demand.[214]

Regulation 5[215] further prescribes how a statutory demand notice is supposed to be served. It provides that the notice must be served personally on the debtor.[216] If the debtor cannot be found, the demand may be served at the registered office or place of business of the debtor or sent to the address of the debtor by registered mail or served on the legal representative of the debtor, if known, or served in any other manner determined by the court.[217]

In *Springs International Hotel Ltd v Hotel Diplomate Ltd and Boney M Katatumba*[218] Musa Ssekaana J of the High Court of Uganda held among others that service of a statutory notice must be effected on the debtor personally as a first option before service can be done on the legal representative of the debtor.[219] He held that a statutory demand is not merely a document like an ordinary letter. It has far reaching consequences and could lead to initiation of winding up proceedings against the company if not responded to within twenty (20) working days.[220] This shows that the form and manner in which a statutory demand is served on the debtor must be strictly adhered to.

Besides the form, it is important to note that all the other statutory requirements of a statutory demand must be satisfied before the court can rely on failure to comply with

211 Regulation 4(2)*(c)*.
212 Regulation 4(2)*(d)*.
213 Regulation 4(2)*(e)*.
214 Regulation 4(2)*(f)*.
215 Insolvency Regulations SI 36 of 2013.
216 Regulation 5(1).
217 Regulation 5(2).
218 High Court Misc. case no. 42 of 2015.
219 *Springs International Hotel Ltd v Hotel Diplomate Ltd and Boney M. Katatumba* High Court Misc. case no. 42 of 2015, 4.
220 Section 4(2)*(e)* of the Act.

a statutory demand to presume that the debtor is indeed unable to pay his or her debts. Notably, a statutory demand must be made in respect of a debt that is not less than the prescribed amount and the debt must be an ascertained debt. The prescribed amount is UGX 2,000,000 (Two million Ugandan shillings),[221] which is approximately equivalent to SAR 8262 (Eight thousand two hundred and sixty-two South African Rand).

Courts have in several cases reiterated the English common law position that bankruptcy proceedings, whether personal or corporate, are a collective proceeding to enforce rights and not to establish them.[222] It was held:

> The use of the word ascertained in the legislation is used for a purpose and definitely that purpose must be given its full effect. A debt can only be ascertained by both parties agreeing to the same or having a common position on it. A debt cannot be certain if one of the parties is disputing the same. Once a debt is not yet ascertained then it means that a right has not yet been established in order to trigger the insolvency proceedings by way of issuing a statutory demand.[223]

While stressing the requirement for the debt to be ascertained before service of a statutory demand, Musa Ssekaana J in *Omer Farming Company Ltd v Rehoboth Agricultural Management Services Ltd*[224] noted:

> The sum effect of failing to have the debt ascertained or an ascertained debt is that it would automatically raise triable issues that would invite court to set aside the statutory demand.[225]

It is for that reason that section 4(2)*(c)* of the Act clearly adds the requirement that where the statutory demand does not relate to a judgment debt, the statutory demand must be verified by a statutory declaration wherein the creditor is expected to state, on oath, the basis for his or her claim against the debtor.

A company may, therefore, be served with a statutory demand in respect of any ascertained debt, not necessarily a judgment debt.[226] This means that a trade creditor

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221 Section 2 and Sched 2 to the Act.

222 *Springs International Hotel Ltd v Hotel Diplomate Ltd and Boney M Katatumba* High Court Misc. case no. 42 of 2015; *Cambridge Gas Transportation Corp v Official Committee of Unsecured Creditors of Navigator Holdings PLC* (2007) 1 A.C 508.

223 Per Musa Ssekaana J of the High Court of Uganda in the case of *Omer Farming Company Ltd v Rehoboth Agricultural Management Services Ltd* High Court Misc. case no.21 of 2019.

224 High Court Misc. case no. 21 of 2019.

225 High Court Misc. case no. 21 of 2019 8.

226 Section 4(2)(ii) of the Act.

or any other person who is owed an established debt above the prescribed amount may choose to serve the defaulting company a statutory notice, without first having to go to court to prove the claimed debt.

This partly explains why insolvency proceedings are still used by some creditors as a debt collection tool in Uganda,[227] with some commentators arguing that insolvency proceedings are one of the sharpest tools available in any debt collector's armoury.[228]

If the company does not settle, compound, secure or otherwise compromise the debt within the statutory period of twenty working days or apply to set aside the statutory notice within ten working days of receipt of the notice,[229] such a debtor will be legally presumed to be unable to pay his or her debts in Uganda and insolvency proceedings can be commenced against him or her within thirty working days after the last date for compliance with the demand.[230]

(b) Execution issued against the debtor in respect of a judgment debt has been returned unsatisfied in whole or in part

This is probably the most direct ground for proving inability to pay debts. All a creditor must prove is that there is execution which was issued by a court of law in Uganda against the debtor for an amount above the prescribed sum and the same has been returned unsatisfied in whole or in part.

This is one of the conventional grounds for proving inability to pay debts in many jurisdictions, including South Africa[231] and the UK.[232] Lord Hoffmann observed in *Re a Company 12209 of 1991*[233] that a company's non–compliance with a statutory demand, or failure to satisfy execution of a judgment debt are matters that can be proved quite simply, usually in a single short witness statement.

227 Waiswa 'A Comparative Analysis of the Legitimacy of the Use of Insolvency Proceedings as a Debt Collection Tool in the United Kingdom and Uganda' 82.
228 Hogg J "Insolvency as a debt collection tool" (2014) Legal & Enforcement Magazine 2; Waiswa 2015/2016 Journal of Insol Europe 3.
229 Sections 4 and 5 of the Act.
230 Section 3(2) of the Act.
231 Section 345*(b)* of the Companies Act 1973.
232 Section 123(1)*(b)* of the Insolvency Act 1986.
233 (1992) BCLC 865, 868.

In such a case, all that the petitioning creditor will have to adduce in court is documentary evidence of the unsatisfied judgment, and once this is proved, court would, ordinarily be inclined to presume the debtor to be unable to pay debts.

(c) Where all or substantially all the property of the debtor is in possession or control of a receiver or some other person enforcing a charge over the company property

This provision was introduced for the first time in Uganda through the Act.[234] It reflects the fact that in Uganda, unlike countries such as UK,[235] the law permits a creditor to appoint a receiver to take over any or all the assets of a debtor as a form of debt enforcement procedure.[236] A creditor may also place a debtor under receivership as a mode of execution of a court decree.[237]

The provision represents a practical recognition that receivership, by its nature, is a legal procedure through which a secured creditor can enforce his or her security.[238] Appointment of a receiver is usually occasioned by default in settlement of an ascertained debt.[239] It is expected that if a debtor is indeed able to pay his or her debt or disputes the debt on genuine grounds, he or she would either pay the debt or object to the appointment of a receiver.[240]

The law rightly presupposes that the action of appointment of a receiver is a symptom of a debtor's inability to pay debts. Hence, if a creditor can prove to court that the same company that owes him or her money above the prescribed amount of UGX 2,000,000, is under receivership or its property is in possession or control of a receiver, then such a creditor can commence insolvency proceedings against the debtor on account of inability to pay debts. Moreover, the Act defines a charge in very wide terms to mean any interest in a chattel paper, a document of title, goods, an intangible, money, a negotiable instrument or a security.[241] For instance, where, a company

234 Section 3 (1) *(c)* of the Act.
235 UK Enterprise Act 2002 abolished the institution of administrative receiverships.
236 Part VII of the Act.
237 Order 42 of the Civil Procedure Rules s 1 71–1.
238 Goode, *Principles of Corporate Insolvency Law* 315.
239 Uganda Law Reform Commission *A Study Report on Insolvency Law* ULRC Publication 13 of 2004,15.
240 Section 177 of the Act.
241 Section 2 of the Act.

mortgages its land to a bank as security for a loan, if the debtor defaults and thereby prompts the mortgagee to enforce against the mortgaged property, that can constitute evidence of inability to pay debts as long as the property forming the subject matter of the mortgage represents a substantial part of all the assets of the company.

This ground does not only arise where the debtor's property is in possession or control of a receiver. It also extends to situations where any other person, such as a mortgagee or other secured creditor, takes debt enforcement measures against all or a substantial portion of the company property. Arguably, the scope of 'inability to pay debts' in Uganda is quite wide.

The scope of meaning of inability to pay debts is further broadened by section 3(3) of the Act. The provision clearly stipulates that someone's inability to pay debts can be proved by other means than those specifically listed in section 3(1)*(a)* of the Act. Therefore, it is understood that in addition to the specific indicators of inability to pay debts, a creditor can still use other tests such as the cash flow and balance sheet tests to prove that a debtor is unable to pay his or her debts. This is further buttressed by the provisions of subsection (4) which adds that in determining whether a debtor is unable to pay the creditor, contingent and prospective debts may be considered.

Inability to pay debts can be proved in many ways that all trading entities in Uganda, if they do not manage their debt appetite, are exposed to the roving risk of being presumed to be unable to pay their debts.

3.4 Conclusion

In this chapter, an account of Uganda's Insolvency Law has been provided. The discussion commenced with an exposé on the historical background to Uganda's legal system. The chapter observed that Uganda's Insolvency Law evolved out of the British common law system. When the Uganda Order in Council of 1902 was adopted, all laws that were applicable in England by 1902 were transposed into Uganda until such a time when the colonial administration enacted specific laws.

In the area of insolvency law, the provisions of the English Companies Act of 1948, which were imported into Uganda through the Companies Act of 1961 Cap110, remained in force in Uganda until 2011 when the Act was enacted specifically to deal with all matters concerning the regulation of personal and corporate insolvency.

The chapter has further presented a summary of the key innovations that were brought into Uganda's Corporate Insolvency Law system by the Act. Most of the new features are still being tested, and their efficacy in transforming Uganda's insolvency legal regime is yet to be properly gauged.

The chapter concluded with an analysis of the concept of inability to pay debts as understood under the Act. Whereas the Legislature tried to provide a statutory definition of the phrase 'inability to pay debts', the meaning remains open to debate. The statutory definition only provides a list of factors, which if proved, can form the basis for court exercising its discretion to determine that a debtor is indeed unable to pay his or her debts.

It has further been observed that much as the law sought to list the common grounds for determining an individual's inability to pay debts, the law opened the gates further by allowing for proof of inability to pay debts in any other ways. This only cast the net of what could qualify as an inability to pay debts wider. The discussion in this chapter has further provided the desired context to this study and created a firm foundation for the next chapter on corporate rescue.

CHAPTER FOUR
CORPORATE RESCUE: THE CONCEPT, NATURE OF AND PURPOSE

4.1 Introduction

In this chapter the meaning, nature and purpose of corporate rescue is considered. The chapter commences with an examination of the historical development of the concept of corporate rescue. The discussion sets the stage to convey a deeper understanding of corporate rescue and why it is increasingly becoming the focus of modern insolvency law.[1] This chapter also emphasises several benefits of corporate rescue over the traditional insolvency procedures, liquidation and winding up.

Corporate rescue measures are often considered as an option when a company has started showing signs and symptoms of financial failure or distress. In a sense, corporate rescue is like a hospital. Its value is most appreciated when one is sick. The most common causes of corporate failure, with specific examples drawn from the referenced countries of South Africa, Uganda and inevitably the UK where both South Africa and Uganda borrowed the bulk of their laws, are considered.[2]

Any step towards understanding corporate rescue and insolvency law in South Africa or Uganda would not be complete without considering the English legal position. The discussion also refers to the US legal system, specifically Chapter 11 of the US Bankruptcy Code,[3] which is widely acknowledged as the first legislative attempt towards nurturing the rescue culture.[4]

The chapter explores the meaning of corporate rescue, the causes of corporate failures, the benefits of corporate rescue over liquidation and the barriers to successful corporate rescue. This involves a discussion of the normative principles, concepts, and approaches to corporate rescue as well as the historical reasons behind the emergence of the rescue culture.

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1 Bo, *Comparative Insolvency Law: The Pre–pack Approach in Corporate rescue* 3. Available at https://www.elgaronline.com/view/9781781007372/09_chapter1.xhtml (Date of use: 10 April 2020); Calitz and Freebody 2016 *De Jure* 265–287.

2 This issue is discussed in 4.6.

3 The US Bankruptcy Reform Act 1 of 1978.

4 Rajaram and Sewpersadh 2018 *South African Journal of Economic Management Science* 2.

4.2 The concept of corporate rescue

In a normal, functional market economy, business failure is an inevitable occurrence.[5] Corporate failure is acknowledged as a natural phenomenon necessary for the efficient functioning of a capitalist market.[6] A market economy emphasises the optimal use of resources and competitive mechanisms which encourage companies to compete for maximum economic value to survive. This is sometimes referred to as the Darwinian philosophy, which portends that only the fittest companies should survive.[7] In a capitalist society, it is natural to leave uncompetitive companies to die and get replaced by stronger ones.[8] It is argued that not all lame ducks can or should be rescued; therefore, the appropriate procedure for the genuinely doomed companies is liquidation.[9] Companies that fall victim to competitive forces and become economically unviable should be churned out by the system.[10] Corporate insolvency law recognises that failure and loss of capital are not uncommon business outcomes.[11]

Hence, just as death occurs in humans as part of the natural cycle of human existence, it is also normal for companies to suffer distress and 'legally die'. However, news of any death often leaves many in tears. Similarly, for companies, every corporate failure triggers many tears, not only those of shareholders, creditors, employees, suppliers, and landlords, but also of the entire community in which the company operated before its collapse.[12] This realisation has over the years shaped insolvency regimes towards a rescue approach. Some commentators have argued that the history of bankruptcy can be described as a process of enlightenment from debtor repression to debtor protection and a redefinition of insolvency from sin to risk, and from moral failure to economic failure.[13]

Many jurisdictions have now embraced a belief that just as all effort is taken to avert death of humans through medical diagnosis, treatment and palliative care, even sick

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5 Reuven, 'Country Crisis and corporate failure: Lessons for prevention and management' *FRBSF Economic Letter* (2002) 1.
6 Argent, *Corporate Collapse: The causes and symptoms* 170.
7 Gross 1994 *Washington University Law Quarterly* 1031, 1035.
8 Wood, 'Corporate Rescue: A critical analysis of its fundamentals and existence' 14.
9 Ashby 2015 *Commonwealth Law Bulletin* 317, 324.
10 Gross 1994 *Washington University Law Quarterly* 1035–1037.
11 Verdoes and Verweij, 2018 *International Insolvency Review* 398, 400.
12 Cassim and others*, Contemporary Company Law* 862.
13 Bridge 2013 Law in Transition 28; *cf* Verdoes and Verweij 2018 *International Insolvency Review* 400.

companies with symptoms of financial distress deserve to be assisted by means of diagnostic examination and treatment. There has been a change in basic assumptions from the hitherto sacrosanct 'pay what you owe' attitude to the benevolent promotion of the continuity of companies in distress.[14]

It is now understood that, just as people never discuss and prepare mortuary and burial arrangements for their sick relatives until their final death point, it is inimical to arrange for burial of a company through liquidation procedures merely because it has shown signs and symptoms of financial ailment. Sick companies deserve treatment, not burial.

Although understood differently by different people depending on their position and interest in the rescue cycle,[15] corporate rescue is a deliberate process through which sick companies are diagnosed, treated, and given palliative care to overcome distress and avoid the risk of death through liquidation.

Corporate rescue encompasses any major intervention necessary to avert the eventual failure of a company.[16] The intervention may be informal or formal,[17] but must have the potential to salvage a company from the jaws of an imminent risk of failure or collapse to constitute a corporate rescue intervention.

What constitutes a major intervention necessary to avert eventual failure of a company as opposed to a normal managerial response to a corporate challenge is difficult to define.[18] This is so, especially because corporate rescue may be achieved through formal but mostly through informal mechanisms that may not involve use of any specific formal insolvency procedures.[19] However, if it is acknowledged that certain unusual measures, formal or informal, were taken to save the troubled company from the risk of an immediate collapse, such an action may be deemed to be an act of corporate rescue.

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14 Verdoes and Verweij 2018 *International Insolvency Review* 400.

15 Bo, *Comparative Insolvency Law: The Pre-pack Approach in Corporate Rescue* 3.

16 Belcher, *Corporate Rescue* 12; Finch 2010 JBL 502; Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 197.

17 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 199.

18 Frisby, *Report to the Insolvency Service: Insolvency Outcomes* (Insolvency Service, London, June 2006) 74.

Corporate rescue may also be defined as the collective strategic proceedings under a legal framework designed to facilitate either the preservation of the distressed company itself or the sale of its underlying business by transferring it to a new owner[20] or to its pre-distress stakeholders.[21]

The difference between corporate rescue and business rescue is discussed later in the chapter.[22] Suffice to note here that whether the strategy adopted results into the rescue of the company or the business, the intervention could amount to corporate rescue. Central to the notion of corporate rescue is the idea that a drastic remedial action is taken at a time of corporate crisis[23] to save a distressed company from liquidation by its pre-distress stakeholders.[24]

Owing to the fact that most company failures are occasioned by financial distress, some scholars also describe corporate rescue as the process through which companies in financial difficulty may be returned to a state of viability and avoid sliding into insolvency.[25]

Corporate rescue or 'corporate reorganisation' as it is sometimes referred to in North American terminology, is understood to be an alternative to immediate liquidation of a company with the aim of preventing its demise.[26] It occurs where the distressed company or the business is able to avoid closure and continue to trade as a going concern after going through a formal or informal rescue procedure.[27] It connotes the restoration of a company to financial health and survival without change of ownership. However, it may also mean the preservation of the value of the company facing financial distress to achieve a better result than an immediate winding-up.[28]

From the different definitions above, it can be deduced that 'corporate rescue' encompasses the processes, formal or informal, through which certain drastic measures are taken with the deliberate objective of either saving the company or the

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20 Bo, *Comparative Insolvency Law: The Pre-pack Approach in Corporate Rescue* 5.
21 Jackson, *The Logic and limits of Bankruptcy Law* 211.
22 This issue is discussed in 4.3.
23 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 197.
24 Adebola, 'Corporate Rescue and the Nigerian Insolvency system' 74.
25 Dignam and Lowry, *Company law* 425.
26 Bo, *Comparative Insolvency Law: The Pre-pack Approach in Corporate Rescue* 5.
27 Armour, Hsu A and Walters, 'The impact of the Enterprise Act 2002 on realisations and costs in Corporate Rescue Proceedings' 2006 Report prepared for the Insolvency Service 1.
28 Parry, *Corporate Rescue* 2.

business from collapsing. The action taken may entail changes in the management, financing, staffing, or *modus operandi* in the running of the business of the company,[29] provided that the action taken provides an alternative to the immediate liquidation of the ailing company.[30]

4.3 Corporate rescue versus business rescue

The boundary and outcome of corporate rescue efforts are not plain.[31] The end products of rescue may be varying.[32] Sometimes, rescue interventions may help to restore the company to its former state, but it is more likely to be reorganised, restructured, refinanced, downsized, subjected to sell-offs or taken over.[33]

This accounts for the lack of consensus among scholars about the precise meaning of corporate rescue.[34] For instance, in England, the initial architecture of the rescue regime is said to have sought to achieve preservation of distressed businesses as opposed to piecemeal sale of the company assets.[35] This is reflected in the Cork Report which heralded business rescues in England and Wales. The report stated that businesses which are capable of contributing value to the economy are the real subjects of rescue, not companies.[36] This would suggest that the primary objective of corporate rescue was rescue of the business, and not necessarily the company itself.

Later reforms of the Insolvency regime in England, expressed mainly through the Enterprise Act 40 of 2002, however, show that the focus of the British Government on rescue extended to the preservation of not only the distressed businesses but also the companies through which the businesses are conducted.[37] It was argued that companies in financial distress must not be allowed to go to the wall unnecessarily,[38]

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29 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 197.

30 Bo, *Comparative Insolvency Law: The Pre-pack Approach in Corporate Rescue* 3.

31 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 199.

32 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 198; Belcher, *Corporate Rescue* 24–34.

33 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 199.

34 Adebola, 'Corporate Rescue and the Nigerian Insolvency system' 75; Frisby 2004 *MLR* 248.

35 Insolvency Law and practice: Report of the Review Committee (Cork Report) (Cmnd 8558,1982) Chapter 4 53 para 193.

36 Adebola, 'Corporate Rescue and the Nigerian Insolvency system' 78.

37 Adebola, 'Corporate Rescue and the Nigerian Insolvency system' 75; The Insolvency Service, Productivity and Enterprise: Insolvency-A second chance (Cmnd 5234, 2001). Available at:https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/263523/5234.pdf (Date of use: 04 December 2019).

38 Per Hewitt RH, Secretary of State for Trade and industry, forward to the Insolvency Service, Productivity and Enterprise: Insolvency-A second chance (Cmnd 5234, 2001).

stressing that the scope of corporate rescue ought to encompass all measures that result into the preservation of the company rather than its business.[39]

On the other hand, in the US, the situation appears fairly settled that rescue refers to a hypothetical sale of a company to its pre-distress stakeholders with the aim of preserving the distressed entity from the risk of liquidation.[40] The US notion of rescue focuses largely on the financial rehabilitation of the distressed company[41] instead of the business. This has resulted into the creation of two inter-related concepts in rescue procedures: 'corporate rescue' and 'business rescue'. Drawing the line between business rescue and corporate rescue is, however, not easy. It entails drawing a hypothetical distinction between the company and the business.[42] Attempts have however been made by scholars[43] to conceptually distinguish corporate rescue from business rescue.

Corporate rescue is generally described as the process of enabling a company in financial difficulties to return to a state of viability and to prevent it from sliding into insolvency.[44] It is a form of rescue procedure whose objective is to provide alternatives to immediate liquidation of a company. The strategic objective of corporate rescue is the preservation of the company as opposed to the business. It is argued that the natural connotation of corporate rescue is that the subject corporate entity survives the intervention and leaves its stakeholders with residual stake in it.[45]

Corporate rescue measures focus on preventing the immediate exposure of the company to liquidation.[46] Alternatives to liquidation may entail sale of the company shares to new investors to raise capital to pay off the most nagging or aggressive creditors who may be feared likely to commence liquidation proceedings against the company. It may also involve laying off staff to cut costs, or even a change in the line

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39 Per Hewitt RH, Secretary of State for Trade and industry, forward to the Insolvency Service, Productivity and Enterprise: Insolvency-A second chance (Cmnd 5234, 2001).
40 Jackson, *The Logic and limits of Bankruptcy Law* 211; Baird and Rasmussen 2001 *Virginia LR* 921.
41 Adebola, 'Corporate Rescue and the Nigerian Insolvency system' 84.
42 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 198.
43 Frisby 2019 *JCLS* 14; *cf* Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 198.
44 Nwafor 2017 Corporate Board: Role, duties and composition 21.
45 Frisby 2019 *JCLS* 14.
46 Bo, *Comparative Insolvency Law: The Pre–pack Approach in Corporate rescue* 4.

of business and to concentrate on only the most economically viable business activities.[47]

Typically, corporate rescue involves changes in the management of the company and may be achieved through reorganisation, refinancing, debt composition, debt rescheduling, or even downsizing the operations by laying off staff.[48] Rescue of a company occurs where the company emerges from the rehabilitation intact and continues with the same operation often including the same workforce and owners.[49]

The key objective of corporate rescue is the restoration of a company in difficulty to normal operation and to preserve its legal personality.[50]

Business rescue on the other hand focuses on the preservation of the business and not of the company. The rescue interventions focus on severing the business from the troubled company, so that the sick company may be liquidated or wound-up, depending on the circumstances. However, the actual business and its activities are maintained as a cohesive, productive unit under new ownership.[51] Business rescue focuses on the continuance of the business.[52]

Business rescue usually happens where a company is insolvent, but successfully manages to institute timely measures to retain the business as an operational enterprise, to save jobs and to ensure the survival of some key economic activities.[53] As was observed in the Cork Report, society has no interest in the preservation or rehabilitation of the company, though it may have legitimate concern in the preservation of the commercial enterprise.[54]

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47 Bo, *Comparative Insolvency Law: The Pre–pack Approach in Corporate rescue* 4.

48 Armour and Walters, '*The Impact of the Enterprise Act 2002 on Realisations and Costs in Corporate Rescue Proceedings* 2006 Report to the UK Insolvency Service 2. Available at: http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.96.6853andrep=rep1andtype=pdf. (Date of Use: 24 July 2020); Bo, *Comparative Insolvency Law: The Pre–pack Approach in Corporate Rescue* 4.

49 Frisby 2004 *MLR* 247, 248–249.

50 Frisby 2019 *JCLS* 14.

51 Bo, *Comparative Insolvency Law: The Pre–pack Approach in Corporate rescue* 4.

52 Verdoes and Verweij 2018 *International Insolvency Review* 400.

53 Finch, *Corporate Insolvency law: Perspectives and Principles* 188.

54 Insolvency Law and Practice, Report of the Review Committee (Cmnd 8558)1982 (the Cork Report) para 193. Available at https://www.amazon.com/Insolvency–Law–Practice–Report Committee/dp/010185580X. (Date of use: 10th June 2020).

Rescue of a business occurs where the company is liquidated but successful steps are taken to retain the economic or organisational aspects of the business.[55] This is mostly achieved through the sale of the company's assets and business as a going concern, which usually fetches more value than assets being sold in a piecemeal fashion, as it happens during liquidation sales.[56]

Whilst the differences enumerated above between corporate rescue and business rescue are acknowledged, in practice, the two terms are used interchangeably to mean the same thing: the process through which a troubled company and/or its business may be saved from sliding into liquidation. Even in countries like South Africa where Chapter 6 of the Companies Act 2008 is clearly titled 'business rescue and compromises with creditors', and Parliament chose to consistently use the phrase 'business rescue' as opposed to 'corporate rescue' in the Companies Act, the way 'business rescue' is defined leaves no doubt that the intention was to make the chapter applicable to all rescue efforts, irrespective of whether they result in the rescue of the company or of the business.

Section 128(1)*(b)* of the Companies Act 2008 defines business rescue as the proceeding(s) to facilitate the rehabilitation of a company that is financially distressed. This is further amplified in section 128(1)*(b)*(iii) of the Companies Act 2008, which provides in essence that the primary objective of a business rescue is to provide for the development and implementation of a plan to rescue the company in a manner that maximises the likelihood of the company to continue in existence on a solvent basis. It is only where this core objective is not possible that the secondary objective is considered, to restructure the company with the objective to produce a better return for the company's creditors or shareholders than what they would get if the company was left to commence liquidation.[57]

The same position exists in Uganda, where Chapter VI of the Insolvency Act 14 of 2011 (the Insolvency Act) provides for administration as a rescue procedure available to financially distressed companies. The Insolvency Act clearly states that one of the fundamental duties of an administrator is to exercise his or her powers in a manner

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55 Finch, *Corporate Insolvency law: Perspectives and Principles* 244.
56 Bo, *Comparative Insolvency Law: The Pre–pack Approach in Corporate Rescue* 5.
57 Cassim and others*, Contemporary Company Law* 864.

that he or she believes to be reasonably likely to facilitate the survival of the company and the whole or any part of its undertaking as a going concern.[58]

This underscores the fact that both in law and fact, no practical difference exists between corporate rescue and business rescue, save that the outcome of the process may lead one to conclude that a particular rescue intervention has resulted in a corporate rescue or a business rescue.

In this study, therefore, 'business rescue' is taken to be part of 'corporate rescue', and the discussion centres around corporate rescue in general.

4.4 The general nature and purpose of corporate rescue

Historically, preventing companies from collapsing was not recognised as one of the traditional objectives of insolvency law.[59] As noted in Chapter Two,[60] in English law, the main overriding objectives of corporate insolvency law are basically three:[61] to maximise returns to creditors; to establish a fair and equitable system for the ranking of claims and distribution of assets amongst creditors; and to provide a mechanism through which the causes of corporate failure are established and those found guilty of mismanagement punished for their omissions or actions, and where appropriate, deprived of the right to be involved in the management of other companies.[62]

The proponents of the creditor wealth maximisation (economic value) philosophy of insolvency law fervently contend that corporate rescue contradicts the goals of insolvency law. They are highly unsympathetic to the whole notion of corporate rescue.[63] They are opposed to the idea that keeping companies in operation and protecting interests beyond those of creditors should ever be an independent goal of insolvency law.[64] They argue that whatever rights and privileges may be conferred in

58 Insolvency Act 14 of 2011 s140(1)*(b)*(i).
59 Gant, 'Constitutions and crises: Balancing insolvency and social policy through the lens of Comparative legal history' (Paper delivered at INSOL Europe Academic Forum 21–23 September 2016 13. Available at: http://irep.ntu.ac.uk/id/eprint/31292/1/PubSub8841_Gant.pdf (Date of use: 08 January 2020).
60 This issue is discussed under 2.4.
61 Goode, *Principles of Corporate Insolvency Law* 58.
62 *ibid*.
63 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 201.
64 Jackson, *The Logic and limits of Bankruptcy Law* 9; Baird 1986 *Journal of Legal Studies* 127.

other areas of law, insolvency law has one primary goal: to allocate the common pool of assets in such a way as to maximise benefits for creditors as a whole.[65]

The arguments by the exponents of the creditor wealth maximisation theory notwithstanding, it is apparent that insolvency of any company often crashes the hopes of many stakeholders who may neither be creditors nor have any formal legal rights to the assets of the business.[66] For instance, business closure affects employees who will lose jobs, tax authorities who will lose a tax payer, suppliers who will lose a customer, nearby property owners who will lose beneficial neighbours and customers who may be forced to look for another supplier.[67] The failure of a corporate enterprise could potentially affect a wide range of parties, most notably creditors, management, employees and shareholders.[68] Therefore, it is utopic to argue that the focus of insolvency law ought to be limited to only the promotion of creditors' interests.

The fact that insolvency of a company naturally triggers a wide range of implications for other non-creditor stakeholders like employees, suppliers and customers, makes it only proper that any theory about insolvency law should be sufficiently broad to holistically address not only the insolvency of the company itself, but also its incidental implications on the entire ecosystem.[69]

It is for this reason that a number of scholars[70] associate themselves with the view that was expressed by the members of the Cork Committee.[71] That view was that the aims of a good modern insolvency system should, at minimum, include an explicit recognition of the fact that the effects of insolvency are not limited to the private interests of the insolvent and his creditors.[72] The interests of society or other groups in society are vitally affected by corporate insolvency and its outcome and these public interests must be recognised and safeguarded. Consequently, provision must be

65 Goode, *Principles of Corporate Insolvency Law* 70; Jackson 1982 *Yale Law Journal* 857.
66 Warren 1993 *Michigan LR* 351.
67 Warren 1993 *Michigan LR* 355.
68 Goode, *Principles of Corporate Insolvency Law* 68.
69 *ibid.*
70 Goode, *Principles of Corporate Insolvency Law* 75; Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 201–206.
71 Insolvency Law and Practice, Report of the Review Committee (Cmnd 8558) 1982 (the Cork Report) para 198.
72 *ibid.*

made for the preservation of viable commercial enterprises capable of making a useful contribution to the economic life of the country.[73]

Corporate rescue interventions seek to treat, manage and potentially cure the early signs and symptoms of financial distress before an ailing company progresses into actual insolvency and its concomitant effects.[74] This directly places corporate rescue at the heart of any meaningful discussion of modern insolvency law.

It is important to note at the outset that despite its name, the conceptual purpose of 'corporate rescue' is not necessarily to prevent a company or corporation from being wound up or liquidated.[75] Corporate rescue procedures are not meant to be a substitute for liquidation or winding up of economically unviable companies.[76] The purpose of corporate rescue is not to resurrect the dead, but to cure the ailing company.[77]

Modern corporate rescue and reorganisation processes seek to take advantage of the reality that in many cases, an enterprise not only has substantial value as a going concern, but the going concern value usually exceeds the company's liquidation value.[78] Even if the business or the company is not eventually restored to a solvent or profitable status, corporate rescue measures often improve the value of the enterprise and results into creditors gaining better returns in the long run.[79] It is believed that where an enterprise is viable, its assets are often more valuable if retained in a rehabilitated business than if sold in a liquidation. The rescue of business preserves jobs, provides creditors with greater returns based on higher going concern values of the enterprise, potentially produces a return for owners and obtains for the country the

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73 Insolvency Law and Practice, Report of the Review Committee (Cmnd 8558)1982 (the Cork Report) para 198.

74 Bo, *Comparative Insolvency Law: The Pre–pack Approach in Corporate rescue* 5.

75 Burdette 2004 *SA Merc LJ* 243.

76 McCormack, *Corporate Rescue–An Anglo–American Perspective* 60.

77 Nwafor 2017 Corporate Board: Role, Duties and Composition 22.

78 Smits 1999 *De Jure* 86.

79 Burdette 2004 *SA Merc LJ* 244.

fruits of the rehabilitated enterprise.[80] This ideology is what is sometimes referred to as the rescue culture.[81]

4.4.1 What rescue culture means

The rescue culture is the ideology that it is appropriate to attempt to save a financially distressed company or at the very least, save its business instead of placing it on the conveyor belt towards dissolution.[82] Rescue culture is a multi-aspect concept, with both a positive and protective role as well as a corrective and a punitive one.[83] At one level, it manifests itself by legislative and judicial policies directed to the more benevolent treatment of insolvent persons, whether they be individuals or corporations, and at the same time to a more draconian treatment of true economic delinquents.[84] On another level, it entails the adoption of a general rule for the construction of statutes, which is deliberately inclined towards the giving of a positive and socially profitable meaning (rather than a negative or socially destructive meaning), to statutes of socio-economic import, such as the insolvency legislation.[85]

The roots of the rescue culture can be traced back to the US's early history as a country of immigrants, eager to start over again, with a general optimism about the future and potential of the US economy.[86] It is contended that the main turning point in the US attitude towards business rescue originated in the second half of the 19th century, when the country had witnessed a high failure rate of railway companies.[87] Due to the strategic importance of the railway industry in the development of the US economy, policy makers devised ways through which they could mitigate the effects of the collapse of railways.[88]

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80 World Bank 'Principles for effective insolvency and creditor/debtor rights system' 2015, 6 Available at http://siteresources.worldbank.org/EXTGILD/Resources/58075541357753926066/2015 Revised_ICR Principles(3).pdf (Date of use: 08 January 2020).

81 Hunter 1999 *JBL* 491.

82 Winston K 'A peep at a rescue culture of corporate insolvency' (20 March 2020) https://www.kennywiston.com/a-peep-at-a-rescue-culture-of-corporate-insolvency/ (Date of use: 01 January 2020).

83 Hunter 1999 *JBL* 491.

84 Burdette 2004 *SA Merc LJ* 244; Hunter 1999 *JBL* 491.

85 Burdette 2004 *SA Merc LJ* 244.

86 Bridge 2013 *Law in Transition* 33.

87 *ibid*.

88 Bridge 2013 *Law in Transition* 33.

The solution is said to have first come from the judiciary when the courts developed the common law equity receivership as a tool for reorganisation to safeguard the company's assets and to allow the company to enter into agreements with its creditors.[89] This was followed by the enactment of the 1898 Bankruptcy Act, which is widely recognised as having, for the first time in US history, introduced the principle of 'fresh start' for businesses in US Bankruptcy legislation.[90] The 1898 Bankruptcy Act was a break away from the English inspired controlled systems that had been tried earlier in the century, providing discharge post liquidation, and the option for the company to enter into a composition with creditors.[91]

The idea of a 'fresh start' attracted dozens of insolvents to apply for bankruptcy and it is still revered as a fundamental characteristic of the modern American bankruptcy system.[92] The fresh start ideology is said to have emerged out of a recognition that it was important for the entrepreneurial spirit of the country to provide formal mechanism through which the honest but unfortunate debtors are relieved from their problem.[93] This attitude has remained central in the development of the bankruptcy system in the US, where business failure is commonly viewed as a product of misfortune rather than wrong doing.[94]

Today, it is not surprising that Chapter 11 procedure under the US Bankruptcy Reform Act of 1978[95] continues to focus on rescue and reorganisation of enterprises over liquidation. The debtor-friendly aspect of early bankruptcy laws is evident in the debtor-in-possession nature of the procedure, which underpins the philosophy to balance the desires of the creditor and the debtor groups while promoting commerce and entrepreneurship.[96]

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89 Bridge 2013 *Law in Transition* 33.
90 *ibid*.
91 Gant, 'Constitutions and crises: Balancing insolvency and social policy through the lens of Comparative legal history' (Paper delivered at INSOL Europe Academic Forum 21–23 September 2016, 10.
92 Gant, 'Constitutions and crises: Balancing insolvency and social policy through the lens of Comparative legal history' (Paper delivered at INSOL Europe Academic Forum 21–23 September 2016, 11.
93 *In Re Brown* 1 Mart (os) 158, 159 (Orleans 1810).
94 Moss 1997 *Brooklyn Journal of International Law* 115.
95 US Bankruptcy Code 1 of 1978.
96 Gant, 'Constitutions and crises: Balancing insolvency and social policy through the lens of Comparative legal history' (Paper delivered at INSOL Europe Academic Forum 21–23 September 2016,25.

The US bankruptcy system remains revered for prioritising rescue and reorganisation over liquidation[97] and for its liberal acceptance of financial failure.[98] It is premised on the notion that allowing assets to be utilised for purposes of preserving jobs is better than destroying them merely to meet the short term interests of the creditors through the often rushed liquidation sales.[99] Indeed, the US approach of a fresh start in bankruptcy has proved extremely influential in the development of business rescue legislation in many parts of the world.[100]

This has resulted in a general paradigm shift in legislative insolvency reforms in Europe and by extension, Africa, including South Africa[101] and Uganda.[102] It moved away from the sacrosanct 'pay what you owe' approach to focusing insolvency regimes in the direction of promoting a balanced facilitation of continuity of companies in distress.[103] It is no longer in dispute that corporate rescue is at the heart of modern insolvency law.

The US Chapter 11 procedures influenced the Cork Committee. That Committee dedicated a lot of its time in articulating the aims of a modern insolvency law, in a way that generally shows a deliberate move to posture an underlying philosophy of restoring companies to profitability and avoiding liquidation as core in English insolvency law.[104] The Cork Report[105] lists the aims of a good modern insolvency law as:

(a) To underpin the credit system and cope with its casualties;
(b) To diagnose and treat an imminent insolvency at an early, rather than a late, stage;
(c) To prevent conflicts between individual creditors;

97 Gant, 'Constitutions and crises: Balancing insolvency and social policy through the lens of Comparative legal history' (Paper delivered at INSOL Europe Academic Forum 21–23 September 2016, 12.
98 Bridge 2013 *Law in Transition* 33.
99 Bradley and Rosenwig 1992 *The Yale Law Journal* 1043–1044.
100 Bridge 2013 *Law in Transition* 33; Burdette 2004 *SA Merc LJ* 245.
101 Cassim and others*, Contemporary Company Law* 864.
102 Nyombi 2015 *International Journal of Law and Management* 2.
103 Verdoes and Verweij 2018 *International Insolvency Review* 400.
104 Insolvency Law and Practice, Report of the Review Committee (Cmnd 8558)1982 (the Cork Report) paras 191–198; 203–204; 232; 235; 238–239; Wood, 'Corporate Rescue: A critical analysis of its fundamentals and existence' 51–52.
105 Insolvency Law and Practice, Report of the Review Committee (Cmnd 8558)1982 (the Cork Report).

(d) To realise the assets of the insolvent, which should properly be taken to satisfy debts with the minimum of delay and expense;

(e) To distribute the proceeds of realisations amongst creditors fairly and equitably, returning any surplus to the debtor;

(f) To ensure that the processes of realisation and distribution are administered honestly and competently;

(g) To ascertain the causes of the insolvent's failure and, if conduct merits criticism or punishment, to decide what measures, if any, require to be taken to establish an investigative process sufficiently full and competent to discourage undesirable conduct by creditors and debtors, to encourage settlement of debts, to uphold business standards and commercial morality and to sustain confidence in insolvency law by effectively uncovering assets concealed from creditors, ascertaining the validity of creditor's claims and exposing the circumstances attending failure;

(h) To recognise and safeguard the interests not merely of insolvents and their creditors but of society and other groups in society who are affected by the insolvency, for instance not only the interests of directors, shareholders and employees but those of suppliers, those whose livelihoods depend on the enterprise of the community;

(i) To preserve viable commercial enterprises capable of contributing usefully to national economic life;

(j) To offer a framework of insolvency law commanding respect and observance, sufficiently flexible to cope with change and which is also:

(1) Seen to produce practical solutions to commercial and financial problems;
(2) Simple and easily understood;
(3) Free from anomalies and inconsistencies;
(4) Capable of being administered efficiently and economically;
(5) To ensure due recognition and respect abroad for English insolvency proceedings.[106]

[106] Insolvency Law and Practice, Report of the Review Committee (Cmnd 8558)1982 (the Cork Report) paras 191–198; Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 26–27.

A review of these aims clearly shows that the Cork Committee placed a lot of emphasis on the value of developing insolvency processes that provide ways of rescuing troubled companies and to help them to realise corporate assets.[107] This resulted into the inclusion of procedures governing administration and Company Voluntary Arrangement (CVA) in the Insolvency Act of 1986[108] to offer a brighter prospect for financially distressed companies.[109]

The Cork Committee believed that rescue opportunities should be taken sufficiently early to stand a chance of success; that the troubled company should be given a breathing space from the pressure of claims and that consideration should be given to the interests, not merely of creditors and shareholders, but of the widest group of parties potentially affected by the insolvency of the company.[110] This position was further explained by Sir Kenneth Cork in his autobiography:

> We saw that if a company was to be saved, action should be initiated a long time before the time when a bank normally appointed a receiver…Companies needed a period when the dogs were called off and they were able to recover a degree of equilibrium. They needed, in other words, a moratorium for which existing law made no provision...the appointment of an administrator, we suggested, would not constitute an act of insolvency. None of the things would happen which happened when a company became officially insolvent. For an administrator should be brought in before a company was declared insolvent, where for instance, the directors were obviously incompetent or dishonest and the ordinary process could not remove them, or where in the national interest the government should take a hand… He would have all the powers and more of a receiver, and he would have to realise the assets for the general good… he would be responsible to all parties with interest in the particular debtor company.[111]

Administration and CVA procedures have become key tools for corporate rescue in the UK. Lord Browne Wilkinson stated in *Powdrill v Watson*[112] that the corporate rescue culture was introduced in the UK by the Insolvency Act 1986 to enable courts to give insolvent companies a moratorium on the enforcement of debts and securities while the possibility of rescue or arrangement with creditors was explored.

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107 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 301.
108 *ibid*.
109 Frisby 2019 *JCLS* 4.
110 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 302.
111 *ibid;* Sir Kenneth Cork, Cork on Cork: Sir Kenneth Cork Takes stock (London Macmillan 1988)195.
112 (1995) 2 AC 394, 441–442.

Lord Browne-Wilkinson further stated that promotion of the rescue culture is an important consideration when interpreting the Insolvency Act.[113]

In *Freakley and others v Centre Reinsurance International Company and others*[114] Lord Hoffmann stated that, unlike Chapter 11 of the US Bankruptcy Code, with which it is sometimes compared, administration does not involve a reconstruction of the company. It usually looks forward to some kind of reconstruction, but that takes place under different statutory provisions.[115]

In essence, an administration order preforms two things: it places a procedural bar on the enforcement of security over the company's property or the commencement or continuance of any legal proceedings or execution against the company. Secondly, it substitutes for the existing management, a court-appointed administrator with power, under the control of the court, to manage the company's business and property.[116]

Ironically, South Africa is one of the first countries to embrace the rescue culture, in the form of judicial management.[117] Judicial management was formally introduced through legislation in the South African Companies Act 46 of 1926 and was later re-enacted in the Companies Act 61 of 1973 as a legislative attempt to align South Africa's legal regime with international trends and developments in corporate reorganisation in England.[118]

Unfortunately, although the theoretical purpose of judicial management set out in section 427 of the Companies Act 61 of 1973 was primarily to engender the restructuring of distressed companies and was indeed seen as a *bona fide* attempt by the legislature to promote the rescue culture in South Africa, it has been labelled a spectacular and abject failure.[119]

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113 *Powdrill v Watson and Another (Paramount Airways Ltd)* (1995) 2 AC 394, 441–442 and 445C–D.
114 (2006) UKHL 45.
115 *Freakley and others v Centre Reinsurance International Company and others* (2006) UKHL para 6.
116 *Freakley and others v Centre Reinsurance International Company and others* (2006) UKHL para 7.
117 Rajak and Henning 1999 *SALJ* 268; Loubser 2004 *SA Merc LJ* 139.
118 Maphiri 2018 MBELR 109.
119 *ibid*; Burdette 2004 *SA Merc LJ* 247.

As will be noted in Chapter Five,[120] the challenges associated with the use of judicial management did not kill the spirit of the South African legislature to nurture growth of a rescue culture. The rescue spirit was reincarnated through the enactment of the Companies Act 71 of 2008, which dedicated a whole chapter 6 of the Act to business rescue. Chapter 6 of the Companies Act is undoubtedly a positive step towards the promotion of the rescue culture in South Africa.

4.4.2 Corporate rescue is no substitute for liquidation

Discussions about corporate rescue sometimes create the impression that rescue efforts are meant to be a substitute for liquidation of all companies; this is wrong. Liquidation is comparable to a process through which a patient's mortuary and burial preparations are arranged with the objective of ensuring orderly disposal of his or her remains, and distribution of his or her properties to the rightful beneficiaries in their respective order of preference. Liquidation is a process through which an insolvent company's life is ended and its assets, if any, distributed.[121] It entails a regulated process through which a terminally ill company's affairs are dealt with and administered prior to its dissolution by ascertaining and realising its assets and applying them firstly to the payment of creditors and then distributing the residue, if any, amongst the shareholders.[122]

The ultimate end for liquidation is dissolution (which is akin to actual death*)* of the company. However, just as humans try as much as possible to postpone their death as far as human intervention can, and they only die after all possible medical manoeuvres have failed, companies too deserve to die only when they must die; not when they can still be saved. This is what corporate rescue seeks to achieve.[123]

The corporate rescue procedure provides a mechanism through which the financially sick, but not dead companies are diagnosed and treated with the primary objective of seeing them healed and returned to a state of normalcy. Rescue efforts provide breathing space to companies suffering from financial distress to recover from liquidity

120 See the discussion in 5.4.

121 Per the Supreme Court of Appeal of South Africa in *Dawid Jacques Richter v ABSA Bank Limited* (20181/2014) ZASCA 100 para 9.

122 Akingbolahan 2003 *Northern Carolina ILCR* 320*.*

123 Nwafor 2017 Corporate Board: Role, Duties and Composition 21–. –22; Dignam and Lowry, *Company Law* 425.

complications, by providing them with an opportunity to restructure and remodel their business operations.[124] It is widely acknowledged that corporate rescue offers a very useful alternative to the liquidation or winding up of a financially distressed company.[125]

Corporate rescue is generally described as the process of enabling companies that are experiencing financial difficulties to return to a state of viability and to prevent them from sliding into insolvency.[126] Corporate rescue involves pulling a company from the jaws of death with the hope of giving it a new lease of life.[127] It is meant to be a flexible, effective process through which the lifespan of a financially distressed company is extended in a manner that balances the interests and rights of all relevant stakeholders.[128]

The basic and central philosophy of corporate rescue processes is that a company in financial distress is worth more as a going concern than if it is liquidated with its assets realised on a piecemeal basis.[129] However, the underpinning belief is that although a company may be sick, if it still has potential to survive, it is better to rescue it than to liquidate it, or to wind it up because the going concern value of a business is generally greater than its liquidation or break-up value.[130]

In South Africa, section 128(1)*(b)* of the Companies Act provides in unequivocal terms that business rescue means the proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for the temporary supervision of the company, and of the management of its affairs, business and property;[131] a temporary moratorium on the rights of claimants against the company or in respect of property in its possession;[132] and the development and implementation of a plan to rescue the

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124 Rabilall, 'Business Rescue as opposed to Liquidation' March 2018. Available at http://www.cipc.co.za/files/3515/2688/8915/Business_Rescue_vs_Liquidation_Article_March_2018.pdf (Date of use: 21 January 2020).

125 Cassim and others, *Contemporary Company Law* 861; Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 201.

126 Nwafor 2017 Corporate Board: Role, Duties and Composition 21–. –22; Dignam and Lowry, *Company Law* 425.

127 Akingbdahan 2013 *Northern Carolina ILCR* 299.

128 Per the Supreme Court of Appeal of South Africa in *Dawid Jacques Richter v ABSA Bank Limited* (20181/2014) ZASCA 100 para 9.

129 Bo, Comparative Insolvency Law: The Pre-pack Approach in Corporate Rescue 5.

130 Cassim and others, *Contemporary Company Law* 863.

131 Section 128(1)*(b)*(i) of the Companies Act 2008.

132 Section 128(1)*(b)*(ii) of the Companies Act 2008.

company by restructuring its affairs, business, property, debt, and other liabilities and equity in a manner that maximises the likelihood of the company to continue in existence on a solvent basis or, if it is not possible to continue in existence, results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company.[133]

This clearly means that for a company to be eligible for corporate rescue, it must be suffering from financial distress, but it must not be in a state of factual insolvency. Unlike liquidation, which is triggered by insolvency, corporate rescue is triggered by financial distress.[134]

4.5 Financial distress as a trigger for rescue procedure

Although related and one may lead to the other, insolvency and financial distress are not synonymous.[135] Financial distress is a variable term that can be applied in several situations. A distressed company is one that requires a major rethink in the way it operates.[136] Distress may be of different kinds and may be caused by a myriad of factors as highlighted in this chapter.[137] The kind of distress which the company must be suffering from before it can be considered eligible to commence business rescue proceedings is financial distress; and it is the primary trigger for business rescue procedure in South Africa.[138]

Financial distress normally arises when a company defaults in meeting its statutory or commercial obligations due to internal or external factors that may bedevil a company and cripple its ability to meet its financial obligations when they fall due, although the company must not be factually or commercially insolvent at the time of initiating the rescue procedures.[139]

Section 128(1)*(f)* of the Companies Act goes on to provide that financial distress, in reference to a particular company at any particular time, means a situation where it

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133 Section 128(1)*(b)*(iii) of the Companies Act 2008.
134 Kastrinou and Jacobs L 'Pre–. –insolvency procedures: a United Kingdom and South African Perspective' https://core.ac.uk/download/pdf/74207718.pdf (Date of use: 27 January 2020).
135 Wruck 1990 JFE 419, 421.
136 Wood, 'Corporate rescue: A critical analysis of the fundamentals and existence' 32.
137 This issue is discussed in 4.6.
138 Cassim and others, *Contemporary Company Law* 864.
139 Kastrinou and Jacobs L 'Pre–. –insolvency procedures: A United Kingdom and South African Perspective' https://core.ac.uk/download/pdf/74207718.pdf (Date of use: 27 January 2020).

appears to be reasonably unlikely that the company will be able to pay all of its debts as they fall due and payable within the immediately ensuing six months,[140] or if it appears to be reasonably likely that the company will become insolvent within the immediately ensuing six months.[141]

Financial distress points to a probable failure in the near future of the business of the company, but the company must not at the time of commencing rescue proceedings be either cash flow (commercially) insolvent or balance sheet (factually) insolvent.[142]

In *Francis Edward Gomley v West City Precinct Properties (Pty) Ltd and others*,[143] Traverso J stated that the provisions of the Companies Act make it clear that the concept of business rescue only applies to companies that are 'financially distressed' as defined in the Companies Act.[144] If a company is not financially distressed, the provisions of Chapter 6 of the Companies Act will not apply to it. It must be either unlikely that the debts can be repaid in six months or that there is a likelihood that the company will become insolvent.[145]

In *Welman v Marcelle Props*,[146] it was held that business rescue proceedings are not for the terminally ill close corporations; they are for the ailing corporations, which given time, can be rescued, and become solvent.

South African courts have indeed, in many cases, denied applications for business rescue where the company seeking rescue is insolvent as opposed to just being financially distressed.[147] This is precisely because rescue should never be seen as the magical panacea to revive an already hopeless company.

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140 Section 128(1)*(f)*(i) of the Companies Act 2008.

141 Section 128(1)*(f)*(ii) of the Companies Act 2008.

142 Cassim and others, *Contemporary Company Law* 864.

143 Case No. 19075/2011. Available at http://www.saflii.org/za/cases/ZAWCHC/2012/33.pdf (Date of use: 27 January2020).

144 According to s 128(1)*(f)* of the Companies Act 2008 **''**financially distressed'' in reference to a particular company at any particular time, means that (i) it appears to be reasonably unlikely that the company will be able to pay all of its debts as they fall due and payable within the immediately ensuing six months; or (ii) it appears to be reasonably likely that the company will become insolvent within the immediately ensuing 6 months.

145 *Francis Edward Gomley v West City Precinct Properties (Pty) Ltd and others* Case no. 19075/2011.

146 193 2012 JDR 0408 GSJ 12.

147 *African Banking Corporation of Botswana v Kariba Furniture Manufacturers* [2015] ZASCA 69.

This is further augmented by the additional requirement that for corporate rescue to be tenable, there must be evidence that the company is viable with reasonable prospects of recovery from its financial woes.[148] The Companies Act provides that before a board of a company can resolve to place a company under business rescue proceedings, the board must be satisfied that there are reasonable prospects for rescuing the company.[149] Similarly, section 130(4)*(a)*(iii) of the Companies Act further provides that reasonable prospects for rescuing of the company is one of the key considerations the courts are required to take into account before granting an order to place a company under business rescue.[150]

In *Newcity Group (Pty) Ltd v Allan David Pellow and others,*[151] the Supreme Court of Appeal of South Africa held among others that it is plain from the wording of the provisions of section 131 of the Companies Act that a court may not grant an application for business rescue unless there is a reasonable prospect for rescuing the company to facilitate its rehabilitation to continue operating on a solvent basis, or if that is not possible, yields a better return for its creditors and shareholders than what they would receive through liquidation.

The same court went further to refer with approval to the holding by Brand JA in *Oakdene Square Properties (Pty) and others v Farm Bothasfontein (Kyalami) (Pty) Ltd and others,*[152] when he stated that reasonable prospect described a yardstick higher than a mere *prima facie* case or an arguable possibility but less than a reasonable probability, a prospect based on reasonable grounds to be established by a business rescue applicant, emphasising thus:

> Self-evidently it will be neither practical nor prudent to be prescriptive about the way in which the [applicant] must show a reasonable prospect in every case. Some reported decisions laid down, however, that the applicant must provide a substantial measure of detail about the proposed plan to satisfy this requirement … But in considering these decisions Van der Merwe J commented as follows in *Propspec Investments (Pty) Ltd v Pacific Coast Investments 97 Ltd and another* 2013 (1) SA 542 (FB) para 11: 'I agree that vague averments and mere speculative suggestions will not suffice in this regard. There can be no doubt that, in order to succeed in an application for business rescue, the applicant must place before the court a factual foundation for the existence of a reasonable prospect that the

148 Section 129(1)*(b)* and 130(4)*(a)*(iii) of the Companies Act.
149 Section 129(1)*(b)* of the Companies Act.
150 Section 130(4)*(a)*(iii) of the Companies Act.
151 Case no: 577/2013 para 15. Available at http://www.saflii.org/za/cases/ZASCA/2014/162.pdf (Date of use: 28th January 2020).
152 2013 (4) SA 539 (SCA) para 21.

desired object can be achieved. But with respect to my learned colleagues, I believe that they place the bar too high.' And in para 15: 'In my judgment it is not appropriate to attempt to set out general minimum particulars of what would constitute a reasonable prospect in this regard. It also seems to me that to require, as a minimum, concrete and objectively ascertainable details of the likely costs of rendering the company able to commence or resume its business, and the likely availability of the necessary cash resource in order to enable the company to meet its day-to-day expenditure, or concrete factual details of the source, nature and extent of the resources that are likely to be available to the company, as well as the basis and terms on which such resources will be available, is tantamount to requiring proof of a probability, and unjustifiably limits the availability of business rescue proceedings.' … I agree with these comments in every respect … [Thus] the applicant is not required to set out a detailed plan … but must establish grounds for the reasonable prospect of achieving one or two goals in s 128(1)(b).[153]

It is evident that, whereas it is common for insolvent companies to attempt to seek refuge in corporate rescue, rescue measures are not designed for companies that are already insolvent. Corporate rescue is only applicable to companies with signs of financial distress, probably on the verge of sliding into insolvency but which have not yet crossed the line into actual insolvency.[154] This is precisely because an insolvent company is generally deemed to be terminally ill, with no reasonable prospect of recovery from its financial conundrum and hence only liable for liquidation, which is the default procedure for the obviously insolvent and unviable companies with no hope of survival.

4.6 Causes of financial distress

Considering the apparent symbiotic connection between corporate rescue and financial distress, it is not easy to have a complete discussion about corporate rescue without examining the causes of financial distress. Unfortunately, financial distress is so wide a subject that it is difficult to sufficiently exhaust it in this study. Therefore, this section highlights some of the most common causes of financial distress. Identifying the causes of failure is acknowledged as an essential step in any meaningful attempt to rescue a company.[155]

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153 *Oakdene Square Properties (Pty) and others v Farm Bothasfontein (Kyalami) (Pty) Ltd and others* 2013 (4) SA 539 (SCA) paras 30-31.

154 Cassim and others, *Contemporary Company Law* 864.

155 Wood, 'Corporate rescue: A critical analysis of the fundamentals and existence' 29; Day and Taylor 2001 Insolvency Lawyer 97.

In the previous section, we observed that distress describes a situation of financial, administrative, and operational despair.[156] It is, therefore, necessary to systematically identify and analyse some of the common triggers of financial distress before any rescue strategies are undertaken. In the same vein, one cannot prescribe medicine for an unknown ailment; thus, we first consider the underlying reasons for the failure before delving into a discussion of the strategies for corporate rescue.

Financial distress is caused by heterogeneous factors, which are both exogenous and endogenous.[157] The success of any enterprise is influenced by a variety of factors emanating from both inside and outside the business itself and thus beyond the control of management, also referred to as the uncontrollable variables.[158]

The exogenous factors are pervasive arising from external circumstances and often affect all companies in the market.[159] These include conditions such as slow growth rate of the economy, shifting preferences, attitudes and behaviours of customers, changing market structures and characteristics which uncontrollably influence the profitability and market strength of individual businesses among others.[160] Exogenous shocks are independent of managerial skills and can be classified into inefficiencies in regulatory development, turbulences in the labour market or natural disasters.[161]

Studies have shown that there are five significant sources of external risk: economic change, competitive change, government constraints, social alteration, and technological change. Indeed, a survey of 81 companies that collapsed because of external risks, shows that about forty one percent of those companies experienced declining performance because of bad macroeconomic conditions, thirty one percent because of changing competitive environment, thirteen percent because of regulatory restrictions on expansions in strategic sectors of the economy, and fifteen percent suffered because of social or technological change.[162]

156 Wood, 'Corporate rescue: A critical analysis of the fundamentals and existence' 28; Jahur and Quardir 2012 Economic management 46–. –61.
157 Outecheva, 'Corporate Distress: An empirical analysis of distress risk' 19.
158 Subhash and Mahajan 1980 *Journal of Marketing* 80–89.
159 Outecheva, 'Corporate Distress: An empirical analysis of distress risk' 19.
160 Subhash and Mahajan 1980 *Journal of Marketing* 80–89.
161 Karels and Prakash 1987 *IJBFA* 577.
162 Bibeault, *Corporate Turnaround: How Managers Turn Losers into Winners* 28–35.

Studies further suggest that three models can be used to determine the immediate cause of a company's distress: the Neoclassical model, which portends that a wrong mixture of assets and inappropriate allocation of assets can cause distress; and the financial model which reveals that the right mixture of assets but with wrong or bad financial structure and liquidity constraints can cause financial distress. The third cause is the corporate governance model, which argues that where the right mixture of assets and financial structures are badly managed, financial distress often occurs.[163]

Nonetheless, if a company is well managed by an experienced and versatile team, external factors may not be the immediate cause of financial distress. Astute managerial teams tend to cope with macroeconomic shocks and their companies usually survive.[164]Good management can properly predict and mitigate such economic stresses. More than 80 percent of companies fail not because of external factors, but due to poor management.[165]

The most immediate causes of financial distress often emanate from within the firm itself. These are sometimes described as the endogenous risk factors, arising from internal problems within the company.[166] Most endogenous risks are caused by acts and omissions of management.[167] Management determines the firm's ability to use its resources to adapt and take advantage of the constantly changing environment. Whilst it is a known fact that management of a company cannot single-handedly control all possible eventualities in the market ecosystem, it is expected that good management can innovatively take calculated risks and navigate the company through all forms of turbulences to success.

Success of any enterprise is hinged on management's ability to execute the company's strategies. Ineffective or poor management usually leads to mistakes in formulating and articulating an appropriate strategic plan and/or its implementation, with several scholars acknowledging that management mistakes are often the immediate causes of over 90 percent of corporate failure.[168] Financial distress occurs

163 Nyasha 2015 University of *Zimbabwe Business Review* 28.
164 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 131.
165 Outecheva, 'Corporate Distress: An empirical analysis of distress risk' 20.
166 Outecheva, 'Corporate Distress: An empirical analysis of distress risk' 19.
167 Outecheva, 'Corporate Distress: An empirical analysis of distress risk' 20.
168 Subhash and Mahajan 1980 *Journal of Marketing* 88; Wood, 'Corporate rescue: A critical

because of management's failure to ably control and anticipate negative economic effects on the firm's profitability and future prosperity.[169] And the inverse is also true. Effective management can run the company and make strategic decisions that can keep the company afloat amidst all sorts of conditions.[170]

Unfortunately, even in the developed economies, most company directors are untrained and unqualified[171] and fail to realise that the company is failing and in need of expert advice to properly diagnose and fix the source of trouble before it is too late.[172]

On a related note, lack of good corporate governance structures also contributes to financial distress. Corporate rescue and insolvency often arise where there is a poor record of compliance with corporate governance standards.[173] In a 2008 report by the International Corporate Governance Network (ICGN), it was observed that poor corporate governance was a significant cause of the 2008 financial crisis, due to company board's failure to understand and manage risk and thereby tolerated perverse incentives.[174]It has been argued that corporate insolvency and good corporate governance are often the opposite sides of the same coin.[175]

In Uganda, it was recently reported that poor corporate governance is the leading cause of insolvency in the country, with the biggest problem being people who want to run businesses as if they are running their own homes, without proper separation of ownership from management.[176]

This often precipitates the immediate causes of failure like poor financial controls,[177] due to a failure to institute adequate steps to control cash flows with all its concomitant effects such as uncontrolled spending, poor record keeping, poor planning and failure to diversify revenue streams.

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analysis of the fundamentals and existence' 29; Lingard, *Corporate rescue and insolvencies* 3 para 1.12.

169 Outecheva, 'Corporate Distress: An empirical analysis of distress risk' 22.
170 Wruck 1990 *JFE* 419, 424.
171 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 126.
172 *ibid*; R3 Ninth Survey (2001) 2.
173 Tomasic 2009 Corporate Rescue and Insolvency Journal 5–9.
174 Skypala The Financial Times (17 November 2008) 6.
175 Tomasic 2009 *Corporate Rescue and Insolvency Journal* 8.
176 Kulabako, 'Insolvency linked to poor governance' 23 December 2019 *New vision* 54.
177 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 124.

Changing market and economic conditions may also trigger corporate failure.[178] Market conditions can change due to a myriad of factors, such as changes in consumer tastes and preferences against a particular product, entry of aggressive competitors into the market, changes in regulatory approach among others.[179] For instance, the change could be triggered by emergence of better substitutes in the market due to improvements in technology and innovation. Can you imagine what happened to companies that were engaged in the manufacture and distribution of radio cassettes after the emergence of CDs, DVDs and MP3 players? What about the manufacturers of typewriters after the advent of computers? The same fate can be said of manufacturers of ladies' half petties, especially in this era of women emancipation where some ladies prefer to wear light, short and for some, transparent attires.

It has also been argued that the incidence of 'zombie' companies in a sector can trigger financial distress of healthy businesses.[180] A zombie company is one whose liabilities exceed its assets but is still capable of paying interest on its current liabilities and hence able to meet its short-term financing needs.[181] Zombie firms may also be described as firms that are unable to cover debt servicing costs over an extended period.[182] Such companies will technically be balance sheet insolvent but able to meet their ongoing contractual obligations as they fall due and hence remain technically cash flow solvent. To maximise short term financial needs, zombie companies usually focus on immediate cash flows rather than profit making, through suicidal pricing and aggressive marketing. This, in turn, pushes healthier rivals to equally engage in uneconomical pricing models to keep up with the market pressure created by the zombie firm, thereby distorting competition and market efficiency.[183] It is argued that zombie companies weigh on economic performance because they are less productive and their presence in the market lowers investment and employment in the more productive companies.[184]

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178 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 131.

179 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 131.

180 *ibid.*

181 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 131.

182 Banerjee and Boris 2018 BIS Quarterly Review 67. Available at https://www.bis.org/publ/qtrpdf/r_qt1809g.pdf (Date of use: 26 February 2020).

183 Hood 2013 Corporate Rescue and Insolvency 181; Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 132.

184 Banerjee and Boris 2018 *BIS Quarterly Review* 67.

The increasing survival of zombie firms congests markets and constrains the growth of the more productive firms to the detriment of aggregate productivity growth and industry profitability. This happens through inflating of wages relative to productivity and depressing market prices and hence jeopardise potential for growth and survival of healthier firms.[185]

Therefore, it is prudent for market and sector regulators to institute deliberate mechanisms for early detection of companies with zombie tendencies and either support them out of their zombie state through refinancing or debt restructuring, or otherwise force them out of the market sooner than later to avert the risk posed by such companies to the wider economy.

Relatedly, onerous regulatory burdens may also trigger financial distress. It is argued that the costs of complying with regulations is a common push-out factor for mostly small businesses,[186] which may not be able to absorb additional costs caused by regulatory changes. Regulators may also cause failures where they, for instance, vacillate in their demands, delay licensing approvals unnecessarily, or impose excessive regulatory costs on businesses.[187]

Unexpected natural calamities may also trigger financial distress.[188] Natural disasters may affect business operations directly through damage to the company property by earthquakes, wildfires, and floods; but also, indirectly through distortion of the normal business flow processes. For instance, the outbreak of the Corona virus in China in December 2019, has affected many businesses across the world. The mobility and work disruptions caused by the COVID-19 pandemic have led to marked declines in Chinese consumption, squeezing multinational companies in several sectors including aviation, education abroad, infrastructure development, tourism, and entertainment among others.[189] Businesses that have been relying on imports and exports to China

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185 Andrews and Petroulakis, 'Breaking the shackles: Zombie firms, weak banks and Distressed restructuring in Europe' 2019 European Central Bank Working Paper Series No. 2240/February 2019 8 Available at https://www.ecb.europa.eu/pub/pdf/scpwps/ecb.wp2240~61e2d9dfec.en.pdf

186 Baldwin, 'Better Regulation: Is it better for business?' 2004 FSB 1; Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 133.

187 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 134.

188 *ibid*.

189 Binghan R and Kavitha H 'This is the impact of the corona virus on business' World

suffered a slump in sales and failed to meet their customers' demands with all the associated legal and reputational implications. The economic impact of COVID-19 are being felt by all countries, but mostly those that had closer links to China either through trade, investment or the movement of people, with many African countries being some of the biggest victims.[190]

According to a Price Waterhouse Coopers (PwC) report on the impact of COVID-19 on South African businesses released on 20 February 2020,[191] it was reported that China is South Africa's largest supplier of imports and it is the biggest buyer of South Africa's exports,[192] noting that many of South Africa's industries will see an adverse impact from the COVID-19, including mobile operators, automobile manufacturers as well as hospitality and retail establishments.[193] The PwC report further noted that mobile phones are South Africa's largest import category by value from China, supplying 85 percent of South Africa's mobile phone imports, with fears that a disruption of this trend may have serious knock-on effects on the wider telecommunications sector in South Africa.[194]

In Uganda, the Bank of Uganda issued similar statements warning that the outbreak of the COVID-19 will dampen economic growth and expose Ugandan businesses to financial stress.[195] It is, therefore, obvious that sooner rather than later, many businesses will face financial distress because of this pandemic.

Economic Forum 21 February 2020. Available at https://www.weforum.org/agenda/2020/02/why–is–coronavirus–a–global business–risk/ (Date of use: 29 February 2020).

190 Raga S 'Economic vulnerabilities to the Corona virus: Top countries at risk' ODI international Economic Development Group 5 February 2020. Available at https://www.odi.org/16639–economic–vulnerabilities–coronavirus–top–countries–risk (Date of use: 01 March 2020)

191 PwC Report 'Impact of trade disrupting COVID-19 on South Africa business' 20th February 2020.Available at https://www.pwc.co.za/en/assets/pdf/impact–of–trade–disrupting–covid–19–on–sa–business.pdf (Date of use: 01 March 2020).

192 Omarjee L and Khumalo 'Coronavirus will likely knock SA mining, tourism and telecom' fin24 29 February 2020. Available at https://www.fin24.com/Economy/South–Africa/coronavirus–will–likely–knock–sa–mining–tourism–and–telecoms–report–20200229–2 (Date of use: 01 March 2020).

193 PwC Report 'Impact of trade–disrupting COVID-19 on South Africa business' 20th February 2020, 1.

194 PwC Report 'Impact of trade–disrupting COVID-19 on South Africa business' 20th February 2020,1.

195 Kiiza C 'Bank of Uganda warns of coronavirus, locusts effect on the economy' *Chimpreports* 13 February 2020. Available at https://chimpreports.com/bank–of–uganda–warns–of–coronavirus–locusts–effects–on–the–economy/ (Date of use: 01 March 2020).

Finally, the last cause of financial distress is late payment of debts by business debtors. Many large firms delay settling of invoices of small suppliers as a deliberate strategy for extracting cheap credit.[196] Instead of borrowing from banks at commercial interest rates, several businesses prefer to exploit their supplier's loyalty, and sometimes, desperation, to obtain goods and services from them on credit and end up delaying payments. An *Intrum Justitia* survey of 2016 indicated that just over a third of UK business respondents considered that late payment of debts posed medium to high risk to their survival,[197] and in 2015, data from the Association of Business Recovery Professionals revealed that late payment was a factor in 20 percent of business insolvencies in the UK.[198]

The situation is not any different in the developing economies. In Uganda, for instance, it is becoming a normal business practice for companies and institutions, including Government agencies, to delay paying for goods and services on time,[199] with some businesses using this as a strategy to manage cash flows and obtain interest free credit from suppliers. This unfortunately plunges suppliers into financial distress.[200]

4.7 What constitutes a successful rescue attempt?

Whereas there appears to be consensus amongst scholars about the meaning of corporate rescue, what constitutes a successful corporate rescue is not quite clear.[201] Success of a business or company is important to many stakeholders, including employees, creditors, lenders, post-commencement financiers, shareholders and the community. Success to each of those constituents might not, however, necessarily mean the same thing. Rescue may be successful from the point of view of some parties such as shareholders or employees, but not from the perspective of others like

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196 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 135.
197 Intrum Justitia 2016 European Payment Report 9–46.
198 *ibid*.
199 Ladu IM 'Domestic arrears: Trouble of local suppliers owed by Government' *Daily Monitor New paper* 2019–07–09. Available at https://www.monitor.co.ug/Business/Prosper/Domestic–arrears–Trouble–of–local–suppliers–owed–by–government–/688616–5187816–amd6p6z/index.html (Date of use: 19 April 2020).
200 Ajinanathi A 'Delayed Payments: A Silent Killer of Local Contractors' 2018 *8M Magazine Construction Digest*. Available at http://www.8mconstruction.com/2018/04/17/delayed–payments–a–silent–killer–of–local–contractors/ (Date of use: 19 April 2020).
201 Conradie and Lamprecht 2018 *SAJEMS* 1.

creditors or the community, and hence the need to qualify any assessment of rescue.[202]

Diversity of interest notwithstanding, a successful corporate rescue entails a company being restored to its former healthy state[203] with most of its employees retained and its assets and business activities left intact under the control of the same management.[204] In the South African context, a successful rescue is said to occur from two primary perspectives: when the company maintains its going concern value; and when the rescue effort results into a better return to creditors.[205]

These primary perspectives are derived from the meaning of business rescue as statutorily encapsulated under the Companies Act no. 71 of 2008, which entails commencement of proceedings to facilitate the rehabilitation of a financially distressed company by providing for the development and implementation of a plan to rescue the company, through restructuring of its affairs, business, property, debt and other liabilities and equity in a manner that maximises the likelihood of the company to continue in existence (maintaining going concern value), and where this is not possible, results in better returns for the company creditors or shareholders than would result from the immediate liquidation of the company.[206]

According to a 2018 study by Conradie and Lamprecht on the indicators of a successful business rescue,[207] most business rescue practitioners in South Africa argued that business rescue is said to be successful under goal one of maintaining going concern value, if at the date of termination of a business rescue, the business rescue plan was substantially implemented, the distressed company exited business rescue as a going concern, the rescue saved as many jobs as possible and the actual outcome of the business rescue compares well to that estimated in the business rescue plan.[208]

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202 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 198.
203 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 197.
204 Zhang, '*Making an efficient and well functioning corporate rescue system in Chinese Bankruptcy laws* 38.
205 Conradie and Lamprecht 2018 *SAJEMS* 7.
206 Section 128*(b)*(iii) of the Companies Act.
207 Conradie and Lamprecht 2018 *SAJEMS* 1.
208 Conradie and Lamprecht 2018 *SAJEMS* 10.

As regards the alternative goal of ensuring that a rescue process results into better returns to creditors than they would gain if the company had gone straight into liquidation, success is said to be achieved where the company's assets were realised under a business rescue plan and the company got deregistered, if the approved plan to maximise returns to creditors was substantially implemented and the returns received under the business rescue proceedings are more than the return that would have been received under immediate liquidation.[209]

From these perspectives, producing a successful rescue is not easy. Of the companies which entered business rescue in South Africa between May 2011 and March 2014, only twelve percent emerged successful.[210] By June 2016, the success rate had only improved to a paltry fifteen percent.[211] In 2019, it was reported that the average rate had dropped further down to an average of about ten percent.[212]

The figures may, however, only be reflective of how complex it is to fairly measure success of rescue procedure. Success in rescue depends on many variables. Mere survival of a company in the wake of renegotiation may not necessarily indicate that a successful rescue has occurred, and the timescales used to judge a rescue may also affect judgement of its success or failure.[213]

Moreover, the end results of a rescue attempt may be various.[214] The company may be restored to its former state; however, this is achieved in fewer cases. In most cases, rescue will result into a company being reorganised through institution of strategic managerial reforms. It may also be restructured through closure of some components of the business. Rescue may also result into refinancing of the company, where new capital is injected into the business or through debt rescheduling. Rescue experts may sometimes recommend downsizing of the company through cutting off some business units or even reduction in employee ratios. Where a diagnostic review of the company shows that the distress was triggered by having dysfunctional components of the business, rescue may result into sell-off of the non-value adding components of the

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209 Conradie and Lamprecht 2018 *SAJEMS* 10.

210 Naidoo, Patel and Padia 2018 *JEFS* 2.

211 *ibid.*

212 The Business day 'Business rescue drags on' April 2019. Available at https://www.businesslive.co.za/bd/opinion/editorials/2019-04-18-editorial-business-rescues-drag-on/ (Date of use: 03 March 2020).

213 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 198.

214 Belcher, *Corporate Rescue* 22–24.

business. In some cases, the only way rescue may be achieved could be through having the company or the business taken over by another company or business management team.[215]

Any rescue attempt will inevitably leave some parties as winners and others as losers,[216] which renders credence to the argument that all rescues are, in some sense, partial, depending on one's position and interest in the process.[217]

It is also worth noting that endurance of the outcome of the rescue process should be considered in determining whether the rescue efforts have been successful or not.[218] This can be measured in terms of stability and sustainability of the rescue outcome. Stability points to survival of the company and its business activities in a reasonable period after the end of the rescue process, while sustainability looks at the ability of the economic activities of the rescued company or business to last for some time. A successful rescue should be able to produce stable and sustainable results.[219]

This measure is, however, not wholly accurate. Sometimes, short term survival may yield better economic benefits to stakeholders. The rescue efforts may, for instance, be deemed successful, irrespective of how long the entity survives, where because of the rescue intervention, an ailing company is returned to profitability and manages to attract an investor who acquires the company at a good price based on its short-term financial health status.

Similarly, it is argued that a fair assessment of a rescue process should consider the effects of the rescue attempt to the wider ecosystem. If the rescue attempt results into rescue of the distressed company at the cost of other stakeholders such as business partners, employees and maybe taxpayer's money, then such a rescue ought not to be considered successful. For instance, it is reported that the 2009 report of the House of Commons Business and Enterprise Committee raised concerns that pre-pack procedures in UK placed too much emphasis on rescuing collapsed businesses and

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215 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 199.

216 Zhang, '*Making an Efficient and well functioning Corporate Rescue System in Chinese Bankruptcy laws* 38.

217 Belcher, *Corporate Rescue* 23.

218 Zhang, '*Making an Efficient and well functioning Corporate Rescue System in Chinese Bankruptcy laws* 38.

219 Belcher, *Corporate Rescue* 23.

too little attention to the damage that phoenix pre-packs cause to other companies and the wider economy.[220]

A similar situation is currently being witnessed in Uganda, where, in a desperate attempt by the Government of Uganda to rescue the incumbent telecommunications company, Uganda Telecom Limited (UTL), the integrity of the entire communications sector is being risked.[221] UTL, which was, at the instance of the Government of Uganda placed under Administration in April 2017,[222] continues to accumulate interconnection debts to its interconnect partners. Moreover, the quality of the services it provides to its customers is at its lowest, let alone operating without paying taxes on goods and services it continues to consume. It is almost natural that no matter how successful the ongoing rescue efforts might turn out to be, the rescue process will eventually end up leaving bigger wounds in the sector than if this company had been left to die over two years ago.

Therefore, it is important that while designing any mechanism for gauging success of a rescue procedure, due attention is put on the impact of the rescue process to the wider economy.[223] Success should mean much more than just saving the company from immediate collapse.

4.8 Common barriers to successful rescue

As noted in the previous section,[224] registering success in rescue proceedings is not a daily occurrence. Many rescue attempts fail even before they take shape, and the failure is usually due to many factors, which are explored below.

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220 House of Commons Business and Enterprise Committee, The Insolvency Service: Sixth Report of Session 2008–9 (HC 198, 6 May 2009) 11; *cf* Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 199.

221 Butagira T and Draku F 'UTL poses national security threat–UCC' 2019 April 2019 *Daily Monitor* Available at https://www.monitor.co.ug/News/National/UTL–poses–national–security–threat–UCC/688334–5169152– .–ofry9q/index.html (Date of use: 09 March 2020).

222 'Govt places troubled UTL in receivership' 2017– .–04– .–28 *The East African.* Available at https://www.theeastafrican.co.ke/business/Govt–places–UTL–under–receivership/2560–3907716–kr2ehq/index.html (Date of use: 09 March 2020).

223 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 199.

224 Discussed under 4.7.

4.8.1 Absence of a solid moratorium regime

When a company shows signs of financial distress, most creditors will rush to collect their debts as fast as possible. This usually results into loss of assets to aggressive creditors because debt collection efforts usually reward the swiftest in enforcement and execution of judgments, even if such efforts trigger eventual collapse of the company. Creditors are usually not benevolent to a dying defaulter.

This explains why stopping the free-for-all approach in which the race goes to the swiftest and assets of the company picked off one by one in the process of execution and debt enforcement to the detriment of the company and the general body of creditors, is revered as one of the traditional objectives of corporate insolvency law.[225]

Collectivism is the cornerstone of insolvency proceedings.[226] It is argued that the collectivist compulsory system of insolvency law is justified on the grounds of a hypothetical bargain assumption that where company creditors fail to agree on forms of enforcement of their claims during insolvency, they would agree to collectivist arrangements rather than procedures of individual action or partial collectivism.[227]

One of the ways through which collectivism is achieved in corporate rescue proceedings is through the provision of a moratorium. A moratorium is widely recognised as probably the most important feature of corporate rescue.[228] A moratorium results into an automatic and general freeze or stay on all legal and execution proceedings against the company and its assets. It affords the company the crucial breathing space and a period of respite to reorganise and reschedule its debts and liabilities without the pressure from creditors.[229]

It enables a company to continue with its business operations and processes as it finds a solution to its problems and allows the administrator or the rescue professional to concentrate on the daunting task of restoring the company to profitability or otherwise manage its affairs for the benefit of creditors as a whole without having to continuously fend off enforcement actions by individual creditors.[230] A stay addresses

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225 Goode, *Principles of Corporate Insolvency Law* 61.
226 Jackson 1982 *Yale LJ* 860.
227 Bo, *Comparative Insolvency Law: The Pre-pack Approach to Corporate Rescue* 9.
228 Cassim and others, *Contemporary Company Law* 878.
229 Cassim and others, *Contemporary Company Law* 879.
230 Goode, *Principles of Corporate Insolvency Law* 423.

the 'anti-commons' problem of blocking actions by individual creditors who try to thwart the wishes of the majority.[231]

The policy objective behind the statutory moratorium is that it helps to preserve the assets in the insolvent estate from the risk of piecemeal dismemberment by creditors who are often understandably anxious to enforce their contractual remedies against the debtor.[232]

In the English case of *AES Barry Ltd v TXU Europe Energy Trading,*[233] Pattern J stated that:

> The moratorium….is primarily concerned to avoid the assets of the company from being removed by creditors while the administrators continue to attempt to achieve the statutory purposes for which the administration order was made.[234]

The immunity from legal proceedings or execution against the company, its property and assets, affords the business rescue expert peace and time to formulate a business rescue plan necessary to salvage the company out of financial danger.[235]

In the US case of *Small Business Admin v Rinehart,*[236] Larson J noted:

> The primary purpose of the automatic stay provision is to afford debtors in Chapter 11 reorganisation an opportunity to continue their business with their available assets.

The extent of protection provided by the moratorium varies from country to country. In the US, the filing of a Chapter 11 petition brings with it a worldwide automatic stay on all proceedings against the debtor or its assets.[237]

In South Africa, the law also extensively provides a company in business rescue with a strong shield against legal proceedings[238] and claims on property interest.[239] The net effect of section 133(1) of the Companies Act is that upon commencement of rescue proceedings, all legal proceedings against the company are automatically

231 McCormack 2018 *JCLS* 14.
232 Udofia, '*The Impact of Insolvency on Corporate Contracts: A Comparative Study of the UK and US Insolvency Regimes'* 134.
233 (2005) 2 BCLC 22.
234 AES Barry Ltd v TXU Europe Energy Trading (2005) 2 BCLC 22, 14.
235 Cassim and others*, Contemporary Company Law* 878.
236 887 F.2d 165 CA 8(S.D.1989).
237 McCormack 2018 JCLS 14; *In re Nortel Networks Inc* (2011) 669 F 3d 128.
238 Section 133 of the Companies Act.
239 Section 134 of the Companies Act.

stayed and all actions for new, pending and ongoing executions and enforcements against the company are frozen unless expressly approved by either the business practitioner or court.[240]

In the next chapter, the extent to which the moratorium provided under the South African legal regime compares with other countries is evaluated.[241] Suffice to note here that going by the provisions of the law, the moratorium available to companies in business rescue in South Africa is generally good and capable of facilitating the attainment of the goals of business rescue in South Africa.

The same conclusion may not apply to Uganda. Whereas the Insolvency Act 14 of 2011 platonically provides some moratorium to companies in provisional administration and administration, which are the rescue procedures in the Ugandan regime, the protection provided leaves a lot to be desired. For instance, whereas section 143(1)*(f)*[242] provides that except with the written consent of the Provisional Administrator or with leave of court, steps shall not be taken to enforce any charge over any of the company property, the same law goes on to allow continuation of exercise of power of enforcement of a charge over company property where such enforcement actions had started prior to the commencement of provisional administration.[243] This provision creates a further motivation to creditors to start enforcement action for their charges as soon as a company shows signs of distress to insulate their enforcement actions against any potential moratorium that may be triggered by the placement of the company into provisional administration or administration as the case maybe.

Moreover, the definition of a charge in the Insolvency Act 14 of 2011[244] is so broad that it basically encompasses all forms of security provided or created by a company, including both fixed and floating charges, continuation of enforcement of which could potentially leave the administrator with virtually no assets with which to turn around the company.

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240 Cassim and others*, Contemporary Company Law* 880.
241 See the discussion in 5.5.4.1
242 Insolvency Act 14 of 2011.
243 Section 143(2) of the Insolvency Act 14 of 2011.
244 Section 2 of the Insolvency Act 14 of 2011.

The same law goes on to oblige a provisional administrator to obtain written consent to his or her appointment from every secured creditor holding a charge on the whole or substantially the whole of the property and undertakings of the company before his or her appointment is registered by the Official receiver.[245] Although the law does not go into detail to prescribe what would happen if the provisional administrator does not obtain the requisite approval from secured creditors, it is apparent that this can be a major procedural irregularity that can be capitalised on to challenge the rescue processes or even be a ground for the termination of administration by court, where such a creditor can demonstrate that the procedure is oppressive or unfairly prejudicial to his or her interests.[246] Similarly, a secured creditor whose consent was not obtained at the commencement of the procedure may withhold his or her consent to a request by the administrator to dispose of the property covered by his or her security;[247] this can further cripple the rescue efforts.

Furthermore, the Insolvency Act 14 of 2011 allows creditors to place defaulting companies into receivership,[248] which has continued to overshadow the Government's efforts to nurture an enviable rescue culture in Uganda.[249] Many other contradictions that are discussed in Chapter 6[250] have defeated efforts to popularise corporate rescue in Uganda, rendering it unsurprising that Provisional Administration and Administration procedures are hardly appreciated as rescue procedures.

4.8.2 Absence of rescue financing mechanism

The most immediate cause of financial distress is usually lack of liquidity. Unfortunately, entering rescue procedure does not, by itself, guarantee any magical change in the liquidity curve of the company. The rescue practitioner must undertake deliberate remedial measures to revive the company and sustain its business as a going concern.

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245 Section 142(2)*(c)* of the Insolvency Act 14 of 2011.
246 Section 169(3)*(f)* of the Insolvency Act 14 of 2011.
247 Section 257*(b)* of the Insolvency Act 14 of 2011.
248 Part VII of the Insolvency Act 14 of 2011.
249 Nyombi 2015 *IJLM* 19.
250 See the discussion under 6.7.

In order for this to happen, certain indispensable business expenditures and activities will require continuous funding.[251] For example, paying for critical office supplies such as utility bills, printing costs, labour costs, rent, office maintenance and other operating expenses as well as the cost of maintaining the value of critical business assets must be borne.[252] Therefore, a rescue practitioner must obtain funding as soon as possible to maintain value of the company.[253]

It is desirable for a company in financial distress to obtain new money at an early stage, preferably prior to the commencement of formal rescue proceedings to facilitate seamless and swift recovery from its liquidity difficulties.[254] Obtaining turnaround finance at the beginning of the financial distress is directly linked to the likelihood of success during rescue proceedings[255] and the reverse is also true. In the US case of *National Labour Relations Board v Bildisco and Bildisco, Debtor in Possession and others*,[256] the court held that the fundamental purpose of reorganisation is to prevent a debtor from going into liquidation, with an attendant loss of jobs and possible misuse of economic resources and in most cases, reorganisation may be successful only if new creditors inject additional capital in the ailing firm.[257]

Securing funding during formal business rescue proceedings is, however, not a walk in the park. In South Africa, it is reported that lack of post commencement finance is one of the five main reasons why business rescue fails.[258] This is mainly because lenders may not see any realistic hope of getting a return on their investment in the sick company.[259] Commencement of rescue proceedings is seen by would-be lenders and business associates as evidence of failure. This is further compounded by the fact that by the time a company begins to manifest signs of financial distress, it will, in most cases, have already exhausted its credit options, breached its loan repayment terms, with a dented credit history that cannot easily attract additional credit. Moreover,

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251 Zhang, '*Making an efficient and well functioning corporate rescue system in Chinese Bankruptcy laws* 42.
252 UNCITRAL Legislative Guide on Insolvency Law 'Treatment of Assets on commencement of Insolvency proceedings Part 2' (New York United States of America 2012) 113 para 94.
253 Calitz and Freebody 2016 De Jure 270; Pretorius and Rosslyn 2014 *SABR* 132.
254 Zhang, '*Making an efficient and well functioning corporate rescue system in Chinese Bankruptcy laws* 42.
255 Pretorius and Du Preez 2013 *SAJESBM* 170.
256 465 US 513 (1983) 528.
257 Cassim and others*, Contemporary Company Law* 882.
258 Pretorius and Du Preez 2013 *SAJESBM* 170.
259 Calitz and Freebody 2016 *De Jure* 270.

such companies will hardly have any unencumbered assets to pledge as security for any additional funding[260]yet banks and other financiers are generally reluctant to assume the obvious risk of lending to a company in apparent financial distress.[261] Lending to a company in rescue is like lending to a patient on a life-support machine.

It has been argued that there are about eleven main reasons why financiers in South Africa are reluctant to provide rescue financing.[262] These include, the profile and actions of the business rescue practitioner appointed; the feeling that some business rescue filings are done for wrong purposes and are done too late when the company is already distressed beyond repair; the negative business rescue culture and perception of business rescue in South Africa; and concerns and uncertainty regarding the priority ranking of post commencement finance. Others are the risk of the financiers losing their money as well as lack of cooperation by banks during business rescue proceedings; the fact that distressed businesses do not readily involve financiers upfront prior to commencement of business rescue; poor relationship between the financiers and the management of the business; non–availability of security; and lack of confidence amongst financiers that business rescue will be successful.[263]

Due to the above reasons and the inherent risks associated with lending to a distressed company, there are generally few sources for post commencement financing.[264] The typical sources of post commencement finance are mainly creditors, banks and shareholders.[265] Trade creditors are usually one of the first providers of post-commencement financing. Creditors are usually motivated to lend to the company during rescue proceedings because of the prior relationship they might have enjoyed with the business and hence more likely to trust it.[266] This happens only where the company had a good credit record before it fell into distress. A creditor may also

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260 Zhang, '*Making an efficient and well functioning corporate rescue system in Chinese Bankruptcy laws* 42.

261 A review of Company Recue and Business Reconstruction Mechanisms, The Insolvency Service (London: HMSO, 1999) items 6(t) and 6(v).

262 Pretorius and Du Preez 2013 *SAJESBM* 183.

263 Gordon J, '*Research on post commencement finance data from South African companies in business rescue' 14.*

264 UNCITRAL Legislative Guide on Insolvency Law 'Treatment of Assets on commencement of Insolvency proceedings Part 2' (New York United States of America 2012) 113 para 99.

265 Pretorius and Du Preez 2013 *SAJESBM* 174.

266 UNCITRAL Legislative Guide on Insolvency Law 'Treatment of Assets on commencement of Insolvency proceedings Part 2' (New York United States of America 2012) 113 para 99.

be motivated to lend to the company because of the need to secure its existing claims against the company.

The second category of potential lenders entail banks. These might be complete strangers to the company but are usually motivated to lend to the troubled company in anticipation that they will earn high returns on the recue financing.[267] However, securing post commencement capital from banks is not easy because most banks do not have specialist business rescue units or special business rescue products.[268] Applications for rescue finance are subjected to the same rigorous credit checks as other loan acquisition criteria. This often leads to delays in approval or outright rejection of the loan applications, since in most cases, the company in distress may not have healthy financial records to attract lending.

Shareholders are also recognised as potential providers of post commencement capital, especially where the shareholder was involved in the management of the company and is still committed to seeing the company or business rescued.[269] This is, however, dependent on the relationship between the rescue practitioner and the shareholders or directors. Where the practitioner was not fronted by or with the concurrence of the company, the shareholders or directors may not be keen to support the rescue efforts.

Similarly, customers may in some cases provide post commencement capital to the company in case the distressed companies' products are crucial to the customer's own business.[270]

The other category of potential financiers are entities such as private equity firms, venture capital providers and distressed lenders. Such alternative financiers are said to have a higher risk appetite and are usually incentivised to lend to distressed companies by the higher risk-return investment, the expectation to buy debts and assets at depressed prices, the higher payment priority terms for rescue funding and

[267] UNCITRAL Legislative Guide on Insolvency Law 'Treatment of Assets on commencement of Insolvency proceedings Part 2' (New York United States of America 2012) 113 para 99.
[268] Pretorius and Du Preez 2013 *SAJESBM* 174.
[269] Pretorius and Du Preez 2013 *SAJESBM* 175.
[270] *ibid*.

the potential to undertake debt-to-equity swaps in cases where they consider the distressed business viable with long term prospects.[271]

One of the reasons why rescue financing, however, is not readily obtainable is the high recovery risks associated with such finance. Unless the law expressly provides super priority rights or priority to the rescue funders, it is not easy to convince a lender to commit funds into a company that is on its death bed.

Considering the significance of post commencement finance in the rescue process, it is important for framers of rescue laws to embed within the corporate recue legal framework, a clear legal mechanism through which a rescue practitioner can obtain rescue funding with less procedural complications, and to create statutory benefits to providers of rescue finance.

In the US, for instance, section 364*(a)* of the US Bankruptcy Code[272] authorises the company to obtain unsecured credit in the ordinary course of business without court approval.[273] Moreover the credit extended to a company during reorganisation or rescue process enjoys priority over unsecured claims incurred at the commencement of the rescue process.[274] This creates an incentive to creditors to provide credit to companies in corporate rescue and this partly explains why Chapter 11 is widely recognised as a mature model rescue system.[275]

In South Africa, the Companies Act incorporates pretty much the same legal framework for super-priority post commencement finance as Chapter 11 of the US Bankruptcy Code.[276] Section 135 of the Companies Act clearly provides that during its business rescue proceedings, a company may obtain financing and any such financing may be secured by the lender utilising any asset of the company to the extent that it is not otherwise encumbered.[277] It goes on to provide that rescue finance shall be paid back in the order of preference prescribed in subsection (3)*(b)* of the same Act.[278]

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271 Pretorius and Du Preez 2013 *SAJESBM* 175.
272 US Bankruptcy Code 1 of 1978.
273 Stoop and Hutchison 2017 *PELJ* 20,4.
274 Cassim and others*, Contemporary Company Law* 882.
275 Stoop and Hutchison 2017 *PELJ* 20,4.
276 Cassim and others*, Contemporary Company Law* 883.
277 Section 135(2)*(a)* of the Companies Act.
278 Section 135(2)*(b)* of the Companies Act.

Without pre-empting the assessment in the next chapter on the adequacy of this provision in promoting successful rescue in South Africa,[279] the mere fact that the South African rescue regime authorises a rescue practitioner to obtain financing during rescue proceedings and that such financing enjoys super-priority ranking over the claims of the pre-commencement creditors, confirms that the South African regime is *prima facie*, in tandem with the recommended model of an efficient rescue regime.[280]

Principle 64 of the UNCITRAL Legislative guide on insolvency law recommends that to create the necessary attraction for lenders to provide post commencement finance, a preference right needs to be accorded to post-commencement finance to ensure that financiers get preference in terms of repayment ahead of ordinary unsecured creditors.[281] Principle 65 recommends that the repayment of post-commencement finance should be granted a security interest, in the unencumbered assets of the company or a lesser preference security on an encumbered asset of the business.[282]

In Uganda, the Insolvency Act is silent on post-commencement finance. This leaves the rescue practitioner at the absolute mercy of lenders and ostensibly accounts for the low levels of uptake and success of rescue proceedings. This is explored further in chapter six.[283]

4.8.3 *Ipso facto* clauses in executory contracts

Ipso facto clauses are contractual provisions that allow one party to terminate or modify a contract on the occurrence of a trigger event.[284] They may also be defined as contractual or lease provisions that terminate or modify a party's interest in a contract or property based on the insolvency or financial condition or the commencement of an insolvency case against such a party.[285]

Quite often, trigger events are defined in the contract to include the occurrence of insolvency and/or other analogous events such as the appointment of an

279 See the discussion in Chapter 5.1
280 Principles 64-66 of the UNICTRAL 'Legislative Guide on Insolvency law' (2004) 113–119.
281 *ibid*.
282 UNICTRAL 'Legislative Guide on Insolvency Law' (2004) 119.
283 See the discussion under 6.7.4.
284 Chong 2019 *SAL Prac* 27.
285 Rubin 2013 *American BIJ* 1.

administrator, liquidator, a receiver, or commencement of business rescue proceedings in respect of the other contractual party.

An executory contract is a contract under which the obligation of both parties to the contract are unperformed and in which the failure of either party to complete the performance of their part of the contract would constitute a material breach excusing the other party from further performance of the contract.[286] An executory contract may also simply be defined as a contract under which both parties have continuous obligations to be performed.

Parties often include *ipso facto* clauses in executory contract to allow each other the possibility to rely on the actual or likely insolvency of the other party to be treated as evidence of anticipatory breach and rescind the contract and mitigate further loss. This is premised on the argument that it would be unfair and disruptive for an innocent party to continue to be bound to a contract with an insolvent counterparty who may not be able to perform its obligation.[287] Thus, *ipso facto* clauses are used to provide some contractual insurance against the risks associated with the insolvency of a party to an executory contract.

Whilst exercising the right to unilaterally terminate a contract on the insolvency of the other contractual party may be commercially justifiable, extending the scope of these clauses to include commencement of rescue proceedings as one of the trigger events may be extremely disruptive to rescue effort. This is especially because rescue proceedings are not strictly insolvency proceedings.[288] As discussed above,[289] entering rescue proceedings does not, on its own, mean that the company is insolvent.

Indeed, in *Welman v Marcelle Props*,[290] the court held *inter alia* that business rescue proceedings are not for the terminally ill corporations. They are for the ailing corporations and if given time, can be rescued and become solvent.[291]

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286 Countryman 1976 *Minn. Law Review* 460.
287 Harwood, 'Restructuring: *Ipso facto* clauses, distressed debt market update and DIP/rescue Finance' 2018, 2. Available at https://www.shlegal.com>docs (Date of use: 11 April 2020).
288 Levenstein 'An appraisal of the new South African business rescue procedure' 298–305.
289 See the discussion in 4.4.
290 193 2012 JDR 0408 GSJ 12.
291 *Per* Tsoka J in *Welman v Marcelle Prop 193* 2012 JDR 0408 (GSJ) para 28.

The primary objective of corporate rescue proceedings is to enable the debtor to survive and continue the business affairs to the extent possible. Continuation of contracts that are beneficial or essential to the debtor's business, with potential to contribute value to the estate is very crucial to the success of any rescue proceedings.[292]

For example, in the telecommunication sector, interconnection agreements, intellectual property assignment contracts and spectrum assignments are crucial for the continued operation of telecommunication business. If the law allows counterparties to terminate such contracts or assignments on the commencement of rescue proceedings, the operations of the entity will automatically become impossible and certainly accelerate the eventual collapse of the business.

Allowing parties to terminate executory contracts because of commencement of rescue proceedings may grossly inhibit the efforts of companies seeking to restructure since the appointment of an administrator or business rescue practitioner as the case may be, may trigger termination of key contracts[293] and end up pre-determining the fate of companies in financial distress and ultimately undermine their ability to be saved as going concerns.[294]

Ipso facto clauses strike at the heart of restructuring attempts because they dramatically increase the leverage that the counterparty has against the company attempting to restructure.[295] They pose acute difficulties for companies attempting to restructure their debts, since a company's restructuring efforts may be undermined if key suppliers or service providers terminate their contracts immediately the company commences business rescue proceedings.

This study argues that unless restrictions are imposed on the other party's right to terminate executory contracts, the creditor may gain considerable bargaining power over the business rescue professional and end up using these clauses to demand for advance payment in exchange for continued performance of the contract. Eventually,

292 UNICTRAL 'Legislative Guide on Insolvency Law' 2004 121 para 112.
293 Blazic, '*Rehabilitation regime or corporate graveyard: Practitioner's perspective of the Australian Part 5–3 A Voluntary Administration Legislation* 42.
294 Harwood, 'Restructuring: *Ipso facto* clauses, distressed debt market update and DIP/rescue Finance' 2018, 3.
295 Harris and Symes 2019 *Australian JCL* 84.

this may offend the normal distribution rules and ultimately defeat the purpose of the rescue proceedings.

Absence of adequate statutory restrictions on the right of counterparties to invoke *ipso facto* contractual clauses to terminate executory contracts entered into with companies in rescue is a major hurdle to successful rescue. Regimes seeking to improve their rescue framework ought to consider providing legal immunity for companies in business rescue against the reach of *ipso facto* clauses. Just like many jurisdictions provide companies in rescue procedure general moratorium against legal and other enforcement proceedings, it is important to consider extending this protection to termination of executory contracts. In the US, section 365 of Chapter 11 of the US Bankruptcy Code of 1978 expressly provides that notwithstanding any provision in any executory contract or unexpired lease, an executory contract or unexpired lease of the debtor may not be terminated or modified at any time after the commencement of rescue proceedings solely because of such commencement.[296] This, in effect, binds counterparties not to terminate any executory contracts merely because of the debtor's decision to place the company into Chapter 11 rescue proceedings. This allows companies that have entered Chapter 11 proceedings to undertake their restructuring strategies with less disruption.

In the subsequent chapters, i argue that the absence of similar provisions in Chapter 6 of the Companies Act in South Africa and the Insolvency Act 2011 in Uganda remain a hurdle which companies in rescue must prepare to deal with if they are to emerge successful.

4.8.4 Lack of cooperation between the rescue practitioner and directors

Whereas a rescue practitioner is expected to provide strategic leadership in turning around the company or business, his or her success is dependent on the adequacy of available information about the business prior to the commencement of the rescue procedure. Moreover, from the rescue expert's point of view, the need for complete and accurate information about the company affairs is urgent[297] since it facilitates the

296 Rosenthal, Bouslog and Cassidy 2018 *American Bankruptcy Institute Journal* 2.
297 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 350.

preparation of the rescue plan to be presented for consideration by the creditors and/or court.

No person is expected to have better information about the company than the directors and officers of the company at the time when it enters rescue procedure. The existing management constitutes the major reservoir for information.[298]Consequently, effective coordination and cooperation between directors and the rescue expert is essential to a successful business rescue or turnaround and facilitates easy flow of information to the business rescue practitioner.[299]

Absence of a good working relationship between the directors and the appointed rescue practitioner directly hampers rescue efforts and stands as one of the common barriers to timely and successful rescue. Without information about the state of the company affairs, the practitioner may not be able to timeously diagnose the extent of the company's distress and may not be able come up with appropriate turnaround strategies to close the identified loopholes.

Although directors and the rescue professionals may sometimes have divergent interests in the rescue process, designers of rescue frameworks need to embed within the rescue laws, clear roles, powers and mandates for both directors and the practitioner during rescue proceedings. The law should have complete mechanisms through which the rescue practitioner can effortlessly obtain accurate and complete information about the company from the company directors.

For this to happen, the law ought to be couched in terms that facilitate mutual co-existence and a sense of interdependence between the directors and the rescue expert. The law should not position the rescue expert as the heavenly angel that comes to expose the weaknesses, errors and omissions of the directors and send them to the coolers for their misfeasance. This may create unnecessary friction, anxiety, and a sense of rivalry between the directors and the rescue practitioner, which may further prolong efforts to turn around the company.

In Uganda, the Insolvency Act 14 of 2011 makes the commencement of provisional administration to look like some form of lawful *coup d'état* against the directors of the

298 Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 350.
299 Cassim and others, *Contemporary Company Law* 886.

company. Upon commencement of provisional administration, the performance of any function and exercise of any powers that the company or any of its directors or secretary would perform or exercise when the company was not in provisional administration is automatically vested in the provisional administrator.[300]

Provisional administration automatically suspends the powers and functions of directors and secretary of the company, except where the provisional administrator may generally or specifically approve.[301] Moreover, the provisional administrator may, on his own and without approval of either the creditors or court, remove from or appoint into office a director of the company.[302]

Whilst it is understood that a rescue expert ought to be given enough latitude and discretion to run and fix the company as he or she may deem necessary to rescue the company from its financial doldrums, giving a lot of powers to the administrator against the directors of the company may create unnecessary tension between the directors and the rescue practitioner. It may frustrate attempts to obtain the key information that is needed by the rescue practitioner to develop an acceptable administration deed or business rescue plan to deliver the company or business out of its challenges. In Chapter Six, we argue that this could be one of the reasons why Administration has not been well embraced by financially distressed companies in Uganda.[303]

Chapter Five argues that the framers of the South Africa law eased this problem when they provided that commencement of business rescue does not automatically remove directors from office.[304] The directors continue to exercise their management roles and functions subject to the express instruction of the practitioner.[305] This was partly because of the realisation that directors are the persons most familiar with and best equipped to know the financial affairs of the company and the extent of its difficulties.[306]

The law further goes on to specify that during business rescue proceedings, each director of the company must attend to the request of the practitioner at all times and

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300 Section 153(1)*(b)* of the Insolvency Act 14 of 2011.
301 Section 155(1) of the Insolvency Act 14 of 2011.
302 Section 153(1)*(d)* and *(e)* of the Insolvency Act 14 of 2011.
303 See the discussion under 6.5.6.3.
304 See the discussion under 5.5.4.4.
305 Section 137(2) of the Companies Act.
306 Cassim and others*, Contemporary Company Law* 887.

provide the practitioner with any necessary information about the company's affairs as may be reasonably required.[307] Moreover, in South Africa, the rescue practitioner cannot, on his own and without proving specified reasons, remove a director of the company from office. The law clearly prescribes that the rescue practitioner can only apply to court for an order authorising him or her to remove a director of the company if he or she feels that such director is impeding the practitioner in the performance of his or her functions and powers in the management of the company or in the development or implementation of the rescue plan.[308]

4.9 Benefits of corporate rescue over liquidation

Legal procedures are like routes to destinations. Each route is developed to facilitate the achievement of specific objectives.

We have already noted[309] that the primary objective of corporate rescue is to rehabilitate a financially distressed company with the hope of preventing it from immediate collapse. Rescue is widely understood as a major intervention necessary to avert the eventual failure of a company.[310] Rescue can be pursued through different procedures depending on the jurisdiction. In South Africa, corporate rescue is pursued through chapter 6 business rescue procedure,[311] while in Uganda the same objective is pursued through provisional Administration and Administration procedure.[312] In the UK, corporate rescue is undertaken through Administration while in the US, it is attained through Chapter 11 reorganisation procedure.[313]

On the flipside, liquidation is one of the traditional insolvency procedures primarily meant to facilitate disposal of the assets of the company and pay whatever proceeds might become available to the creditors in their order of preference as prescribed by law. It seeks to achieve orderly and collective disposal of the assets of an insolvent company for the benefit of creditors.

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307 Section 137(3) of the Companies Act.
308 Section 137(4) of the Companies Act; Cassim and others, *Contemporary Company Law* 887.
309 Discussed under 4.4.
310 Belcher, *Corporate Rescue* 4; Cassim and others, *Contemporary Company Law* 861; Finch and Milman, *Corporate Insolvency Law: Perspective and Principles* 197.
311 Chapter 6 of the Companies Act.
312 Part VI of the Insolvency Act 14 of 2011.
313 Cassim and others, *Contemporary Company Law* 861.

From a conceptual perspective therefore, it is apparent that whereas the primary target beneficiary of liquidation processes are creditors, corporate rescue seeks to benefit a wide range of stakeholders, including creditors, the debtor, employees and the community as whole. Corporate rescue developed out of the realisation that the economic benefits of the preservation of a company was an equally important consideration to the maximisation of returns to creditors.[314]

The purpose of rescue procedure is to revive companies that are on the brink of economic collapse and salvage those that could be viably saved to promote the restoration of production, safeguard employment and continue reward of capital and profit to the benefit of the economy at large.[315]

While quoting section 128(1)*(b)* of the Companies Act, Binns-Ward J in *Koen and Another v Wedgewood Village Golf and Country Estate (Pty) Ltd and others*[316] held:

> Business rescue means proceedings to facilitate the rehabilitation of a company that is financially distressed by providing for;
>
> (i) The temporary supervision of the company and of the management of its affairs, business and property;
> (ii) A temporary moratorium on the rights of claimants against the company or in respect of property in its possession;
> (iii) The development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, debt and other liabilities and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to continue in existence, results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company.

The judge proceeded:

> rescue is intended to serve that public interest by providing a remedy directed at avoiding the deleterious consequences of liquidation in cases in which there is a reasonable prospect of salvaging the business of a company in financial distress or of securing a better return to creditor than would probably be achieved in immediate liquidation.[317]

In the UK, the Cork Committee recommended the introduction of administration as an alternative to liquidation and other creditor-centric procedures like receiverships, because it was believed that administration will facilitate reorganisation of distressed

314 Omar 1997 *JIBL* 127.
315 Gant 2014 *Nottingham IBLeJ* 51.
316 (2012) 2 SA 378 (WCC).
317 *Koen and Another v Wedgewood Village Golf and Country Estate (Pty) Ltd and others* 2012 (2) SA 378 (WC).

companies with a view to restoring them to profitability, maintain employment, develop proposals for realising assets for creditors and stockholders as well as continue carrying on business.[318]

As a result, corporate rescue was widely understood as a process through which companies are facilitated to withstand their financial difficulties, return to a state of viability and prevent them from sliding into insolvency.[319] It is widely accepted that corporate rescue offers a very useful alternative to liquidation or winding up of companies.[320]The following are some of the notable benefits of corporate rescue over liquidation:

4.9.1 Preservation of jobs

By prolonging the life of the company and its business, corporate rescue helps in preserving jobs for the people employed in the debtor company. Unlike liquidation and winding up proceedings, which seek to primarily protect the interests of creditors, corporate rescue is intended to promote efficient rescue and recovery of financially distressed companies in a manner that balances the rights and interests of all relevant stakeholders,[321] including employees.

The purpose of business reorganisation or rescue procedure, unlike liquidation is to restructure the finances of a business so that it continues to operate, provide its employees with jobs, pay its creditors and produce returns to its shareholders. It is more economically efficient to reorganise than to liquidate a company because it preserves jobs and business assets.[322]

Although employment protection and business rescue are seen by some commentators[323] as extraneous to corporate insolvency law, preserving employment is now widely acknowledged as a very important policy objective behind efforts to

318 Insolvency Law and Practice, Report of the Review Committee (Cmnd 8558)1982 (the Cork Report) paras 496–498; *cf* Goode, *Principles of Corporate Insolvency Law* 302.

319 Digman and Lowry, *Company Law* 425; Nwafor 2017 Corporate Board: Role, Duties and Compositions 21.

320 Cassim and others*, Contemporary Company Law* 861.

321 Section 7*(k)* of the Companies Act 2008.

322 McCormack, *Corporate Rescue Law* 31.

323 Goode, *Principles of Corporate Insolvency Law* 645.

engender corporate rescue.[324] More often than not, the people who immediately suffer when companies collapse are employees, yet preservation of employees' rights has never been a priority for liquidators. Maximisation of returns to creditors is the primary driver for the actions and decisions taken by liquidators, and since attainment of this objective may not always require the company to continue operating, in most cases, commencement of liquidation proceedings results into closure of all business operations. Indeed, in many jurisdictions, commencement of liquidation or winding up proceedings automatically suspends the employment contracts of all company employees. In *Reginald Ngwato and Another v Liebenberg Dawid Ryk Van Der Merwe and 4 others*[325] Malindi AJ stated:

> It is declared that section 38(1) of the Insolvency Act 24 of 1936 as read together with section 339 of the Companies Act 61 of 1973 together with item 9 of Schedule 5 of the Companies Act 71 of 2008 means that the contract of service of employees whose employer, which is a company, has been liquidated, are suspended with effect from the date of granting of a provisional or final liquidation order, if no provisional order was granted.[326]

In terms of section 38(5) of the Insolvency Act 24 of 1936, the purpose of the suspension of the employee's contract as opposed to outright termination, is arguably to enable the liquidator to discuss and consult with the affected employees on how to deal with their contracts of service during liquidation. This does not appear to be feasible in practice. At that time, the liquidator is pre-occupied with the daunting task of exploring all possible ways through which to maximise collections and value for the benefit of creditors. Section 38(9) of the Insolvency Act clearly provides that if no conclusive agreements are reached between the employees and the liquidator after 45 days of the appointment of the liquidator, by operation of law, all employee's contract are automatically terminated.

It is arguable that issuance of a liquidation order almost always results into loss of jobs by employees; thus, many jurisdictions are now looking at corporate rescue as a better alternative, since corporate rescue seeks to facilitate preservation of the business by ensuring that all or part of the business is purchased or run as a going concern which helps to maintain the jobs of employees.

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324 Cassim and others, *Contemporary Company Law* 899; Gant 2014 *Nottingham IBLeJ* 51.
325 No. 2014/28470 [2016] ZAGPJHC 398.
326 *Reginald Ngwato and Another v Liebenberg Dawid Ryk Van Der Merwe and 4 others* case no. 2014/28470 [2016] ZAGPJHC 398 para 61.

Unlike liquidation and winding up, which automatically render employees' contracts terminated and leaves the employees with only the right to claim for any unpaid wages just like any other unsecured creditors of the company,[327] the commencement of business rescue proceedings does not automatically affect the rights of employees.

Section 136 of the Companies Act expressly provides that "despite any provision to the contrary, during business rescue proceedings, employees of the company before the beginning of the proceedings shall continue to be so employed on the same terms and conditions as before except to the extent that changes occur in the ordinary course of attrition or where the employees and the company in accordance with the applicable labour laws, agree different terms and conditions."[328] Employment contracts are also excluded from among the contracts which the business rescue practitioner may cancel or suspend during rescue proceedings.[329]

Furthermore, the law bestows upon employees of companies in business rescue specific rights, including the right to notice of each court proceedings, decision, meeting or other relevant event concerning the business rescue proceedings.[330] Others include the right to participate in court proceedings arising during business rescue proceedings,[331] the right to be consulted by the practitioner during the development of the business rescue plan and to be afforded an opportunity to review and comment on any such plan,[332] and where the employee also qualifies as a creditor, the right to vote with other creditors on a motion to approve a proposed business plan.[333]

Even as they continue working for the company during rescue procedure, section 135(1) classifies any remuneration, reimbursements or other payments to employees as part of post-commencement finance, with a super-preferential right to be paid ahead of other secured and unsecured creditors.[334]

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327 Section 38(10) of the Insolvency Act 24 of 1936; s 339 of the Companies Act 61 of 1973.

328 Section 136(1) of the Companies Act 2008; Loubser, 'Some Comparative Aspects of Corporate Rescue in South African Company Law' 47.

329 Section 136(2) of the Companies Act 2008.

330 Section 144(3)*(a)* of the Companies Act 2008.

331 Section 144(3)*(b)* of the Companies Act 2008.

332 Section 144(3)*(d)* of the Companies Act 2008.

333 Section 144(3)*(f)* of the Companies Act 2008.

334 Section 135(3)*(a)* of the Companies Act 2008.

In *The employees of Solar Spectrum Trading 83 (Pty) Ltd v Afgri Operations Ltd and Solar Spectrum Trading 83 (Pty) Ltd,*[335] Kollapen J stated that in introducing the provisions relevant to business rescue proceedings in the Companies Act, the South African legislature has demonstrated a shift from creditor's interests to an attempt to balance a wider range of often competing interests.[336]

This clearly shows that the business rescue procedure recognises employees as key stakeholders in the rescue process. Unlike liquidation which thwarts employees' hope for livelihood, business rescue preserves the rights of employees, and it shall be argued in Chapter 5 that this is one of the reasons why the South African rescue regime is revered as a model law on corporate rescue.

4.9.2 Promotes diagnosis and treatment of corporate failure

In the old English case of *Salomon v A Salomon and Co. Ltd,*[337] Lord Macnaghten of the House of Lords held, *inter alia,* that once a company is incorporated, it acquires legal personality, attains maturity at incorporation and begins to enjoy all the rights and privileges of separate legal personality, including the right to sue and be sued, the right to own property in its own name, the right to contract with others, until its name is removed from the register.[338] Indeed, following that case, the entire world now recognises that a company is like a human being: it is born at incorporation and it can die through liquidation procedure.

For a long time, there has been limited appreciation that just like human beings, companies may also fall sick, with financial distress being one of the common symptoms of corporate sickness.

Milman[339] summarised this perception thus:

> Early companies' legislation paid little attention to the rehabilitation of distressed companies. The assumption was that if a company fell into difficulties, the problem would be terminal, and the best solution would be liquidation. Companies were artificial legal entities, viewed with considerable

335 (2011) 6418.
336 *The employees of Solar Spectrum Trading 83 (Pty) Ltd v Afgric Operations Ltd and Solar Spectrum Trading 83 (Pty) Ltd* (2011) 6418 para 9.
337 [1896] UKHL 1, [1897] AC 22.
338 Cassim and others, *Contemporary Company Law* 34–35.
339 Milman *Reforming Corporate Rescue Mechanisms* 416.

suspicion in many quarters and a few people would shed a tear about an untimely death of a company.[340]

This is further reflected by the fact that whereas there are many hospitals and specialised medical doctors to treat sick human beings, in the corporate world, the traditional approach has been to assume that every time a company shows signs of financial sickness, it does not deserve any diagnosis or palliative care. It should just be subjected to liquidation procedure, which as noted earlier,[341] is intended to have an orderly burial for a company and to ensure that its assets are collected, sold and the proceeds distributed amongst its creditors and the balance to its descendants, the shareholders.[342] Liquidation is just but a means of ending the legal life of a company.[343]

The advent of the concept of corporate rescue was a recognition that companies are like humans and can be treated. Rescue involves pulling a company from the jaws of death to give it a new lease of life.[344]It provides a mechanism through which sick companies can be diagnosed, treated and possibly healed, depending on the nature and severity of its sickness.

Section 141 of the Companies Act provides that as soon as practicable after being appointed, a practitioner must investigate the company's affairs, business, property, and financial situation, evaluate how severe the company's financial woes are and thereafter consider whether there is any reasonable prospect for the company to be rescued.[345]

Through exercise of this investigative power, a rescue expert undertakes a full financial and structural diagnosis of the company affairs and goes beyond the normal management of the company to look deeper into the business operations of the company, its financial reporting lines, expenditure patterns and business potential.[346]

This is further augmented by the imposition of duty on the directors of the company to cooperate with and assist the practitioner to understand the depth of the company's

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340 *ibid;* Akingbolahan 2013 *Northern Carolina ILCR* 293–94.
341 This issue has been discussed under 4.4.2.
342 *Per* Supreme Court of Appeal of South Africa in *Dawid Jacques Richter v ABSA Bank Limited* (20181/2014) ZASCA 100 para 9.
343 *Akingbolahan* 2013 *Northern Carolina ILCR* 320.
344 *ibid*.
345 Section 141 of the Companies Act; Cassim and others, *Contemporary Company Law* 895.
346 Finch, *Corporate Insolvency law* 243; *cf* Shadman 2013 *The Northern University Journal of Law* 59.

troubles.[347] The business rescue practitioner is further expected to continue monitoring the companies' financial situation on a regular basis and to timeously inform the key stakeholders as soon as he or she forms the opinion that there is no reasonable prospect of a successful business rescue and accordingly seek approval to discontinue the rescue process.[348] Where this happens, the rescue practitioner will recommend that the company's financial situation is irretrievably critical and hence recommend that it enters liquidation, which in this case would be like moving a patient from the normal ward to the intensive care unit.

Similarly, where the rescue practitioner's investigations show that there are no more reasonable grounds to believe that the company is in financial distress, he or she must inform the stakeholders and move to terminate the rescue procedure.[349] Again, this would be comparable to discharging a patient from a hospital.

Where the rescue practitioner finds that there is evidence of reckless trading, fraud or other contraventions of the law relating to the management of the company before the commencement of the rescue procedure, he or she is obliged to report such breaches to appropriate authorities for further consideration. He or she may even direct the management of the company to institute any appropriate measures to avert further exposure of the company to financial leakages or any other transgressions that might have caused the financial distress.[350] In other words, the rescue practitioner will advise the company directors to undergo a lifestyle change, to embrace safer life behaviours. Therefore, by exercising the investigative and diagnostic power during corporate rescue procedure, the rescue practitioner plays a role comparable to that of a doctor. Through the practitioner's professional interventions, findings and recommendations, the causes of financial distress can be identified and treated early enough. This can save the company from sliding further into actual insolvency and eventual collapse of the company, with all its concomitant effects, like job losses.

347 Section 142 of the Companies Act; Cassim and others, *Contemporary Company Law* 896 – 897.

348 Section141(2)*(a)* of the Companies Act; Cassim and others, *Contemporary Company Law* 896.

349 Section141(2)*(b)* of the Companies Act.

350 Section 141(2)*(c)* of the Companies Act 2008; Cassim and others, *Contemporary Company Law* 896.

4.9.3 Maintains business value

Related to the foregoing benefit is the potential for business rescue to help financially distressed companies to maintain value for their businesses and assets. This benefit is predicated on the economic theory that greater value may be obtained from keeping the essential components of a business together rather than breaking them up and disposing of them in fragments.[351]

The architects of corporate rescue recognised that not all companies and businesses can be saved, especially where rescue processes are started late when the company has reached a point of no return.[352] Where, after commencement of rescue processes, the rescue expert forms an opinion that the company cannot be rescued on a solvency basis, rescue efforts should immediately shift towards achieving the second default objective of corporate rescue, which is to ensure that creditors or shareholders get a better return than they would if the company had gone straight into liquidation.[353]

This is premised on the primary philosophy underlying much of the corporate rescue processes that a company in financial distress may be worth more as a going concern than if it is liquidated with its assets realised on a piecemeal basis.[354]

The going concern value of a company can be realised where the company assets are preserved and sold in the form of a complete takeover or a bulk sale, which involves the sale of the entire business, including good will and other intangibles.[355]

By their very nature, corporate rescue proceedings, unlike liquidation, are designed to capture the going concern surplus in corporate restructurings and insolvency.[356]The going concern surplus is realised where the company's business and assets are preserved as an operating unit, surviving either through a successful turnaround or

351 UNCITRAL 'Legislative Guide on Insolvency Law' (New York United States of America 2015) 11.

352 Goode, *Principles of Corporate Insolvency Law* 130; Lord Walker in *BNY Corporate Trustee Services v Eurosail–UK* [2011] EWCA Civil 227 paras 48–49.

353 Section 128(1)*(b)*(iii) of the Companies Act; *cf* McCormack 2018 *JCLS* 3.

354 Cassim and others, *Contemporary Company Law* 862; McCormack 2018 *JCLS* 4.

355 Armour J 'The Law and Economics of Corporate Insolvency: A Review' 2001 ESRC Centre for Business Research, University of Cambridge, Working Paper No. 197 4. Available at https://www.cbr.cam.ac.uk/fileadmin/user_upload/centre– .–for– .–business research/downloads/working– .–papers/wp197.pdf (Date of use: 15 May 2020).

356 Bo, *Comparative Insolvency Law: The pre-pack Approach in Corporate Rescue* 5.

reorganisation, or through a going concern sale, where the whole or substantial part of the business and assets of the ailing company are preserved and kept as one complete whole.[357]

A company is said to have going-concern surplus only to the extent that it has assets that are worth more if located within an existing company business. If all the assets of the company can be used elsewhere independently on their own, the business may have no value as a going concern and may not be capable of generating any going concern surplus.[358]

In the past, the going concern surplus was mainly derived from the intangible assets through which the company would operate its business, and hence the company's going concern value would be maintained where the rescue effort would succeed in holding together the intangible assets of the company such as patents, trademarks, account receivables customers lists and the human capital.[359] The going concern value of a company would be measured by estimating the income stream that the assets would generate if they were kept together and comparing it to the amount that the assets would fetch if they were sold off piecemeal.[360]

In the modern service sector-oriented economy, most businesses are largely information-based, and the most valuable resource companies have is human capital and relationship networks.[361] The going-concern surplus of such a company is largely anchored in the value of the business relationships that the company has established with key customers, regulators and other relevant stakeholders.[362]

In the predominantly service oriented modern economy, going concern value of companies resides principally in the various relationships among people, among assets and between people and assets.[363] Networks of relationships are at the centre of a modern business and the costs incurred in creating these necessary relationships

357 Bo, *Comparative Insolvency Law: The pre-pack Approach in Corporate Rescue* 5.
358 Baird and Rasmussen 2002 *Stan L R* 758.
359 Bo, *Comparative Insolvency Law: The pre-pack Approach in Corporate Rescue* 7.
360 Baird and Jackson1984 *University of Chicago LR* 109; *cf* Bo, *Comparative Insolvency Law: The pre-pack Approach in Corporate Rescue* 6.
361 McCormack 2018 *JCLS* 7.
362 Butler and Gilpatric 1994 American Bankruptcy Institute LR 282; McCormack 2018 *JCLS* 7.
363 LoPucki 2003 *Stan LR* 645.

will inevitably be lost if the business is scattered to the winds through a piecemeal sale of assets through disruptive proceedings such as liquidation and winding up.[364]

In South Africa, the Companies Act presents several measures through which the going concern value of companies can be maintained during business rescue. As mentioned,[365] once a company enters into business rescue proceedings, there is a general moratorium on all enforcement and execution proceedings against the company and its assets.[366] Business rescue also provides a general shield over the company property against unauthorised disposal during rescue proceedings.[367]

This helps the company to remain a going concern, and if its assets have a going concern value, it increases its chances of obtaining the going concern surplus which can end up benefiting creditors and shareholders. On the other hand, the 'fire sales' of assets and the negative publicity that often characterise terminal procedures such as liquidation, inevitably erodes any residual value of the company and its business.[368] This translates into less returns, if any, to creditors and shareholders.

4.10 Conclusion

In this chapter, the meaning and nature of corporate rescue has been examined from both a doctrinal and comparative perspective. The rescue culture developed out of the strategic desire to mitigate the pain and loss that corporate demise causes to shareholders, creditors, employees and the community.[369]

The chapter highlighted that corporate rescue seeks to save companies in financial distress from going straight into liquidation, noting that corporate rescue is only apt for companies that are experiencing financial distress, but not yet insolvent and terminally ill. Liquidation remains the ultimate procedure for the irretrievably insolvent companies.[370]

364 McCormack 2018 *JCLS* 7; Bo, *Comparative Insolvency Law: The pre-pack Approach in Corporate Rescue* 7.
365 This issue has been discussed under 4.8.1.
366 Section 133 of the Companies Act 2008.
367 Section 134 of the Companies Act 2008.
368 McCormack 2018 *JCLS* 4.
369 See the discussion in 4.4.1.
370 This issue was discussed in 4.4.2.

Since financial distress is the primary trigger for rescue efforts, the common triggers of financial distress have been considered.[371] Poor management and failure to adhere to good corporate governance practices are the most immediate causes of financial distress. It is important to undertake rescue interventions early enough at the first sight of the symptoms of financial distress.[372]

It was noted that absence of a solid moratorium and post-commencement rescue finance as well as indiscriminate application of *ipso facto* clauses and lack of cooperation from the management of the company are some of the leading barriers to successful rescue efforts. A mild comparative discussion on the extent to which the current legal regimes in South Africa, Uganda, UK and the US address these barriers was also made.

The chapter concluded with a discussion of the benefits of corporate rescue over liquidation. Corporate rescue helps in preserving jobs, it promotes diagnosis and treatment of corporate failure, and it assists to maintain business value.[373]

The discussion in this chapter has provided enough context for the next two chapters, which seek to assess the efficacy of the legal framework regulating corporate rescue in South Africa and Uganda.

371 See the discussion under 4.6.
372 See the discussion in 4.4.1.
373 This issue is discussed in 4.9.3.

CHAPTER FIVE
SOUTH AFRICA'S CORPORATE RESCUE FRAMEWORK

5.1 Introduction

South Africa is revered as one of the first countries to have embraced corporate rescue in 1926.[1] This was through the introduction of judicial management in the Companies Act 46 of 1926 (the Companies Act of 1926).[2] At that time, the concept of judicial management was quite unfamiliar to any other comparable legal system.[3]

This chapter commences with a discussion on the history of corporate rescue in South Africa, with specific focus on the circumstances that motivated the Government to introduce judicial management in South Africa.[4] This is followed by an evaluation of judicial management generally, and why it turned out to be labelled as a 'spectacular and abject failure'.[5]

The discussion entails an analysis of the challenges that were encountered by stakeholders during judicial management proceedings, and how these obstacles necessitated the advent of informal rescue mechanisms. It is argued that the informal rescue mechanisms later became accepted as better alternatives to judicial management and heralded the review of the legal framework to give effect to the hitherto informal rescue measures. This culminated into the introduction of Chapter 6 of the Companies Act 71 of 2008 (the Companies Act).

The discussion advances into an analysis of the salient features of South Africa's business rescue procedure, with specific focus on the scope and eligibility criteria for commencing business rescue, how the rescue practitioner is appointed, removed, supervised and how the procedure may be terminated or ended.

The effects and implications of commencement of business rescue procedure on the various stakeholders is also evaluated, as well as the mechanisms for funding of rescue processes.

The chapter concludes with a discussion on the development of business rescue plan and how it is considered, approved or rejected by the affected parties. For easy flow of arguments, the discussion on the different features of the Companies Act

1 Loubser 2004 *SA Merc LJ* 137, 139.
2 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 53.
3 Mikovhe 2018 *Mich. Bus and Entrepreneurial LR* 101, 105.
4 See the discussion under 5.2.
5 *Oakdene Square Properties Ltd v Farm Bothasfontein (Kyalami) Ltd* 2012 (3) SA 273 (GSJ) 5; See the discussion under 5.3.2.

simultaneously entail an evaluation of the strengths and/or weaknesses of the different aspects of South Africa's corporate rescue regime.[6]

5.2 History of corporate rescue in South Africa

As already discussed,[7] the concept of corporate legal personality was first introduced in South Africa during the pre-union era, through the Joint Stock Companies Limited liability Act 23 of 1861,[8] which was a replica of the English Joint Stock Companies Act of 1844[9]and the Limited Liability Act of 1855.[10] These pieces of legislation reflected the dogmatic English pro-creditor inclination, with limited focus on corporate rescue. At that time, company and insolvency laws did not generally include rescue procedures. Each time a company failed to pay its debts, the law gave its creditors rights to commence debt recovery proceedings against it without any need to first support it out of its problems. The general focus of company and Insolvency law was in favour of enabling creditors to recover their debts, even if doing so would result into the eventual collapse of the company.[11]

After the unionisation of the South African states in 1910, the union Government enacted the Companies Act of 1926 as the first consolidated local statute on companies in post-union South Africa.[12] The Companies Act of 1926 was based on the Transvaal Companies Act 31 of 1909, which was also copied from the English Companies (Consolidation) Act of 1908.[13]

Although the general architecture of Company law and Insolvency law at that time did not focus on corporate rescue, the South African Union parliament found it necessary to introduce judicial management in the Companies Act of 1926.[14] Judicial management was a novel procedure that presented an opportunity to debt-stricken companies to restructure their debt without having to go into liquidation.[15] The inclusion of judicial management in the Companies Act of 1926 was a complete

6 This is discussed under 5.5.
7 See the full discussion in 2.3.2.
8 Burdette, A Framework for Corporate Insolvency Law Reform in South Africa' 38.
9 7 and 8 Victoria Ch 110.
10 18 and 19 Victoria Ch 133.
11 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 52–53.
12 *ibid.*
13 Burdette, A Framework for Corporate Insolvency Law Reform in South Africa' 38.
14 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 53.
15 *ibid.*

departure from the existing spectra of company law at that time,[16] and it marked the birth of corporate rescue in South African's company law history.

It is reported that when the Bill for the Companies Act of 1926 was first introduced in the Union Parliament in 1923, the then Minister of Justice who piloted the Bill made the following instructive comments regarding the rescue provisions:

> [T]hese sections are derived from the practice in England and America under which receivers in equity are appointed, in the case of an important concern in regard to which there is some fear that it will go into liquidation; one which can pay its debts and which can be helped by someone officially appointed for the purpose. Powers of that kind would be used sparingly by the courts. To take a hypothetical case. You might have a large wool factory getting into difficulties and which ought to be helped because it is an institution which helps the country. Then your court could intervene, when it is shown that this concern is solvent, and thus help it through its difficulties. I quite admit that this is a power that would not be used in any country very much, and has not been used much in England or America, but might be used to save a concern, and it is for such sparing use that it has been inserted in the bill. The concerns you would like to help with this power are industrial concerns such as factories manufacturing articles in South Africa. You might be able to help a few of these concerns out of the mire at times.[17]

From these remarks, it is apparent that the objective of the Union Parliament at that time was to introduce a procedure that would be applied in very limited circumstances to protect vital industries. This was a very desirable feature in a young country like South Africa where primary industries and industrial undertakings needed every form of encouragement and support to survive.[18]

The Companies Act of 1926 created a legal window through which companies that had symptoms of inability to pay debts, but exhibited potential for recovery, could be saved from liquidation.[19] If court was satisfied that there was a reasonable probability that a troubled company could be operated by a judicial manager and be enabled to meet its obligations, court would grant a judicial management order. The effect of the judicial management order was to keep the company alive by taking it out of the control of its directors, who presumably had mismanaged its affairs, and place it under the control of a court supervised independent manager.[20]

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16 Olver, 'Judicial Management in South Africa' 2.

17 Hansard House of Assembly Debates Vol. 6 1926–02–05 col 996–997; Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 53–54.

18 Olver, 'Judicial management in South Africa' 3.

19 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 54.

20 Olver, 'Judicial Management in South Africa' 4.

The immediate object of a judicial management order was to secure for the company a moratorium against its creditors, but the ultimate objective was to nurse its eventual restoration to normalcy after paying off its creditors.[21]

The introduction of judicial management in South African company law stood out as a unique feature because at that time, the principles of fresh start or rescue culture as is known today, had not found general acceptance in many comparable jurisdictions.[22] Even the English Companies (Consolidation) Act of 1908, on which the South African Companies Act of 1926 was based, did not contain a rescue procedure.[23]

Although a few amendments were made to it, judicial management did not change very much over the years.[24] Most notably, the Companies Act Amendment Act 11 of 1932, improved judicial management when it made provision for a moratorium on claims by creditors and introduced the principles of impeachable transactions.[25]

Judicial management procedure was carried through to the Companies Act 61 of 1973 (the Companies Act of 1973), with an entire chapter dedicated to this procedure,[26] and it remained part of South Africa's Company law until the Companies Act was enacted. This was partly because the legislature realised that it would be unwise for a developing economy to permit companies, which assist in the development of industries and commercial enterprises to be dissipated by winding-up and dissolution due to temporary setbacks, where there was a reasonable probability that such companies could, if granted a moratorium, be able to overcome their difficulties, discharge their debts and become successful concerns.[27]

Judicial management was a redeeming procedure that could be used by companies that were experiencing temporary financial challenges because of mismanagement or other special circumstances. This would be achieved by replacing the existing management of the company with a court appointed manager, otherwise referred to as the judicial manager, to take over the company's business with the purpose of

21 Chapter XV of the Companies Act of 1973.
22 Michael R 1999 *J.S. Afr. Law* 315.
23 Olver, 'Judicial Management in South Africa' 4.
24 Burdette, 'A Framework for Corporate Insolvency Law Reform in South Africa' 246.
25 *ibid.*
26 Chapter XV of the Companies Act of 1973.
27 Henning in Rajak, *Insolvency Paw and Practice* 1993, 304; Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 56.

restoring it to profitability.[28] There is, therefore, no doubt that judicial management was intended to be a rescue procedure. Unfortunately, judicial management was generally never accepted as an effective corporate rescue procedure; it never impressed users as a better alternative to liquidation and was regarded as a dismal failure.[29] This resulted into its eventual abolishment and replacement with business rescue procedure under chapter 6 of the Companies Act.

Considering that judicial management was and remained the foundational corporate rescue procedure in South Africa's history for a whopping 82 years, a discussion on corporate rescue in South Africa would be incomplete without considering its pros and cons.

5.3 Judicial management as a rescue procedure

Whereas the architects of judicial management in South Africa were influenced by the practice of receiverships in Britain and the United States of America,[30] they tried to broaden its scope to give it a rescue outlook, beyond the traditional receiver and manager practice, which was and still is more creditor-centered than rescue oriented.

Unlike equity receiverships whose primary focus was on helping creditors to recover their debts from the defaulting debtors, judicial management sought to provide an avenue for nursing troubled companies out of their financial challenges. A judicial manager's duty was to operate the company with the objective of reviving it and ultimately hand it back to its former managers or shareholders.[31]

Judicial management was introduced in South Africa to offer important concerns, which were in temporary financial difficulties, a measure of protection in the hope that with better management, they would overcome their problems and avoid the harmful effects of liquidation[32]

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28 Burdette, A Framework for Corporate Insolvency Law Reform in South Africa' 343; Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 56.

29 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 58.

30 Loubser 2004 *SA Merc LJ* 150.

31 Olver, 'Judicial Management in South Africa' 19.

32 Union of South Africa House of Assembly Debates Vol. 6 25th February 1926 Col 983; Olver, 'Judicial Management in South Africa' 28.

While contrasting liquidation and judicial management, Snyman J in *Leif v Western Credit (Africa) Pty Ltd*[33] remarked:

> A winding up order, in its nature, is intended to bring about the dissolution of the company, whereas the purpose of a judicial management order is to save the company from dissolution. An important feature of a winding-up order is that upon such an order being granted, there is a *concursus creditorium*. A judicial management order on the other hand usually provides for a moratorium in respect of the company's debt in the hope that it will lead ultimately to the payment of all creditors and the resumption by it of normal trading…a winding-up order is usually granted where a company is in fact insolvent, whereas a judicial management order is usually granted where a solvent company has run into financial difficulties.[34]

An application for a judicial management order could be made by anyone entitled to apply for the winding up of a company,[35] including the company itself, one or more creditors, contingent or prospective creditors or any one or more members of the company.[36] Sections 195 to 198 of the Companies Act of 1926 empowered a court to make an order for the appointment of a judicial manager. The judicial manager would then take over the management of the distressed company, restructure its debt and see it through its challenges without having to go into liquidation.[37]

Although some scholars[38] have questioned the potency of judicial management as a corporate rescue measure, it is argued that its limitations notwithstanding, the legislative wisdom to include it in the Companies Act of 1926 as an alternative procedure to liquidation of distressed companies, was an indelible step in the journey towards building a corporate rescue culture in South Africa. It created a judicial procedure through which companies that were unable to pay their debts could be saved from the risk of immediate liquidation. This laid the foundation for the current legal framework on corporate rescue in South Africa.

33 1966 (3) SA 344 (W).
34 *ibid;* Pretorius and others*, Hahlo's South African Company Law through the cases* 736.
35 Sections 427(2) and 346 of the Companies Act of 1973; Loubser 2004 *SA Merc Law J* 150.
36 Section 346 of the Companies Act of 1973.
37 Burdette, A Framework for Corporate Insolvency Law Reform in South Africa' 343–345.
38 Burdette Part 1 2004 *SA Merc LJ* 241, 250; Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 58.

5.3.1 Requirements for a judicial management order

The requirements for the grant of a judicial management order were summarised in section 427 of the Companies Act of 1973. It provided that where a company, by reason of mismanagement or another reason, became unable to pay its debts or probably unable to meet its obligations, it could apply to court for a judicial management order. However, the company had a burden to prove that there was a reasonable probability that if it was placed under judicial management, it would be able to pay its debts or to meet its obligations and become a successful concern. In these circumstances the court could, if it appeared just and equitable, grant a judicial management order in respect of that company.[39]

The applicant for a judicial management order had to prove all the requirements contained in that provision, namely:

(a) That a company was by reason of mismanagement or for any cause, unable to pay its debts or is probably unable to meet its obligations;

(b) That as a result of the mismanagement or other reason, the company has not become or is prevented from becoming a successful concern;

(c) That there was a reasonable probability that if it is placed under judicial management, it could pay its debts and become successful; and

(d) That it would be just and equitable for the court to grant a judicial management order.

The first part of the requirements related to the state of the company which had to be proved before an applicant could be deemed to have *locus standi* to apply for a judicial management order, and the second part related to what was expected to be achieved after obtaining the order.[40] Moreover, the court still had discretion to either grant or reject an application for a judicial management order, even if all the requirements appeared to have been fulfilled.[41]

One of the key considerations the court had to take into account was whether the challenges the company was facing were attributable to mismanagement of the

[39] Section 427(1) of the Companies Act of 1973; Loubser *2005 Int. Insolv. Rev* 60.
[40] Burdette Part 1 2004 *SA Merc LJ* 248.
[41] Olver, 'Judicial Management in South Africa' 33.

company and whether it was just and equitable for the court to make such an order.[42] This meant that whenever an application for judicial management order would be made, the court had an opportunity to ensure that it holistically evaluates the circumstances of the case, and take into account the interests of not only the applicant, creditors, shareholders or the company itself, but a whole spectrum of interests of all interested parties.[43]

The court could also grant a judicial management order where an application for winding up of a company had been made, if it appeared that placement of the company under judicial management could remove the grounds for its winding-up and possibly allow the company to become a successful concern.[44]

In addition, the law provided that the court would not grant a judicial management order unless it was reasonably satisfied that the company had the potential to succeed after undergoing judicial management. In *Weinberg and another v Modern Motors (Cape Town) (Pty) Ltd*,[45] De Villiers JP cautioned petitioners that:

> I would like to make it clear that in these matters, petitioners and their advisers should bear in mind that the court may sometimes in the past have granted rules *nisi* of this description without having insisted on full information, information sufficient to satisfy it that the applicant has put up a case showing a reasonable probability of success. This amounts to a finding of fact based on evidence before it. A mere confident hope expressed in affidavits and not sufficiently supported by concrete evidence is not enough.[46]

Judicial management was generally seen as an exceptional remedy that the courts would grant to redeem companies that showed potential to regain stability and benefit creditors, shareholders, and the economy as a whole.[47] An applicant for a judicial management order had a daunting task of placing before the court cogent evidence to prove that there was a reasonable probability that through judicial management, the company and its business would be rescued from the risk of liquidation.[48]

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42 Olver, 'Judicial Management in South Africa' 33.
43 *Samuels v Nicholls and Another* 1948 (2) SA 255 (W); *De Jager v Karoo Koeldranke Roomys Bpk* 1956 (3) SA 594 (C).
44 Section 427(3) of the Companies Act of 1973; Loubser 2005 *Int. Insolv Rev* 60.
45 1954 (3) SA 998 (C).
46 *Weinberg and Another v Modern Motors (Cape Town) (Pty) Ltd* 1954 (3) SA 998 (C).
47 Olver, 'Judicial management in South Africa' 42.
48 Burdette, 'A Framework for Corporate Insolvency Law Reform in South Africa' 249.

It has been argued that this requirement was quite onerous on the applicants, who, in addition to proving that the company was unable to pay its debts, also had to convince the court that the company would be able to pay its debts and become successful if a judicial management order were granted.[49]

Upon being convinced about the merits of the application, the court would then make a provisional judicial management order.[50]The effect of the provisional judicial management order was that the company would be placed under the management of the provisional judicial manager subject to the supervision of the court. This would divest the company directors of their powers and authority to act on behalf of the company and the court would also make orders for a general stay of all actions and proceedings against the company during judicial management.[51] This would be followed by meetings with creditors and the Master of the High Court to consider, among others, a report by the provisional judicial manager and decide whether it is desirable for the provisional judicial management order to be made final.[52]

The judicial manager was required to prepare a statement of assets and liabilities of the company, a complete list of creditors, particulars regarding the sources of revenues from which the company was expected to raise money for purposes of facilitating business continuity as well as an opinion about the prospects of the company becoming a successful concern and the removal of the facts or circumstances which had prevented the company from becoming a successful concern.[53]

Where the judicial manager believed that the continuation of judicial management would not enable the company to become a successful concern, he or she was obliged to inform the company members, shareholders and creditors of this finding. The provisional judicial manager was required to immediately apply to the court for an order of cancellation of the judicial management order and the winding up of the company.[54]

49 Loubser, 'Some Comparative Aspects of Corporate Rescue in South African Company Law' 24.
50 Section 428 of the Companies Act of 1973.
51 Section 428*(b)* of the Companies Act of 1973; Loubser 2005 *Int. Insolv. Rev.* 60.
52 Section 431 of the Companies Act of 1973.
53 Section 430 of the Companies Act of 1973; Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 58.
54 Section 440 of the Companies Act of 1973; Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 58.

5.3.2 Why judicial management failed as a rescue procedure

Although it was promising on paper, judicial management was unfortunately widely seen as a 'spectacular and abject failure' in practice,[55] with several scholars arguing that it never took off as an alternative to liquidation.[56]

Below, we highlight some of the notable deficiencies, which inhibited its viability as a corporate rescue procedure.

Judicial management was criticised for relying on the court in an excessive manner.[57] It has been argued that this is one of the most important drawbacks of judicial management,[58] mainly because of the general apathy against the court proceedings as well as the high costs associated with the court proceedings.[59] It was difficult to convince a company faced with the risk of closure due to insolvency, to again spend more money on the court proceedings. The costs incurred during judicial management processes were so high that it did not make the process attractive for creditors because all the available funds would end up being spent on the processes for securing a judicial management order.[60] This rendered the restructuring procedure unaffordable, especially for the small to medium enterprises.[61]

The courts generally considered judicial management to have been an extraordinary remedy.[62] Although the statutory provisions on judicial management in both the Companies Act of 1926 and the Companies Act of 1973 were quite clear about the circumstances under which applications for judicial management could be determined, the courts generally regarded judicial management as an extraordinary measure.[63] The courts exhibited a general reluctance to grant judicial management orders because they considered it a special remedy that could only be granted under extraordinary circumstances.[64] This was because of the dogmatic belief that a creditor

55 Mikovhe 2018 *Michigan Business and Entrepreneurial LR* 101, 109.
56 Burdette Part 1 2004 *SA Merc LJ* 241; Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 58.
57 Klopper 1999 *Stellenbosch LR* 417.
58 Burdette Part 1 2004 *SA Merc LJ* 249.
59 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 58.
60 Burdette Part 1 2004 *SA Merc LJ* 249.
61 Mikovhe 2018 *Michigan Business and Entrepreneurial LR* 101, 109.
62 Burdette Part 1 2004 *SA Merc LJ* 248.
63 *ibid.*
64 *Silverman v Doornhoek Mines Ltd* 1935 TPD 349, 353; *Samuel v President Brand Gold Mining Co. Ltd* 1969 (3) SA 629 (A) 663; *Tenowitz v Tenny Investments (Pty) Ltd* 1979 (2) SA 680 (E) 683.

of a company that is unable to pay its debts is entitled to make use of liquidation to recover payment of his or her claims.[65] It was argued that the decisions in judicial management applications displayed a mistrust by the courts of the legitimacy of judicial management as a beneficial procedure. Judicial management was regarded as an illegitimate infringement on the rights of creditors since it prevented them from exercising their right to liquidate impecunious companies.[66]

This was made worse by the fact that, while in the court, an applicant for a judicial management order had a daunting task of proving that there was a reasonable probability that the company would become a successful concern after undergoing judicial management.[67] In *Tenowitz v Tenny Investments (Pty) Ltd,*[68] the court held that an applicant for judicial management had to prove something more than a reasonable probability that the company could be resurrected before a final judicial management order could be granted. This required a high threshold of proof, 'a reasonable probability rather than a mere possibility that creditors' claims would be eventually paid in full after the company had been placed under judicial management, yet one of the other requirement for grant of the judicial management order was that the applicant had to prove that the company sought to be placed under judicial management was already insolvent.[69] This burden was difficult to discharge as applications for judicial management would be made too late when the company was already eligible for liquidation, and the possibility for rescue had already diminished and almost become unimaginable.[70]

Insolvency or pending insolvency of the company should never have been a condition precedent for the grant of a judicial management order. This acted as an impediment for its general use and defeated the objective of the procedure.[71]

The practice of appointing liquidators to act as judicial managers also contributed to the general failure of judicial management as a rescue procedure. It was ludicrous to appoint liquidators as judicial managers, since liquidators were perceived as trained

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65 Burdette Part 1 2004 *SA Merc LJ* 249; Loubser 2013 *SA Merc LJ* 453–454.
66 *ibid.*
67 Klopper (1999) *Stellenbosch LR* 362–363; Rajak and Henning 1999 *SALJ* 267.
68 1979 (2) SA 680 (E) 683.
69 Burdette 1991 *De Jure* 57–58.
70 *ibid*.
71 Klopper 1999 *Stellenbosch LR* 417.

to only liquidate companies and not to save them.[72] This resulted into a general view that judicial management was an unsupervised form of winding up, since the same judicial manager could also be appointed as the liquidator for the same company.[73] It was argued that:

> The practice of appointing professional liquidators as judicial managers also created difficulty as the objectives and duties of these two categories of persons remained diametrically opposed. The liquidator's function was to carry on the business with a view to stop trading and sell off assets as soon as possible. The judicial manager's objective was to carry on the business with a view to restoring it to financial health.[74]

The appointment of liquidators as judicial managers also created a latent conflict of interest because the fees for liquidation were often higher than for judicial management.[75] This created an inherent motivation for judicial managers to progress judicial management into liquidation and hence earn more fees.[76] It was argued that the wrong people were used as judicial managers; instead of appointing liquidators, a panel of retired or semi-retired business people should have been the one appointed to oversee judicial management.[77]

The absence of an automatic right to obtain post-commencement finance during judicial management is also said to have inhibited its potency as a rescue procedure.[78]Raising additional funding during judicial management was not automatically part of the judicial manager's powers, but he would have to separately seek for the court's permission to obtain post-commencement finance. In *Standard Bank of South Africa v Pharmacy Holdings Ltd,*[79] the court held that this power could only be granted if the court was convinced that creditors and shareholders would not otherwise be prejudiced by the acquisition of the rescue finance. The general premise was that provision of post-commencement finance was undesirable and inadvisable except in very special circumstances.[80] This severely curtailed judicial manager's

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72 Burdette Part 1 2004 *SA Merc LJ* 250.
73 Olver 1986 *THRHR* 86.
74 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 60.
75 Olver 1986 *THRHR* 84.
76 *ibid*; Mpofu, 'Exploring the Novel Concept of Business Rescue under the South African Companies Act 71 of 2008' 15.
77 Rajak and Henning 1999 *SALJ* 282–285.
78 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 62.
79 1962 (1) SA 245 (W) 246.
80 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 62; Loubser in Parry (ed), *European Insolvency Law: Current Issues and Prospects for Reform* 32.

ability to *timeously* secure the requisite funds to power the continuous operations of the business out of its financial woes.

Last but not least, the absence of an automatic moratorium on all actions, proceedings, execution of writs, summons, and other court processes against the company during judicial management also undermined its efficacy.[81] The judicial manager had to separately apply for an order of the court before a moratorium could be granted and it was entirely possible that the court could decide to grant a judicial management order but refuse to order a moratorium. In such a case, judicial management would be doomed since it was almost impossible for a company in financial distress to regain financial stability without protection from enforcement actions by creditors.[82]

The failure of judicial management and its inability to match international best practice rescue principles was summarised as follows:

> Judicial management has been a failure as a corporate rescue mechanism since its inception, mainly due to the expenses involved, the commencement standards, the fact that liquidators are used as judicial managers, the requirement that the company must already be insolvent before the mechanism can be used, and the fact that the company must repay all its debts before a judicial management order can be lifted. Judicial management is an expensive and time-consuming procedure, and the only real success stories have been with very large companies that can absorb the exorbitant costs. Besides a general moratorium which is not automatically granted by the court but has to be specifically requested for by the applicant (section 428(4) of the Companies Act of 1973) judicial management does not conform in real terms to international best procedure in the field of corporate rescue.[83]

Despite its limitations, there is consensus amongst leading scholars that judicial management created a firm foundation and was a natural precursor to the current business rescue system in South Africa.[84]

81 Loubser, 'Some Comparative Aspects of Corporate Rescue in South African Company Law' 44.
82 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 60.
83 Burdette, 'A Framework for Corporate Insolvency Law Reform in South Africa' 135; Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 63.
84 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 63; Klopper 1999 *Stellenbosch LR* 417.

5.4 The rebirth of formal corporate rescue in South Africa

Although South Africa is credited for having been one of the first countries to have embraced corporate rescue in the form of judicial management since 1926,[85] from the mid 1980's, it became apparent that South African legal regime was no longer in sync with modern international corporate rescue trends.[86] South Africa's judicial management procedure was largely perceived as creditor-focused and remained an unattractive option as an effective business rescue regime within South African context.[87]

The challenges of judicial management did not however kill South African's spirit and zeal to create a regulatory regime that facilitates business survival. A number of discussions were held by different scholars and stakeholders, where it became apparent that South Africa was in dire need of a corporate law reform in the field of rescue of financially distressed companies to replace judicial management.[88] There was a clear recognition that judicial management had failed and every one was asking about what could be done to improve the situation, especially taking into account the premium the government was placing on saving jobs and businesses.[89]

This culminated into the publication of a policy paper entitled 'South African Company Law for the 21st Century' by the Department of Trade and Industry (the DTI) in 2004.[90] The paper revealed that the DTI was undertaking a large scale, fundamental revision of South African Company law and provided the guidelines for the corporate law reform process.[91] The reform efforts sought to address the challenges that were witnessed during the unsuccessful judicial management mechanisms to engender a system that reflects internationally recognised ideals on corporate rescue mechanisms for financially ailing companies.[92]

In the forward to the Policy paper, the Minister of Trade and Industry, Mr. Mandisi Mpahlwa, stated that the decision by the DTI to review and modernise Company law

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85 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 261.
86 *ibid.*
87 Burdette Part 1 2004 *SA Merc LJ* 250.
88 Burdette, 'A Framework for Corporate Insolvency Law Reform in South Africa' 3–4.
89 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 266.
90 *Government Gazette* no. 26493 of 23 June 2004 Government Notice 1183 South African Company Law for the 21st century-Guidelines for corporate Law reform.
91 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 267.
92 Bradstreet R (2010) *SA Merc LJ* 195–. –213, 196.

in South Africa was based on the need to reform South Africa's corporate law and align it with international trends to reflect and accommodate the changing environment for business in South Africa and globally.[93]

While emphasizing the policy objectives for reforming corporate rescue and judicial management, the Policy paper[94] quoted an extract from the *South African Law Journal* by Rajak and Henning:

> "It has been observed that all modern corporate rescues are united on one matter, the absence of which, possibly more than anything else, has helped to bring South Africa's judicial management to its present perceived impotence. This is the recognition that the agreed plan by which the future relations of the debtor and its creditors will be governed may well include the reduction of the debtor's over all indebtedness. To insist, as the South African rescue provision does, that a protective moratorium is available only where there is a reasonable probability that if the debtor is placed under judicial management, it will be unable to pay its debts or to meet its obligations is to ignore the well-nigh universal reality of creditor being prepared for their own benefit to forgive part of the debt. It is frequently the case that a creditor will benefit far more from having the debtor back in the market place than from suing the debtor into extinction. A radically new rescue provision should provide a mechanism under which a specified majority of creditors can approve a plan under which the debtor may emerge from protection and resume normal commercial dealings."[95]

This made it very clear right from the outset, that the objective of the review process was to create a robust corporate rescue framework, appropriate for the needs of a modern economy in South Africa, taking into account the existing provisions of Chapter 11 of the US Bankruptcy Code.[96]

This resulted in extensive public consultations about the proposed changes and in August 2005, drafting started, and a Bill was later published in April 2006 for public comment.[97]

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93 *Government Gazette* no. 26493 Notice 1183 South African Company Law for the 21st century– Guidelines for corporate Law reform 23rd June 2004, 1. Available at: https://static.pmg.org.za/docs/2004/appendices/040820review.pdf (Date of use: 26 July 2020)

94 *Government Gazette* no. 26493 Notice 1183 South African Company Law for the 21st century– Guidelines for corporate Law reform 23rd June 2004, 45. Available at: https://static.pmg.org.za/docs/2004/appendices/040820review.pdf (Date of use: 26 July 2020)

95 Rajak and Henning 1999 *SALJ* 286.

96 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 268.

97 Mongalo, *Modern Company Law* xxiv. Available at: http://www.cilt.uct.ac.za/usr/companylaw/downloads/articles/mongalo_lawreform.pdf (Date of use: 26 July 2020).

After consideration of the comments from the public, in 2008, the Bill was finally introduced back in Parliament as Companies Bill 2008, and was finally adopted on 19 November 2008.[98] In the memorandum of the objects of the Companies Bill 2008, it was indicated that Parliament introduced Chapter 6 to replace judicial management with a modern business regime, largely self-administered by the company, under independent supervision within constraints set out in the Chapter and subject to court's intervention at any time by way of application to the court by any of the stakeholders.[99]

The introduction of Chapter 6 in the Companies Act brought South Africa's company law in line with international best practices on corporate rescue and solidified the rescue culture in South Africa.[100] The chapter introduced business rescue to provide for temporary measures to facilitate the rehabilitation of financially distressed companies in South Africa.[101]

5.5 Features of Chapter 6 of the Companies Act

On 8 April 2009, the Companies Act was assented to by the President of South Africa and came into force on 1 May 2011.[102] This marked an end to a long journey of activities towards the reformation of South African company law and fundamentally rewrote South Africa's company law.[103] The Companies Act 2008 dedicated a whole Chapter to 'Business rescue and compromise with creditors', with one of the pronounced objectives of the Companies Act being to provide for the efficient rescue and recovery of financially distressed companies in a manner that balances the interests of all relevant stakeholders.[104] The new procedures under the Chapter 6 were deliberately designed to prevent the demise, through winding-up of viable companies by making provision for their possible rescue.[105]

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98 Mongalo, *Modern Company Law* xxiv.
99 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 270.
100 *ibid.*
101 Bradstreet 2010 *SA Merc LJ* 195.
102 The Department of Trade and Industry 'The Companies Act no. 71 of 2008: An explanatory Guide' 2010, 6. Available at https://cdn.ymaws.com/www.iodsa.co.za/resource/collection/CB7E5DC1–E790–4BED–9693–9F8AA33E0032/Companies_Act_Guide.pdf (Date of use: 29 Jul 2020).
103 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 276.
104 Section 7*(k)* of the Companies Act 2008; Cassim and others*, Contemporary Company Law* 861; Delport *Henochsberg on the Companies Act 71 of 2008* 449.
105 Bradstreet 2010 *SA Merc LJ* 195.

In *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd*,[106] the court stated:

> The end sought by the business rescue regime in Chapter 6 of the Act is the efficient rescue or rehabilitation of a company that is financially distressed and in doing so, the interests of all stakeholders are to be taken into account.[107]

It has been argued that Chapter 6 of the Companies Act 2008 contains the essential characteristics of a modern and effective corporate rescue mechanism.[108] Its introduction was in line with the objective of Government to have an effective procedure that provides mechanism through which financially distressed companies can attain relief and recovery from their problems in a manner that balances the rights and interests of all relevant stakeholders.[109] The provisions of Chapter 6 are said to have brought South African company law in line with the practices in modern jurisdictions.[110] It incorporated approaches that seek to afford distressed companies the opportunity to place themselves into a sound financial footing that facilitates the rescue of the underlying business with the rights of employees and the interests of society generally recognised and taken care of.[111]

Hereunder is an analysis of the salient features of chapter 6 of the Companies Act 2008.

5.5.1 Definition of 'business rescue'

Unlike before where the law was not explicit about the meaning of business rescue, the Companies Act lucidly defines what 'business rescue' means. Section 128(1)*(b)* of the Companies Act provides the definition of 'business rescue' as proceedings to facilitate the rehabilitation of a company that is financially distressed by providing:

> (i) the temporary supervision of the company, and of the management of its affairs, business and property;

106 2013 (6) SA 471 (GNP).

107 *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd* 2013 (6) SA 471 (GNP) para 40.

108 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 281.

109 Mikovhe 2018 *Michigan Business and Entrepreneurial LR* 101, 112.

110 Rushworth 2010 *Acta Juridica* 376.

111 Rushworth 2010 *Acta Juridica* 376; Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 277.

(ii) a temporary moratorium on the rights of claimants against the company or in respect of property in its possession, and

(iii) the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt and other liabilities, and equity in a manner that maximises the likelihood of the company to so continue in existence on a solvent basis, or if it is not possible for the company to continue in existence, results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company.[112]

The definition of 'business rescue' describes the purpose and aims of corporate rescue procedure under Chapter 6 of the Companies Act 2008.[113] A few deductions can be made from it. First, it shows that the primary objective of the legislature was to ensure that the procedure under Chapter 6 of the Companies Act facilitates the 'rehabilitation' of financially distressed companies.[114] Unfortunately, the Companies Act 2008 does not define what 'rehabilitation' means.[115] Some scholars have argued that this creates some vagueness.[116] However, considering that the word 'rehabilitation' is a common English word, the omission of a definition for it in the Companies Act 2008 is not, in my considered view, fatal. Black's law dictionary[117] defines 'rehabilitation' as the process of reorganising a debtor's financial affairs so that the debtor may continue to exist as a financial entity, with the creditors satisfying their claims from the debtor's future earnings. The term would also appear to intimate the recovery of the company to complete solvency.[118]

In the personal insolvency case of *Ex Parte Le Roux,*[119] the court stated that the effect of rehabilitation of an insolvent is to restore him or her fully to the marketplace, and more importantly to obtaining credit.[120] It is settled at common law that rehabilitation envisages the rescue or saving of a financially distressed company from liquidation.[121]

Secondly, the definition confirms that whereas Chapter 6 is titled, 'Business rescue and compromises with creditors', it seeks to engender the rescue of financially

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112 Section 128(1)*(b)* of the Companies Act 2008.
113 Delport *Henochsberg on the Companies Act 71 of 2008* 449.
114 Section 128 of the Companies Act 2008.
115 Delport, *Henochsberg on the Companies Act 71 of 2008* 449.
116 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 283.
117 Garner *Black's Law Dictionary* 1398–1399.
118 Delport, *Henochsberg on the Companies Act 71 of 2008* 449.
119 1996 (2) SA 419 (C) 423.
120 Mpofu, 'Exploring the Novel Concept of Business Rescue under the South African Companies Act 71 of 2008' 17.
121 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 284.

distressed companies and not businesses.[122] This was emphasised by Traverso J in *Gormley v West City Precinct Properties (Pty) Ltd*,[123] when she held:

> Business rescue has as its aim proceedings to facilitate the rehabilitation of a financially distressed company by providing for the temporary moratorium on the claimants, the implementation of a plan to rescue the company by restructuring its affairs in a manner that maximises the likelihood of the company continuing to function on a solvent basis or if that is not possible, a plan that would achieve a better return for the company creditors than the payment they would receive if the company were to be immediately liquidated.[124]

In *Southern Palace Investment 256 (Pty) Ltd v Midnight Storm Investments 386 (Pty) Ltd*[125] Eloff AJ summed up the overall objective of business rescue in South Africa in comparison with the Australian system when he stated:

> Like its Australian equivalent, one of the aims of the remedy is to render it possible for companies in financial difficulty to avoid winding-up and to be restored to commercial viability. Both jurisdictions recognise the desirability of a company in distress to continue in existence. Business rescue does, however, not necessarily entail a complete recovery of the company in the sense that, after the procedure, the company will have regained its solvency, its business will have been restored and its creditors paid. There is also a further recognition that even though the company may not continue in existence, better returns may be gained by adopting the rescue.
>
> The scheme created by the business rescue procedure in Chapter 6 of the new Act envisages that the company in financial distress will be afforded an essential breathing space while a business rescue plan is implemented by a business rescue practitioner. It is, however, necessary to caution against the possible abuse of the business rescue procedure, for instance, by rendering the company temporarily immune to actions by creditors so as to enable the directors and other stakeholders to pursue their own ends. The Courts in Australia have been careful not to allow their equivalent procedure to be used where there appears to be an ulterior purpose behind the appointment of an administrator by the directors. It is necessary that an application for business rescue carefully scrutinized so as to ensure that it entails a genuine attempt to achieve the aims of the statutory remedy[126]

Thirdly, section 128*(b)*(iii) of the Companies Act points to the fact that the framers of the law recognised that business rescue proceedings can result into any one of the two possible outcomes of a rescue intervention.[127] The primary objective is to have

122 See the discussion under 4.3
123 2013 JDR 1893 (WCC).
124 *Gormley v West City Precinct Properties (Pty) Ltd* 2013 JDR 1893 para 6.2.
125 2012 (2) SA 423 (WCC).
126 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 290–291.
127 Joubert 2013 *THRHR* 554.

the financially distressed company return to normalcy and continue in existence as a going concern,[128] while the secondary objective is to attain a better return for creditors or shareholders than would otherwise result if the company were to be liquidated.[129]

The appreciation that corporate rescue may not always result into the redemption of the company but could facilitate a more organised disposal of the assets of the company as a going concern, reflects a pragmatic understanding of the rescue realities. Unlike judicial management where the singular objective was to enable the company to return to solvency,[130] section 128(1)*(b)* of the Companies Act has a dual purpose. If a distressed company emerges out of business rescue procedure having met either of the two possible outcomes, it is considered to have successfully undergone business rescue.[131]

A successful rescue is deemed to occur if the company returns to its normal state and continues in existence as a going concern, or if the realisation of assets during business rescue procedure results into a better return for the company's creditors and shareholders than would be obtained under liquidation.[132]

The primary objective of business rescue is the development and implementation of a plan to rescue the company to facilitate its survival and continuation on a solvent basis, through the restructuring of its affairs, business, property, debts and equity.[133]

This confirms that the first part of the definition of business recue is in line with the basic international principles of business rescue.[134] The provision adequately shows that business rescue in South Africa seeks to facilitate the reorganisation of financially distressed companies with the objective of placing them back into the marketplace, with better capacity to purchase goods and services and continue contributing to the development of the wider economy as quickly as possible.[135]

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128 Joubert 2013 *THRHR* 554.
129 *ibid*.
130 Stein and Everingham, *The New Companies Act Unlocked* 410.
131 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 284.
132 Conradie and Lamprecht 2015 *South African Business Review* 6.
133 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 284.
134 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 284; Delport, *Henochsberg on the Companies Act 71 of 2008* 450.
135 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 285; Rajak 1995 *JJS* 4.

The definition further confirms that besides supporting the rescue of ailing companies, business rescue procedure creates a decent entry route to liquidation by companies that cannot be rescued. The procedure guarantees creditors and shareholders of financially distressed companies a better return if the company is first placed under business rescue than if it went straight in liquidation.[136]This reflects a fundamental paradigm shift from the old position under the Companies Act of 1973, where judicial management could not be utilised to secure a better return for creditors and shareholders in circumstances where it was clear from the outset that the company would never be saved from immediate liquidation.[137]One of the prerequisites under section 427(1)*(b)* of the Companies Act of 1973 was that before a company could be placed under judicial management, it had to be proved that it would be able to pay its debts or to meet its obligations to creditors and become a successful concern after judicial management.[138]

In *Millman NO v Swatland Huis Meubiteerders (Edms) Bpk: Repfin Acceptances Ltd Intervening,*[139] it was emphasised that even though it could be more advantageous to dispose of the business of a company under judicial management rather than in liquidation, this was not a factor that could influence the court to grant an order of judicial management in respect of a company which will in all probability be able to discharge more than a percentage of its liabilities.[140] This inflexibility and insistence on an eventual return to solvency was one of the reasons why judicial management turned out to be an abject failure.[141]

In *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others,*[142] the Supreme Court, while drawing on the rescue provisions under the Australian Corporations Act 50 of 2001, held *inter alia* that the wording of section 128(1)*(b)* of the Companies Act is clear that business rescue is not only

136 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 285; Rajak 1995 JJS 4.
137 Stein and Everingham, *The New Companies Act Unlocked* 409.
138 para 27.
139 1972 (1) SA 741 (C).
140 *Millman NO v Swatland Huis Meubiteerders (Edms) Bpk: Repfin Acceptances Ltd Intervening* 1972 (1) SA 741 (C), 745A.
141 Stein and Everingham, *The New Companies Act Unlocked* 409.
142 2013 (4) SA 539 (SCA) para 24.

available to save companies from being liquidated, but may also be utilised to get a better return for creditors and shareholders. Brand JA held:

> [B]business rescue means to facilitate 'rehabilitation' which in turn means the achievement of one of the two goals: (a) to return the company to solvency, or (b) to provide a better deal for creditors and shareholders than what they would receive through liquidation. This construction would also coincide with the reference in section 128(1)(h) to the achievement of the goals (plural) set out in section 128(1)(b). It follows, as I see it, that the achievement of any of the two goals referred to in section 128(1)(b) would qualify as business rescue.[143]

The foregoing notwithstanding, where an applicant for business rescue seeks to achieve the alternative objective, which is to obtain a better return for the creditors and shareholders, he or she must factually demonstrate that the sale of the company assets or its business under business rescue will result into a better return to the creditors and shareholders than they would receive if the company went straight into liquidation.[144] In *Southern Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd,*[145] Eloff AJ stated:

> In relation to the alternative aim referred to in section 128(b)(ii) of the new Act, being to procure a better return for the company's creditors and shareholders than would result from the immediate liquidation thereof, one would expect an applicant for business rescue to provide concrete factual details of the course, nature, and extent of the resources that are likely to be available to the company, as well as the basis and terms on which such resources will be available. It is difficult to see how, without such details, a court will be able to compare the scenario sketched in the application with that which would obtain in an immediate liquidation of the company. Mere speculative suggestions are unlikely to suffice.[146]

Where someone seeks to use business rescue to achieve the alternative objective, he or she must demonstrate sufficient evidence to show how entry into business rescue will practically help the company to maintain its value and be able to generate better returns to the creditors and shareholders than if it went straight into liquidation.

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143 *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others* 2013 (4) SA 539 (SCA) para 26.

144 Le Grange J in *Investec Bank Limited v Aslo Holdings (Pty) Ltd* (2012) ZAWCHC 110.

145 2012 (2) SA 423 (WCC) para 25.

146 *ibid*; Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 289.

5.5.2 Modes of commencement of business rescue

There are basically two ways through which business rescue proceedings may be commenced in South Africa:[147]voluntary commencement and compulsory commencement.[148]

Voluntary commencement occurs where the board of directors of a company passes a resolution to voluntarily begin business rescue proceedings.[149] This happens where the board has reasonable grounds to believe that the company is financially distressed and there appear to be a reasonable prospect of rescuing the company.[150]

Compulsory commencement happens where an affected person applies to the court for an order to place a company under supervision and commence business rescue proceedings.[151]

Considering the significance of the commencement procedure, both modes of commencement are discussed in detail below.

5.5.2.1 Voluntary commencement

This mode of commencement is provided for under section 129(1) of the Companies Act. For ease of reference, the said provision is reproduced hereunder:

> Subject to subsection (2)*(a)*, the board of a company may resolve that the company voluntarily begin business rescue proceedings and place the company under supervision, if the board has reasonable grounds to believe that—
>
> (a) the company is financially distressed; and
> (b) there appears to be a reasonable prospect of rescuing the company.
>
> (2) A resolution contemplated in subsection (1)—
>
> *(a)* may not be adopted if liquidation proceedings have been initiated by or against the company; and
> (b) has no force or effect until it has been filed.
>
> (3) Within five business days after a company has adopted and filed a resolution, as contemplated in subsection (1), or such longer time as the Commission, on application by the company, may allow, the company must—
> (a) publish a notice of the resolution, and its effective date, in the prescribed manner to every affected person, including with the notice a sworn statement

147 *Panamo Properties (Pty) Ltd and Another v Nel and Others NNO* 2015 (5) SA 63 (SCA) para 8.
148 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 306.
149 Section 129 of the Companies Act 2008.
150 Cassim and others*, Contemporary Company Law* 865.
151 Section 131(1) of the Companies Act 2008.

of the facts relevant to the grounds on which the board resolution was founded; and

(b) appoint a business rescue practitioner who satisfies the requirements of section 138, and who has consented in writing to accept the appointment.

(4) After appointing a practitioner as required by subsection (3)*(b)*, a company must—
(a) file a notice of the appointment of a practitioner within two business days after making the appointment: and
(b) publish a copy of the notice of appointment to each affected person within five business days after the notice was filed.

(5) If a company fails to comply with any provision of subsection (3) or 4-
(a) its resolution to begin business rescue proceedings and place the company under supervision lapses and is a nullity; and
(b) the company may not file a further resolution contemplated in subsection (1) for a period of three months after the date on which the lapsed resolution was adopted, unless a court, on good cause shown on an *ex parte* application, approves the company filing a further resolution.

(6) A company that has adopted a resolution contemplated in this section may not adopt a resolution to begin liquidation proceedings, unless the resolution has lapsed in terms of subsection (5), or until the business rescue proceedings have ended as determined in accordance with section 132(2).

(7) If the board of a company has reasonable grounds to believe that the company is financially distressed, but the board has not adopted a resolution contemplated in this section, the board must deliver a written notice to each affected person, setting out the criteria referred to in section 128(1)*(e)* that are applicable to the company, and its reasons for not adopting a resolution contemplated in this section.

This entry route to business rescue was intended to be an easy way through which directors of a company may, at the earliest possible moment, place a company into business rescue immediately it shows signs and symptoms of financial distress.[152] It was designed to be a low hurdle route, intended to encourage directors of a financially distressed company to seek for help at an early stage instead of waiting until it is too late.[153]

The law clearly shows that the decision to voluntarily place a company into business rescue is at the behest of the board of directors, who must act collectively rather than individually.[154] It has been argued[155] that this provision is in line with section 66 of the

152 Cassim and others, *Contemporary Company Law* 866.
153 *ibid.*
154 Zolani,' The Balancing of Creditor Interest in Business Rescue Provisions of the Companies Act 2008' 82.
155 Cassim and others, *Contemporary Company Law* 866.

Companies Act, which entrusts the day-to-day management of the company to the board of directors.[156] The rationale for making provision for this voluntary route is that the board of a company is in a better position to know when a company is financially distressed and hence best equipped to timeously pass a resolution to place it under business rescue.[157]

Shareholders' approval is not necessary before the board passes a resolution to commence business rescue in South Africa.[158] In fact, shareholders of a company do not have a right to pass a resolution to voluntarily place a distressed company under business rescue.[159]

This approach follows the Australian system, where it is the board of directors and not shareholders who authorise the commencement of administration.[160] The rationale for not subjecting voluntary commencement of business rescue to shareholder's approval was to minimise unnecessary delay, costs and to promote swiftness and efficiency in making decisions to place financially distressed companies under rescue procedure.[161]It has been argued that this approach accords with a debtor-friendly business rescue system, and the underlying objective of engendering a flexible business rescue regime that is uncomplicated and easy to implement.[162]

It is believed that directors, more than shareholders, would be the first to know about the impending financial problems of the company. Subjecting such realisation to the approval of shareholders could potentially delay the process and publicise the company's financial situation before the company acquires protection against third party actions.[163]

The board resolution must, however, be passed by the board members giving their consent, and it must be adopted in accordance with the company's memorandum of

156 Cassim and others, *Contemporary Company Law* 866.
157 Per Gutta N in *Lazenby v Lazenby Vervoer VV and Others* 2014 ZANWHC 41 para 23; Delport *Henochsberg on the Companies Act 71 of 2008* 462.
158 Zolani,' The Balancing of Creditor Interest in Business Rescue Provisions of the Companies Act 2008' 82.
159 Cassim *and others, Contemporary Company Law* 866.
160 Section 436A (1) of the Corporation Act 2001; Cassim and others, *Contemporary Company Law* 866.
161 Cassim and others, *Contemporary Company Law* 866.
162 *ibid.*
163 Loubser, 'Some Comparative Aspects of Corporate Rescue in South African Company Law' 51.

incorporation.[164] *In Panamo Properties (Pty) Ltd and Another v Nel and Others NNO,*[165] the Supreme Court of Appeal held:

> The passing of a resolution to commence business rescue cannot readily be described as a procedural requirement. It is merely the substantive means by which the company may take that step. The board is under no obligation at all to take such a resolution, although, if it is financially distressed, it may be obliged to inform shareholders and creditors of the reasons for not doing so (s 129(7). It cannot then be described as a requirement much less a procedural requirement.

The board must not just act according to its own whims. The board of directors must have legitimate reasons before resolving to place a company in business rescue.[166] In *Griessel and Another v Lizemore and Another,*[167] Spilg J held that there must be a legitimate business purpose before deciding to place a company under business rescue.[168] The judge went on to emphasise that the requirement for good faith is implicit in the scheme of Chapter 6, which seeks to balance the interests of all affected parties including creditors and employees.[169]

Whereas the board of directors is empowered to pass a resolution to commence business rescue, it must act in good faith and there must be reasonable grounds to believe that the company is indeed financially distressed with good reasons to believe that it can be saved through business rescue.[170] The stipulation that the board must have reasonable grounds for believing that the two preconditions for such a resolution exist seems to indicate that the directors voting in favour of the commencement of business rescue proceedings must first really believe that these requirements are present. Secondly, this belief must be based on sound reasons.[171] It has been opined that this implies that the board must have reasonable grounds for believing, and not necessarily that reasonable grounds must exist.[172]

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164 Section15 of the Companies Act 2008; Mpofu, 'Exploring the novel concept of business rescue under the South African Companies Act 71 of 2008' 22.

165 2015 (5) SA 63 (SCA) para 23.

166 Delport, *Henochsberg on the Companies Act 71 of 2008* 462.

167 *Griessel and Another v Lizemore and Another* 2015/24751[2015] ZAGPJHC 187.

168 *ibid.*

169 *Griessel and Another v Lizemore and Another* 2015/24751[2015] ZAGPJHC 187 para 83.

170 Section 129(1) of the Companies Act 2008; Mpofu LLM dissertation 25.

171 Loubser, 'Some Comparative Aspects of Corporate Rescue in South African Company Law' 55.

172 Loubser, 'Some Comparative Aspects of Corporate Rescue in South African Company Law' 55; Delport *Henochsberg on the Companies Act 71 of 2008* 462.

Section 128 of the Companies Act further clearly indicates that a company will be deemed to be financially distressed if, at any particular time, it appears to be reasonably unlikely that it will be able to pay its debts as they fall due and payable within the immediately ensuing six months,[173] or if it appears to be reasonably likely that the company will become insolvent within the next six months.[174]

Regarding the second precondition of there being reasonable prospects of rescue, the board is expected to have reasonable grounds for believing that there is a reasonable prospect that the company can be rescued if placed under business rescue.[175] It has been argued that the choice of the word 'prospect' which could mean either a possibility or a probability, must be taken to mean a reasonable possibility, since a possibility is said to be more definitive than a probability.[176]

In *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd*[177] the Supreme Court of Appeal in South Africa stated that directors voting in favour of a business rescue must truly believe that the prospects of rescue exist, and such a belief must be based on a concrete foundation.[178]

The board must also ensure that the decision to place a company under business rescue is made in good faith, for a proper purpose, in the best interest of the company and with a degree of care that is reasonably expected of directors.[179]

5.5.2.2 Compulsory commencement

Where the board fails to pass a resolution under section 129(1)*(a)* of the Companies Act to place a financially distressed company under business rescue, section 131(1) of the Companies Act mandates any affected person to apply to the court at any time for an order to place the company under supervision and to commence business rescue proceedings.[180]

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173 Section 128(1)*(f)*(i) of the Companies Act 2008.
174 Section 128(1)*(f)*(ii) of the Companies Act 2008; Loubser, 'Some Comparative Aspects of Corporate Rescue in South African Company Law' 56.
175 Section 129(1)*(b)* of the Companies Act 2008.
176 Loubser, 'Some Comparative Aspects of Corporate Rescue in South African Company Law' 58.
177 (228/2014 [2015] ZASCA 69;2015(5) SA 192(SCA); [2015] 3 ALL SA 10 (SCA).
178 Paragraph 30.
179 Section 76(3) of the Companies Act 2008; Cassim and others, *Contemporary Company Law* 524.
180 Cassim and others*, Contemporary Company Law* 873.

Section 131(1) reads:

> Unless a company has adopted a resolution contemplated in section 129, an affected person may apply to a court at any time for an order placing the company under supervision and commencing business rescue proceedings.

Section 131(1) of the Companies Act clearly shows that only an affected person[181] can apply to the court for an order for compulsory commencement of business rescue of a company.[182] Neither the company nor the directors of a company are authorised to apply to court for a business rescue order.[183] Even if a director believes that the company is financially distressed and should be placed under business rescue, if he or she cannot convince the majority of his or her fellow directors to pass a resolution for voluntary commencement of business rescue under section 129(1)*(a)* of the Companies Act, that individual director cannot apply to court in his or her capacity as a director for a business rescue order.[184]

The limitation on individual directors not being able to apply to the court for an order to place the company under business rescue was, in my considered view, intended to ensure collective responsibility amongst directors. If the board does not collectively believe that a company should be placed under business rescue, then the minority should not use the court to override the majority position. This engenders collectivism in company management.

If the board fails or otherwise delays to make a resolution under section 129(1)*(a)* of the Companies Act for one reason or another, the framers of the law created room for any affected person, who feels that the company requires remedial intervention, to apply to the court for an order placing the company under supervision and commence business rescue proceedings.[185]The application by an affected person may be done at any time, even if the company is under liquidation proceedings.[186] In fact, according to section 131(6) of the Companies Act, where, by the time the affected person files his or her application for business rescue, liquidation proceedings have already been

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181 Section 28(1)*(a)* of the Companies Act 2008 defines an affected person to be a creditor or shareholder of a company, or a registered trade union or an employee that is not a member of a trade union.

182 Motshwane 2017 *Emerging Markets Restructuring Journal 2.*

183 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 335.

184 *ibid.*

185 Section 131(1)*(a)* of the Companies Act 2008.

186 Cassim and others*, Contemporary Company Law* 873.

commenced by or against the company, the application for business rescue suspends the liquidation proceedings until the court has adjudicated upon the application[187]or the business rescue proceedings end.[188]

To be eligible to maintain an application in this regard as an affected person, one just needs to prove that he or she is either a shareholder, creditor, trade union representing a group of the company employees or a single employee who may not be a member of a trade union.[189] It has been argued that for purposes of section 131(1) of the Companies Act, a person is a creditor and thus an affected person, even if his or her debt is disputed.[190] To make matters worse, the Companies Act neither defines who qualifies as a creditor, nor does it set a minimum threshold for someone to be an eligible creditor capable of triggering section 131 of the Companies Act. This leaves the floodgates worryingly open, with the risk that a frivolous person can easily cook up evidence and end up filing an application for business rescue for no legitimate reasons.

In *Resources Washing Pty Ltd v Zululand Coal Reclaimers Proprietary Limited and Others,*[191]the court stated that although the word 'creditor' is not defined in the Companies Act, it should carry its normal meaning.[192]This confirms the view that any person who is owed any sum of money by the company, irrespective of the value of the debt, would qualify as an affected person, with *locus standi* to file and sustain an application for business rescue under section 131(1) of the Companies Act, if he can satisfy the court about the grounds set out in section 131(4) of the Companies Act. The legislature should have provided a definition of who qualifies as a 'creditor' and ought to have set some minimum debt value as qualification for eligibility to trigger this provision.

The grounds upon which the court is empowered to grant an application for business rescue as enumerated under section 131(4) of the Companies Act 2008 are also not

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187 Section 131(6)*(a)* of the Companies Act 2008.
188 Section 131(6)*(b)* of the Companies Act.
189 Section 128(1)*(a)* of the Companies Act.
190 Cassim and others*, Contemporary Company Law* 873.
191 10862/14 [2015] ZAKZPHC 21.
192 *Resources Washing Pty Ltd v Zululand Coal Reclaimers Proprietary Limited and Others* (10862/14 [2015] ZAKZPHC 21 para 30.

sufficiently clear. There are primarily three grounds upon which court may make an order to place a company under supervision and commence business rescue proceedings,[193]but even when the said grounds are satisfied, the court must be convinced that there is a reasonable prospect for rescuing the company.[194]

Section 131(4) of the Companies Act 2008 provides as follows:

> After considering an application in terms of subsection (1), the Court may-
> (a) Make an order placing the company under supervision and commencing business rescue proceedings, if the court is satisfied that
> (i) The company is financially distressed as defined under section 128(1)(f);
> (ii) The company has failed to pay over any amount in terms of an obligation under a public regulation or contract in respect of employment related matters, or;
> (iii) It is otherwise just and equitable to do so for financial reasons; and that there is a reasonable prospect for rescuing the company.
> (b) Dismiss the application, together with any further necessary and appropriate order, including an order placing the company under liquidation.

From that provision, it is clear that the first ground upon which court bases its decision to determine whether or not a company should be placed under business rescue is that the company is 'experiencing' financial distress.[195] In line with section 128(1)(f) of the Act, it is apparent that for a company to be financially distressed and hence eligible for business rescue, it should not be already insolvent. As Tsoka J emphasised in *Anthonie Welman v Marcelle Props 193 CC and Another,*[196] business rescue proceedings are not for the terminally ill, nor for the chronically ill, but for the ailing corporations, which, given time, can be rescued and become solvent.[197]

The second ground upon which an application to place a company under business rescue can be made is if the applicant can prove to the court that the company has failed to pay over any amount in terms of an obligation under a public regulation or contract in respect of employment related matters.[198] From the way in which section 131(4)*(a)*(ii) of the Companies Act is phrased it is apparent that a company need not to have defaulted on its payment under a public obligation or a contract of employment on more than one occasion before an affected person can present an application

193 Cassim and others*, Contemporary Company Law* 874.
194 Section 131(4) of the Companies Act 2008.
195 Section 131(4)*(a)*(i) of the Companies Act 2008.
196 339558/2011 [2012] ZAGPJHC 32.
197 *Walman v Marcelle Props 193 CC and Another* [2012] ZAGPJHC 32 para 28.
198 Section 131(4)*(a)*(ii) of the Companies Act 2008.

against it. An application can be presented based on a single default in making a payment arising out of a public obligation for any amount of money or a contractual obligation relating to employment. This is unduly harsh with an element of overkill.[199]

The Companies Act 2008 does not provide any further specific details about the payments covered under this limb. However, judging from the general wording of the provision, it can be deduced that the statutory obligations referred to are limited to payments due to medical aid funds, pension funds, payments to South African Revenue Services, the Workmen's Compensation Fund and the Unemployment Insurance Fund.[200]

According to section 131(4)*(a)*(iii) of the Companies Act 2008, the third ground upon which an affected person can apply for an order to place a company under supervision and commence business rescue is if 'it is otherwise just and equitable to do so for financial reasons'.[201] In *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothsfontein (Kyalami) (Pty) Ltd and Others,*[202] Claassen J dealt with the question of what is meant by the phrase 'it is otherwise just and equitable to do so for financial reasons'. He observed that:

> The immediate question arises: 'for financial reasons' of whom, the company, the creditors, shareholders, or the employees? Since the company cannot apply to court for a business rescue order, as it is not an 'affected person', one can immediately say that the financial reasons of the company are not referred to. However, that would render this provision absurd as it is primarily the financial health of the company which is at stake. I have little doubt that the legislature never intended such absurdity. I would, therefore, hold that financial reasons relating to all the stakeholders, except that of the practitioner, contemplated in the business rescue provision, are to be considered by the court when applying this provision.[203]

The courts have attempted to interpret section 131(4)(iii) of the Companies Act based on the construct of section 344 of the Companies Act of 1973, which generally provides that a company may be wound up by the court if it appears that it is just and equitable

199 Cassim and others*, Contemporary Company Law* 847.
200 Loubser, 'Some Comparative Aspects of Corporate Rescue in South African Company Law' 62.
201 *ibid.*
202 2012 (3) SA 773 (GandJ).
203 *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothsfontein (Kyalami) (Pty) Ltd and Others* 2012 (3) SA 773 (G and J) para 17.

for the company to be wound up.[204] In *Moosa NO v Mavjee Bhawan Pty Ltd,*[205] it is stated that the phrase 'just and equitable' postulates not facts but only a broad conclusion of law, justice and equity.

In *Erasmus v Pentamed Investments (Pty) Ltd,*[206] the court observed that this provision affords the court a wide judicial discretion in determining any matter before it.

It has been argued:

> The just and equitable phrase is found in a number of related pieces of legislation as well as in the remedial provisions of the 1996 Constitution. If not quite ubiquitous, then the phrase is at least exceedingly well travelled. The words just and equitable are intended to be elastic in their application to allow the courts to intervene to relieve against an injustice or inequity.[207]

It is, therefore, not sufficient for an applicant to submit that there are grounds for placing a company under business rescue. The applicant must demonstrate to court that it is just and equitable to place the company under supervision and commence business rescue.[208]

Unlike the provision under section 344*(h)* of the Companies Act of 1973, which stops at saying 'just and equitable', section 131(4)*(a)*(iii) of the Companies Act adds that it must be just and equitable for financial reasons. The applicant must demonstrate to court that there are financial reasons making it just and equitable for the company to be placed under business rescue. This can be done by showing how his or her financial position as an affected person will be improved if the company is placed under business rescue instead of being liquidated.[209]

A court will not grant an order to place a company under supervision if the application was not brought in good faith or if the application is an abuse of process.[210] Before lodging an application for business rescue under section 131(1) of the Companies Act

204 Mpofu, 'Exploring the Novel Concept of Business Rescue Under the South African Companies Act 71 of 2008' 39.
205 1967 (3) SA 131 (T).
206 1982 (1) SA 178 (W) 181.
207 Maloka and Muthugulu 2016 *PER/PELJ* 4.
208 Section 131(4)*(a)*(iii) of the Companies Act 2008.
209 Cassim and others, *Contemporary Company Law* 874.
210 *ibid.*

2008, an affected person must present cogent evidence to prove existence of the statutory grounds specified in section 131(4) of the Companies Act 2008. This is a necessary control against possible abuse by overzealous creditors who would be threatening companies with business rescue applications, just to mount pressure on them to settle their debts.[211]

Compared to the requirement for a board resolution under section 129(1)*(a)* of the Companies Act, the threshold under section 131 is stricter. The court must be satisfied that there are reasonable grounds to believe that the company is financially distressed and there appears to be a reasonable prospect of rescuing the company.[212]

In *Lidino Trading 580 CC v Cross Point Trading (Pty) Ltd, in re: Mabe v Cross Point Trading 215 (Pty) Ltd*,[213] Kruger J summarised the position in law as follows:

> Before granting a business rescue application, the court must be satisfied that there is a reasonable prospect for rescuing the company (section 131(4)(a)(iii)), apart from the other requirements listed in section 131(4) (a). It has been held that a prospect here means an expectation, which in turn signifies a possibility. A possibility is reasonable if it rests on a ground that is objectively reasonable – per Van der Merwe J, in *Prospec Investments (Pty) Ltd and Another v Pacific Coast Investments 97 Ltd*.[214]

In *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothsfontein (Kyalami) (Pty) Ltd and Others*,[215] the Supreme Court of Appeal delivered an illustrious decision on what is expected of an applicant for a business rescue order, specifically the requirement that there is 'a reasonable prospect for rescuing a company' as set out in section 131(4) of the Companies Act 2008.[216] In providing guidance on what an applicant is required to prove in support of a claim that there is a reasonable prospect of rescuing the company, the court held:

> As a starting point, it is generally accepted that it is a lesser requirement than the 'reasonable probability' which was the yardstick for placing a company under judicial management in terms of s 427(1) of the 1973 Companies Act. On the other hand, I believe it requires more than a mere prima facie case or an arguable possibility. Of

211 2012 (3) SA 773 (G&J).
211 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 343.
212 Loubser, 'Some Comparative Aspects of Corporate Rescue in South African Company Law' 61.
213 (2130/2012) [2012] ZAFSHC 155.
214 *Lidino Trading 580 CC v Cross Point Trading (Pty) Ltd, in re: Mabe v Cross Point Trading 215 (Pty) Ltd* [2012] ZAFSHC 155 para 18.
215 2012 (3) SA 773 (G&J).
216 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 343.

> even greater significance, I think, is that it must be a reasonable prospect– with the emphasis on 'reasonable'– which means that it must be a prospect based on reasonable grounds. A mere speculative suggestion is not enough. Moreover, because it is the applicant who seeks to satisfy the court of the prospect, it must establish these reasonable grounds in accordance with the rules of motion proceedings which, generally speaking, require that it must do so in its founding papers.
>
> Self-evidently, it will be neither practical nor prudent to be prescriptive about the way in which the appellant must show a reasonable prospect in every case. Some reported decisions laid down, however, that the applicant must provide a substantial measure of detail about the proposed plan to satisfy this requirement...But in considering these decisions, Van der Merwe J commented as follows in *Prospec Investments v Pacific Coasts Investments 97 Ltd* 2013 (1) SA 542(FB) para 11: ' I agree that vague averments and mere speculative suggestions will not suffice in this regard. There can be no doubt that, in order to succeed in an application for business rescue, the applicant must place before the court a factual foundation for the existence of a reasonable prospect that the desired object can be achieved.[217]

The courts have also intimated that, whereas the applicant for an order of business rescue ought to have a reasonable basis for believing the possibility of rescuing the company, he or she does not need to provide concrete details in the foundation documents in support of the application.[218] In *Zoneska Investments (Pty) Ltd t/a Bonatla Properties (Pty) Ltd v Midnight Storm Investments 286 Ltd and Others*, Stelzner AJ remarked:

> Each plan will need to be evaluated, based on the facts placed before the Court, as to the potential of the plan being workable and whether there is a reasonable possibility that the objectives contained in section 128 can be met.[219]

From the above analysis, it is worth noting that whereas on the surface, section 131 of the Companies Act appears to be a straight path through which affected persons can apply for an order to place a company under supervision and commence business rescue, this route is riddled with a number of procedural hurdles, which the applicant must surmount before court can grant the order. Caution must, therefore, be exercised before presenting an application for business rescue, especially because an

[217] Per Brand J in *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothsfontein (Kyalami) (Pty) Ltd and Others* (609/2012) [2013] ZASCA 68 paras 29–30.
[218] Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 247.
[219] *Zoneska Investments (Pty) Ltd t/a Bonatla Properties (Pty) Ltd v Midnight Storm Investments 286 Ltd and Others* [2012] 4 ALL SA 590 (WCC) para 54.

unsuccessful application can easily result into an order for liquidation being made against the company[220] with all its associated implications on all the stakeholders.[221]

5.5.3 Duration of business rescue proceedings

By its very nature, business rescue is temporary and not meant to be a long term procedure.[222] It is expected that unless otherwise extended by the court, business rescue proceedings should not last for more than three months from the time of commencement.[223] This ensures that the restructuring of the company is undertaken within short timeframes so as to preserve the business and its ongoing relationship with customers, suppliers and creditors.[224] The quicker the process, the less the prejudice to creditors and employees.[225]

Determining the time when business rescue is deemed to commence is very important.[226] It determines when the consequences of business rescue, such as the moratorium on actions against the company[227] and restriction on dealings in company assets[228] and shares[229] come into force.

5.5.3.1 Time when business rescue proceedings begin

According to section 132(1) of the Companies Act, business rescue proceedings are deemed to begin when:

(a) The company-

- (i) Files a resolution to place itself under supervision in accordance with section 129(3) of the Act; or
- (ii) Applies to the court for consent to file a resolution in terms of section 129(5)(b) of the Act;
- (iii) An affected person applies to the court for an order placing the company under supervision in terms of section 131(1); or

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220 Section 131(4)*(b)* of the Companies Act 2008.
221 Cassim and others*, Contemporary Company Law* 875.
222 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 365; Delport, *Henochsberg on the Companies Act 71 of 2008* 449.
223 Section 132(3) of the Companies Act.
224 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 365.
225 Cassim and others, *Contemporary Company Law* 877.
226 *ibid.*
227 Section 133 of the Companies Act 2008.
228 Section 134 of the Companies Act 2008.
229 Section 137 of the Companies Act 2008.

(iv) A court makes an order placing a company under supervision during the course of liquidation proceedings, or proceedings to enforce a security interest, as contemplated in section 131(7).

There appears to be no controversy over the first circumstance under which business rescue is deemed to commence under section 132(1)*(a)*(i) of the Companies Act 2008. It is clear that once a company passes a resolution under section 129(1)*(a)* of the Companies Act 2008 to be placed under supervision and commence business rescue, the company must file a notice of its resolution with the Companies and Intellectual Property Commission (the CIPC)[230] within five business days.[231]In accordance with section 132(1)*(a)*(i) of the Companies Act, once a company files the physical copy of its resolution to commence business rescue with the CIPC, that is the date upon which it is deemed to have entered business rescue.

The second and third circumstances are not very clear. Section 132(1)(ii) of the Companies Act provides that a company commences business rescue when it applies to court for consent to file a resolution in accordance with section 129(5)*(b)* of the Companies Act.

In essence, the provision states that where a company passes a resolution to voluntarily commence business rescue, the company must file a copy of the subject resolution with the CIPC within five business days, but where the company fails to file its resolution, the business rescue proceedings will become a nullity and the company will be barred from filing another resolution to commence business rescue for a period of three months unless a court, on good cause being shown on an *ex parte* application, approves filing of a further resolution to commence business rescue.[232] In such a case, the company is deemed to have commenced business rescue proceedings from the time when it applies to court for an order authorising it to file its resolution at the CIPC.[233]

Section 132(1)*(a)*(iii) of the Companies Act 2008 also provides that a company commences business rescue when an affected person applies for an order to place the company under supervision and to commence with business rescue.

230 Section 1 of the Companies Act 2008 defines 'the Commission' to mean the CIPC established under s 185 of the Companies Act 2008.
231 Section 129(3) of the Companies Act 2008.
232 Section 129(5) of the Companies Act 2008.
233 Cassim and others*, Contemporary Company Law* 876.

Both circumstances are problematic because the Companies Act 2008 does not define when one is deemed to have applied for the requisite court order.[234] The controversy largely rotates around the question whether, like section 348 of the Companies Act of 1973, business rescue proceedings are deemed to commence on the date when the application for business rescue is made in court, or from the date when court actually considers the application and grants the business rescue order.[235]

There are basically two possible interpretations to this provision. The first interpretation is influenced by the traditional understanding, which has for many years been accepted with respect to winding up proceedings. It is generally accepted that winding-up of a company is deemed to commence from the date when a petition is presented in court, and not when the actual order is made.[236] Moreover, it is understood that an application is deemed to be presented in court from the time when an application in a proper and complete form is lodged with the Registrar of court.[237]Most probably, this is what the drafters of the Companies Act 2008 intended. However, the intention of Parliament is not clearly reflected in the wording of these provisions.[238] Other scholars have thus preferred to stick to the plain interpretation that by using the words 'applies to court', the drafters intended this to mean the time when one actually appears in court,[239] in which case the commencement date of business rescue is deemed to be the date when, under section 132(1)*(b)* of the Companies Act 2008, an affected person files the application in court, and under section 132(1)*(a)*(ii) of the Companies Act 2008, when the company applies to court for consent to file its resolution with the CIPC.[240]

It would appear that strictly speaking, business rescue commences before an order is made by court, because the Companies Act only talks about when the company or the affected person 'files in court'. This apparent logical interpretation unfortunately poses practical complications and contradictions in procedure. It would mean that from the time when an application is filed in court, the general moratorium on legal proceedings,

234 Loubser, 'Some Comparative Aspects of Corporate Rescue in South African Company Law' 82.
235 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 366.
236 Cassim and others*, Contemporary Company Law* 920.
237 *Lief v Western Credit (Africa) (Pty) Ltd* 1966 (3) SA 344 (W) 347*; Nel and Others NNO v The Master and Others* 2002 (3) SA 354 (SCA) 358; *Development Bank of Southern Africa Ltd v Van Rensburg and Others NNO* 2002 (5) SA 425 (SCA) 431–432.
238 Loubser, 'Some Comparative Aspects of Corporate Rescue in South African Company Law' 82.
239 *ibid*.
240 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 367.

which, in terms of section 133 of the Companies Act comes into force during the proceedings, is triggered long before the court makes the order for business rescue.[241] It would also imply that from the time an application is filed in court, the actions of the directors of the company are, by operation of law, automatically subjected to approval by a business rescue practitioner, yet at that time, no practitioner is already appointed.[242] This would pose several unintended consequences.

Loubser observes:

> Serious complications could arise if business rescue proceedings commence before an order to this effect has been issued and all the legal consequences of such an order come into force, which is what this provision implies. It would, for example, mean that the general moratorium on legal proceedings that applies during the proceedings comes into effect and the directors' authority and powers to manage the company are curbed, but without a practitioner to take over these duties. The obvious further question then is what happens if the court refuses to grant an order for business rescue proceedings after the process has already started! This must surely rank as one of the most ill-considered or badly drafted provisions in the Act.[243]

The difficulty in interpreting these provisions has also been acknowledged by courts. In *Investec Bank Ltd v Andre Bruyns,*[244] Rogers AJ observed:

> There is an intricate debate before me as to whether business rescue proceedings in respect of the two companies have already commenced or whether they will only commence if and when an order is made by the court. The parties were *ad idem* that the commencement date of business rescue proceedings in the present case fell to be determined with reference to section 132(1)(b) of the Act rather than section 132(1)(c). On this basis, the date on which business rescue proceedings in respect of the two companies commences depends on what date is contemplated by the phrase, '[when]…an affected person applies to the court for an order.' in section 132(1)(b). The answer to this question is not free from difficulty. It is an important one that will no doubt have to be decided in due course by our courts. When that question arises for decision, it will also need to be considered whether-if business rescue proceedings are indeed found to commence at the date of launching of the application-the said result ensue forthwith on the launching of the application or only retrospectively after the making of a court order.[245]

That would mean that if one files an application in the court Registry, an application will be deemed to be made. Consequently, the company will be deemed to commence business rescue at that time.

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241 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 367.
242 Section 137(4) of the Companies Act 2008.
243 Loubser 2010 *TSAR* 9.
244 case no. 19449/11.
245 *Investec Bank Ltd v Andre Bruyns* case no. 19449/2011 para 12.

In *Taboo Trading (Pty) Ltd v Pro Wreck Scrap Metal CC and Others,*[246] the court added more qualifications. In that case it was held that an application is not deemed to be made in court until it has been duly served on the CIPC and the other affected persons as mandated under section 131(2) of the Companies Act. Hartzenberg AJ held:

> A business rescue application is only to be regarded as having been made once the application has been lodged with the Registrar, duly issued, a copy thereof served on the Commission and each affected person has been properly notified of the application.[247]

With all due respect, however, the interpretation of court in *Taboo Trading (Pty) Ltd v Pro Wreck Scrap Metal CC and Others* is only valid with respect to the meaning of an 'application' for commencement of business rescue under section 131 of the Companies Act. It is acknowledged that it would not be proper to consider an application for an order of business rescue as having been made, until the application is duly lodged in the court registry, a copy served on the CIPC, and each affected party as required under section 131(2) of the Companies Act.

For purposes of determining the time when business rescue commences however, sections 132(1)*(a)*(ii) and 132(1)*(b)* of the Companies Act clearly determine that business rescue proceedings are deemed to commence immediately the company 'applies to court' for consent to file a resolution in terms of section 129(5)*(b)* or when a person 'applies to the court' for an order placing a company under supervision in accordance with section 131(1) of the Companies Act. The trigger for commencement is just the act of applying to court by either the company or an affected person.

Lastly, section 132(1)*(c)* prescribes the last circumstance under which business rescue commences as being, when, during liquidation proceedings, or proceedings to enforce security interest, a court makes an order placing the company under supervision. Therefore, the commencement occurs not when the applicant just applies to court, or serves the application on the affected parties, but when court makes an order placing the company under supervision.

Considering the controversy surrounding the import of sections 132(1)*(a)*(ii) and 132(1)*(b)* of the Companies Act as has been argued above, it is recommended that

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246 2013 (6) SA 141 (KZP).

247 *Taboo Trading (Pty) Ltd v Pro Wreck Scrap Metal CC and Others* 2013 (6) SA 141 (KZP) para 11.4.

the legislature should consider clarifying this position by amending the Companies Act to insert a provision which expressly provides that business rescue commences after the court has made an order granting an application made under section 132(1)*(a)*(ii) or section 132(1)*(b)* of the Companies Act.

5.5.3.2 Time when business rescue proceedings end

Business rescue proceedings, irrespective of how they are started, end in a similar manner.[248] According to section 132(2) of the Companies Act 2008, business rescue proceedings end when:

> (a) The court-
> (i) Sets aside the resolution or order that began those proceedings; or
> (ii) Has converted the proceedings to liquidation proceedings;
> (b) The practitioner has filed with the Commission a notice of the termination of the business rescue proceedings; or
> (c) A business rescue plan has been-
> (i) Proposed and rejected in terms of Part D of this Chapter, and no affected person has acted to extend the proceeding any manner contemplated in section 153; or
> (ii) Adopted in terms of Part D of this Chapter and the practitioner has subsequently filed a notice of substantial implementation of that plan.

This provision seems clear, and its interpretation elicits no debate. In fact, in *Ex Parte Nel No and Others,*[249] although counsel for the practitioner tried to persuade court to go against the clear wording of section 132(2)*(a)*(i) of the Companies Act which provides that business rescue proceedings end once court sets aside a resolution or order that began those proceedings, Tuchten J stated that the purpose of the law will be better served if the provisions of section 132(2)*(a)*(i) of the Companies Act are applied in their literal sense.[250]

In that case, the applicants sought for a court order to allow a business rescue practitioner to remain in-charge of a company after court had made an order setting aside the resolution upon which the company had voluntarily entered business rescue. The court had instead ordered the company to be placed under liquidation. The applicant argued that since they had filed a notice of appeal against the order by which court had set aside the resolution, the court should stay execution of that order by

248 Cassim and others, *Contemporary Company Law* 877.
249 case no. 45279/2014.
250 *Ex Parte Nel No and Others* (GNP) case no. 45279/2014 para 56.

allowing the business rescue practitioner, and not the liquidator that had been appointed by the court, to take charge of the company. The judge noted:

> [T]he process initiated pursuant to section 129(1) resolution takes only the interest of the company into account. A section 130 order setting aside the resolution is made after a hearing in court in which the interests of all parties who wished to advance their views have been considered.[251]

It is, therefore, not sufficient for the directors or an affected party to cause the company to enter business rescue. Business rescue must be thought of as a temporary procedure, expected to be concluded within a short time, not exceeding three months, except in exceptional circumstances.[252] It is expected that within that short time, the company should be able to come up with a robust rescue plan to reverse the company's financial challenges. Unfortunately, from a practical point of view, three months is too short for the business rescue practitioner to reverse the company troubles. In *South African Bank of Athen Ltd v Zennies Fresh Fruits CC, Business Partners Ltd v Zennies Fresh Fruit CC and Another*,[253] Kusevitsky AJ held:

> Can it be that a company enjoys the protection of business rescue indefinitely to the detriment of its creditors? Although the Act does not directly specify the length a company can be under business rescue, section 132(3) provides a guide under which the legislature envisaged companies to remain under business rescue. This section provides that if a company's business rescue proceedings have not ended within three months after the start of those proceedings, or such longer time as the court, on application by the practitioner may allow, the practitioner must prepare a progress report of the business rescue proceedings and update it at the end of each subsequent month and deliver it to each affected person until the end of the proceedings.[254]

Business rescue should, therefore, not be used as an end to the company troubles, but rather a short-term route towards finding a lasting solution to the company's challenges.

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251 *Ex Parte Nel NO and Others* (GNP) case no. 45279/2014 para 53.

252 Section 132(3) of the Companies Act 2008.

253 [2018] ZAWCHC 11.

254 *South African Bank of Athen Ltd v Zennies Fresh Fruits CC, Business Partners Ltd v Zennies Fresh Fruit CC and Another* [2018] ZAWCHC 11 para 34.

5.5.4 Legal consequences of business rescue

The primary objective of business rescue proceedings is to provide the company with protection against disruptive processes in order for it to restructure its affairs and operations with the hope of improving and becoming a successful concern.[255] The commencement of business rescue proceedings places a company under a unique legal umbrella designed to protect the company and its property against the risks associated with insolvency, such as enforcement actions from creditors.

In *Koen v Wedgewood Village Golf and Country Estate (Pty) Ltd,*[256] Binns-Ward J stated that the mere institution of business rescue proceedings materially affects the rights of third parties to enforce their rights against the subject company.[257] During business rescue, the company retains its corporate personality with capacity to contract, own property, run its business, hire and fire staff, but with a wide range of legal immunities as discussed below.

5.5.4.1 Moratorium

A moratorium means the suspension of a specific activity.[258] The commencement of business rescue proceedings temporarily protects the company from legal proceedings by its creditors and other claimants.[259]According to section 133(1) of the Companies Act, during business rescue proceedings, no legal proceedings, including enforcement action against the company, or in relation to any property belonging to the company or lawfully in its possession, may be commenced or continued in any forum, except

(a) With the written consent of the practitioner;
(b) With the leave of the court and in accordance with any terms the court considers suitable;
(c) As a set-off against any claim made by the company in any legal proceedings, irrespective of whether these proceedings commenced before or after the business rescue proceedings began;
(d) Criminal proceedings against the company or any of its directors or officers;
(e) Proceedings concerning any property or right over which the company exercises the power of a trustee; or

255 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 377.
256 2012 (2) SA 378 (WCC).
257 Paragraph 10.
258 Garner *Black's Law Dictionary* 1101.
259 Section 133(1) of the Companies Act 2008.

(f) Proceedings by a regulatory authority in the execution of its duties after written notification to the business rescue practitioner.[260]

As already noted,[261]the extent to which any rescue regime protects the business entity against disruptive claims and actions by third parties during rescue proceedings determines how successful or unsuccessful a regime will be. A moratorium is of cardinal importance to business rescue.[262] It provides the crucial breathing space or a period of respite during which the company is given the opportunity to reorganise and reschedule its debts and liabilities.[263] A moratorium is described as a cornerstone of all business rescue procedure.[264]

A reading of section 133 of the Companies Act gives general comfort that the moratorium provided to companies in business rescue in South Africa is generally extensive and adequate.[265] It protects companies in business rescue against all legal proceedings, including both court proceedings and other quasi-legal proceedings and also provides immunity in respect of the property of the company against enforcement actions.[266]The essence of the moratorium is simply to provide the company with the required breathing space, or the necessary period of respite to restructure its affairs in such a way as would allow it to resume operation on the basis of profitability.[267]

The protection afforded to companies under section 133(1) of the Companies Act should not, however, be unreasonably interpreted to mean that all actions by creditors of the company, based on existing contracts with company are covered by the moratorium.[268] This would strip creditors of all vestiges of protection in all contractual relationships with the company during the subsistence of the moratorium.[269] Indeed, the courts have provided guidance on the scope of cover provided under section 133 of the Companies Act. In *Murray NO and Another v FirstRand Bank Ltd,* the Supreme Court of Appeal of South Africa instructively stated:

> Section 133(1) of the Act places a moratorium on 'legal proceedings, including enforcement action'…the Act does not contain a definition of these terms. However,

260 Added by s 84 of the Companies Amendment Act 3 of 2011.
261 See discussion under Chapter Four, 4.8.1.
262 *Murray NO and Another v FirstRand Bank Ltd* 2015 (3) SA 438 (SCA) para 14.
263 Cassim and others, *Contemporary Company Law* 879.
264 Kloppers 1999 *Stell LR 417,* 429.
265 Cassim and others, *Contemporary Company Law* 879.
266 Nwafor 2017 'Corporate Board: Role, Duties and Composition' 60.
267 *Murray NO and Another v FirstRand Bank Ltd* 2015 (3) SA 438 (SCA) para 14.
268 Nwafor 2017 'Corporate Board: Role, Duties and Composition' 61.
269 *ibid*.

> the term ‘legal proceedings’, is well-known in South African legal parlance and usually bears the meaning of a lawsuit…. Unsurprisingly, counsel were agreed that the cancellation of an agreement does not constitute a ‘legal proceeding’ as envisaged in section 133(1) of the Act.
>
> As to the meaning of the phrase ‘enforcement action’, in my view, Westbank correctly submitted that, in our legal parlance, ‘enforce’ or ‘enforcement’, usually refers to the enforcement of obligations. In the context of s 133(1) of the Act, it is significant that reference is made to ‘no legal proceedings, including enforcement action. The inclusion of the term ‘enforcement action’ under the generic phrase ‘legal proceedings’, seems to me to indicate that enforcement action is considered to be a species of ‘legal proceedings’ or, at least, is meant to have its origin in legal proceedings. This conclusion is strengthened by the fact that s133(1) provides that no legal proceedings, including enforcement action, ‘may be commenced or proceeded with in any forum’. A forum is normally defined as a court or tribunal…and its employment in s133(1) conveys the notion that ‘enforcement action’ relates to formal proceedings ancillary to legal proceedings, such as the enforcement or execution of court orders by means of writs of execution or attachment.[270]

Whereas the moratorium provided during the business rescue process is generally good as far as it protects the company against legal proceedings and enforcement actions, it does not interfere with the exercise of other non–court-based actions against the company. In *Murray NO and Another v FirstRand Bank Ltd 2015*[271] the court emphasised that from a linguistic perspective, the protection against enforcement action as envisaged in section 133(1) does not include protection of the company against cancellation of an agreement entered into by the company before the commencement of business rescue.[272]

This reflects the position that had earlier been stated by Tolmay J in *Madodza (Pty) Ltd v ABSA Bank Limited,*[273] that section 133 requires that for the asset to be protected by the moratorium, it must either be the property of the company or in the lawful possession of the company. Where the property in issue is neither owned nor in the lawful possession of the company, the business rescue practitioner may consent that the owner of the property may exercise his or her rights against the property, or the owner may seek leave of the court to do so.[274]

Notwithstanding the above understanding, it is generally difficult for a third party to obtain release of property which is in possession of the company from the scope of

[270] *Murray NO and Another v FirstRand Bank Ltd* 2015 (3) SA 438 (SCA) paras 31–32.
[271] 2015 (3) SA 438 (SCA).
[272] *Murray NO and Another v FirstRand Bank Ltd* 2015 (3) SA 438 (SCA) para 33.
[273] (2012) ZAGPPHC 165 para 8.
[274] Section 134(2) of the Companies Act 2008.

the moratorium. This is so because in addition to section 133(1), which provides the general moratorium, section 134(1)*(c)* of the Companies Act provides further restrictions on the exercise of rights by third parties against propert in lawful possession of the company.

Section 134(1)*(c)* provides:

> Subject to subsections (2) and (3), during a company's business rescue proceedings-
>
> (c) despite any provision in an agreement to the contrary, no person may exercise any right in respect of any property in the lawful possession of the company, irrespective whether the property is owned by the company, except to the extent that the practitioner consents in writing.

This provision strikes directly on the private agreements entered into between the creditor and the company since it operates to prevent creditors and any other third parties from exercising any rights over the company's property, including basic rights like demanding rental fees accruing from the creditor's property which is occupied by the company.[275] Moreover, the restriction imposed by this provision applies even where the property in issue is not owned by the company.[276] Some commentators have labelled these restrictions as expropriatory and an affront to the constitutional right to own property.[277] However, where a third party legitimately feels that his or her rights have been unfairly impeded by the moratorium extended to a company in business rescue, such a person is entitled to apply for consent from the business rescue practitioner or even apply to court for leave to get back his or her asset.[278]

Moreover, section 134(2) of the Companies Act 2008 is very instructive that the practitioner must not unreasonably withhold consent to a claim by a third party, and in considering any such request for consent, the practitioner is supposed to have regard to the purposes of Chapter 6 on business rescue, the circumstances of the company and the nature of the property and the rights claimed in respect of it.[279]

Although sections 133 and 134 of the Companies Act 2008 might seem to be abrasive to the rights of third parties, they reflect a firm step that was taken by the South African

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275 Nwafor 2017 'Corporate Board: Role, Duties and Composition' 62.
276 Cassim and others*, Contemporary Company Law* 881.
277 Nwafor 2017 'Corporate Board: Role, duties and composition' 63.
278 Section 133(1)*(b)* of the Companies Act 2008.
279 Section 134(2) of the Companies Act 2008.

legislature in addressing the negative effects of uncoordinated enforcement actions by creditors and other claimants against the company in business rescue. These provisions add great value to business rescue procedure in South Africa. The protection afforded to the company provides the rescue practitioner enough time to concentrate on preparing the business rescue plan for consideration by the body of creditors.

5.5.4.2 Solidifies employees' rights

According to the Cork Committee:

> The preferential treatment of employees in an insolvency in respect of their claims for unpaid wages was originally a social measure. It was introduced in an effort to ease the financial hardship caused to a relatively poor and defenseless section of the community by the insolvency of their employer. In the early days of the Bankruptcy Acts, there was no welfare state, and wages were low.[280]

It is argued that the plight of employees during the insolvency of their employer has not changed in many countries to date and:

> There can be no doubt that employees do deserve special protection. Very often their wages or salaries are their sole source of income. The loss of employment can thus have devastating effect on them and their families, an effect exacerbated by non–payment of their entitlement by their employer. The relationship between employee and employer is a continuing relationship requiring mutual trust and confidence and it is a relationship in which the employee is very clearly the subordinate. Moreover, without the work of employees, the employer's business would not function and creditors would not get paid.[281]

Unlike many jurisdictions where employees are usually seen as the lost souls of Insolvency law,[282] the framers of the Companies Act 2008 deliberately addressed the plight of employees during business rescue in South Africa. From the onset, one of the confessed objects of the Companies Bill 2008 was to ensure that business rescue proceedings recognise and preserve the rights and interests of employees.[283] The legislature sought to enhance the protection of the interests of workers, by not only recognising them as creditors if the company owed them money before the

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280 Cork Insolvency Law and Practice: Report of the Review Committee (the Cork Committee) (Cmnd.8558) (1982) 324 para 1428. See also Westbrook and others, *A global View of Business Insolvency Systems* 187.

281 Westbrook and others *A Global View of Business Insolvency Systems* 188.

282 Cassim and others*, Contemporary Company Law* 884; Finch *Corporate Insolvency Law: Perspective and Principles* 778.

283 Item 10 of the Memorandum on the Objects of the Companies Bill 2008.

commencement of the business rescue proceedings, but also by affording them specific rights to participate in the business rescue proceedings based on their status as employees of the company.[284]

This objective has been achieved by entrenching employees' rights in the legislation in three fundamental ways. First, the Companies Act 2008 includes 'employees' in the definition of 'affected persons' who enjoy several powers and rights.[285] Secondly, employees are recognised as creditors where, by the time of commencement or during business rescue procedure, the company owes them remuneration.[286] Thirdly, the Companies Act 2008 protects employment contracts from the risk of unilateral termination by the business rescue practitioner.[287]

Regarding protection of employees' contracts, section 136(1) of the Companies Act explicitly provides that despite any provision of an agreement to the contrary,

> (a) During a company's business rescue proceedings, employees of the company immediately before the beginning of those proceedings continue to be so employed on the same terms and conditions, except to the extent that-
> (i) Changes occur in the ordinary course of attrition; or
> (ii) The employees and the company, in accordance with applicable labour laws, agree different terms and conditions; and
>
> (b) Any retrenchment of any such employees contemplated in the company's business rescue plan is subject to section 189 and 189A of the Labour Relations Act 1995 and other applicable employment related legislation.

The Companies Act specifically excludes employment contracts entered into before the commencement of business rescue from the scope of power extended to a business rescue practitioner to entirely, partially or conditionally suspend or apply to a court for cancellation of contractual obligations of the company arising during business rescue proceedings.[288]

It has been argued that section 136 of the Companies Act conforms to one of the predominant underlying objectives of business rescue, which is to preserve employment and to ensure that the attainment of creditor's wealth maximisation does not override the interests of employees.[289]The provision leaves employees sufficiently

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284 Joubert and Loubser 2016 *De Jure* 95.
285 Section 128(1)*(a)*(ii) and (iii) of the Companies Act 2008.
286 Section 135(1) of the Companies Act 2008; Joubert and Loubser 2016 *De Jure* 96.
287 Section 136(1)*(a)* of the Companies Act 2008.
288 Section 136(2)*(a)* of the Companies Act 2008; Joubert and Loubser 2016 *De Jure* 105.
289 Cassim and others*, Contemporary Company Law* 885.

insulated from the risk of loss of employment or unfair variation to their pre-commencement negotiated employment contacts. This study argues that this creates a good motivation for employees to advocate for placing distressed companies under business rescue, rather than resorting to liquidation or winding up, which would automatically suspend all employment contracts.[290] In *Reginald Ngwato and Another v Liebenberg Dawid Ryk Van Der Merwe and 4 others*[291] Malindi AJ stated:

> It is declared that section 38(1) of the Insolvency Act 24 of 1936 as read together with section 339 of the Companies Act 61 of 1973 together with item 9 of Schedule 5 of the Companies Act 71 of 2008 means that the contract of service of employees whose employer, which is a company, has been liquidated, are suspended with effect from the date of granting of a provision or final liquidation order, if no provisional order was granted.[292]

In terms of section 38(9) of the Insolvency Act, if no conclusive agreements are reached between the employees and the liquidator after 45 days of the appointment of the liquidator, by operation of law, all employee's contracts are automatically terminated. This position was confirmed by Steenkamp J in *Christopher Peter Van Zyl NO and Others v The Commissioner for Conciliation, Mediation and Arbitration and 2 Others.*[293] It was held:

> in terms of section 38(9) of the Insolvency Act, contracts of service which are suspended due to the provisional liquidation of a company automatically terminate, by operation of law, 45 days after the appointment of the liquidator finally appointed as such, unless the parties have agreed otherwise after the consultation process prescribed by section 38(5 and (6).[294]

This demonstrates that unlike business rescue, liquidation has immediate effect on employees and as was already argued in Chapter 4,[295] is contrary to the purpose of job preservation, which is one of the primary policy objectives behind the introduction of business rescue in South Africa's legal regime and in other jurisdictions too.[296]

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290 Section 38(1) of the Insolvency Act 24 of 1936 (the Insolvency Act); s 339 of the Companies Act of 1973.

291 2014/28470 [2016] ZAGPJHC 398.

292 *Reginald Ngwato and Another v Liebenberg Dawid Ryk Van Der Merwe and 4 others* case no. 2014/28470 [2016] ZAGPJHC 398 para 61.

293 case no. C212/2011.

294 *Christopher Peter Van Zyl NO and Others v The Commissioner for Conciliation, Mediation and Arbitration and 2 Others* case no. C212/2011 para 21.

295 Discussed under 4.9.1.

296 McCormack *Corporate Rescue Law–An Anglo-American Perspective* 31.

In a recent case of *National Union of Metalworkers of South Africa and Another v South African Airways (SOC) Ltd and Others,*[297] Van Niekerk J held:

> The preamble to section 136(1) records that during a company's business rescue proceedings, employees employed by the company immediately before the beginning of those proceedings continue to be employed on the same terms and conditions. That is the default position. It is a position that acknowledges that the commencement of business rescue proceedings does not in itself prejudice an employee's condition of service, including his or her work security.[298]

The judge proceeded:

> In short, unless an event that qualifies as a change of terms and conditions of employment either by the ordinary course of attrition or by the employee's consent, there is complete protection of employees during business rescue proceedings.[299]

To further protect employees' contracts from termination, sections 135(1) and (3) of the Companies Act categorises post-commencement employment related benefits and unpaid remuneration as post-commencement finance, which enjoys super–priority under the Companies Act.[300] It has been argued that section 135(1) is broad enough to cover wages, reimbursement for expenses and contributions by the employer to the employees' pension.[301]

The position of employees is further boosted by section 144(2) of the Companies Act, which unequivocally provides that any remuneration, reimbursement for expenses or other amount of money relating to employment that became due and payable before the commencement of business rescue proceedings but were not paid to the employee immediately before the commencement of business rescue proceedings, will be treated as preferred unsecured claims. This means that the commencement of business rescue, by operation of law, catapults employees' claims to become preferred claims, eligible for payment ahead of other unsecured creditors, but after the post-commencement financers.[302]

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[297] case no. J424/2020.

[298] *National Union of Metalworkers of South Africa and Another v South African Airways (SOC) Ltd and Others* case no. J424/2020 para 29.

[299] *National Union of Metalworkers of South Africa and Another v South African Airways (SOC) Ltd and Others* case no. J424/2020 para 31.

[300] Section 135(3) of the Companies Act 2008; Cassim and others*, Contemporary Company Law* 900.

[301] Stoop and Hutchison 2017 PER/PELJ 17.

[302] Cassim and others*, Contemporary Company Law* 900.

As a result, employees become one of the primary beneficiaries of business rescue proceedings, which represents a laudable attempt to ensure that employees are protected. It also reflects a stakeholder-inclusive approach to resolving corporate insolvency conundrums.[303]

Section 144(3) goes on to create more rights for employees during business rescue. It provides that during a company's business rescue process, every registered trade union representing any employees of the company, and any employee who is not so represented, is entitled to:

> (a) Notice of each court proceedings, decision, meeting or other relevant event concerning the business rescue proceedings and such notice must be given to employees at their workplace and served at the head office of the relevant trade union;
> (b) Participate in any court proceedings arising during the business rescue proceedings;
> (c) Form a committee of employees' representatives;
> (d) Be consulted by the practitioner during the development of the business rescue plan, and afforded sufficient opportunity to review any such plan and prepare a submission contemplated under section 152(1)I;
> (e) Be present and make a submission to the meeting of the holders of voting interests before a vote is taken on any proposed business rescue plan, as contemplated under section 152(1)(c);
> (f) Vote with creditors on a motion to approve a proposed business plan, to the extent that the employee is a creditor, as contemplated in subsection (1); and
> (g) (g) If the proposed plan is rejected, to (i) propose the development of an alternative plan, in the manner contemplated under section 153; or (ii) present an offer to acquire the interest of one or more affected, in the manner contemplated in section 153.[304]

The law further declares that the previously mentioned rights of employees and their representatives are additional to any other rights arising or accruing to them in terms of any other law, contract, collective agreement, shareholding, security or court order.[305] One such legal right is the right by employees, as affected persons,[306] to apply to court for business rescue, where they feel that the future of their company is threatened. This right can aptly be exercised where some other party has placed the company before a legal procedure that presents adverse implications to the rights of employees, such as liquidation.

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303 Stoop and Hutchison 2017 *PER/PELJ* 18.
304 Section 144(3) of the Companies Act 2008.
305 Section 144(5) of the Companies Act 2008.
306 Section 128(1)*(a)*(ii) and (iii) of the Companies Act 2008.

According to section 131(4) of the Companies Act 2008, one of the considerations upon which court may determine whether to grant an application for business rescue is if the company has failed to pay over any amount in terms of an obligation under or in terms of a public obligation, or contract with respect to employment related matters.[307] Moreover, in terms of section 131(6) of the Companies Act 2008, if liquidation proceedings have already been commenced by or against the company at the time when an application is made for business rescue under section 131(1) of the Companies Act 2008, the application for business rescue will suspend the liquidation proceedings until the court has adjudicated upon the application, or if the order for business rescue is granted, until the business rescue proceedings end.

In *The employees of Solar Spectrum Trading 83 (Pty) Ltd v Afgri Operations Ltd and Solar Spectrum Trading 83 (Pty) Ltd,*[308] the employees of Solar Spectrum Trading 83 (Pty) Ltd applied for business rescue of their employer, after one of its creditors (Afgri operations Ltd) had applied for liquidation of the company. The court considered the circumstances under which employees of a company, as affected persons, can sustain an application for placement of their employer under business rescue to forestall its dissipation through liquidation. The court held that by introducing the provisions on business rescue under the Companies Act, the legislature demonstrated a shift from creditors' interest to an attempt to balance wider range of often competing interests, noting that the stakeholders whose interest require a careful balancing would be creditors, shareholders, and employees.[309]

While providing guidance on what factors ought to be considered in assessing whether there is a reasonable prospect for rescuing the company, Kollapen J held:

> The words 'reasonable prospect' in the context of section 131(4) were considered by the court in Southern Palace *supra*. The court beyond indicating the cause of the demise or failure of the company's business as well as the proposed remedy would have to be adequately addressed, also provided some indicator which in its view, would constitute concrete and objectively ascertainable details going beyond mere speculation and these would include:
>
> (a) The likely cost of rendering the company able to commence with its intended business, or to resume the conduct of its core business;
> (b) The likely availability of the necessary cash resource in order to enable the ailing company to meet its day to day expenditure, once its trading operation

307 Section 131(4)*(a)*(ii) of the Companies Act 2008.
308 (2011) 6418.
309 *The employees of Solar Spectrum Trading 83 (Pty) Ltd v Afgri Operations Ltd and Solar Spectrum Trading 83 (Pty) Ltd* (2011) 6418 para 9.

commence or resumed. If a company will be reliant on loan capital or other facilities, one would expect to be given some concrete indication of the extent thereof and the basis or terms upon which it will be available;

(c) The availability of any other necessary resource, such as raw materials and human capital;

(d) The reasons why it is suggested that the proposed business plan will have reasonable prospect of success.[310]

The judge further held:

> I do not necessarily understand the factors listed in *Southern Palace supra* with regard to satisfying the requirement of reasonable prospects to be applicable in each case, given the caveat expressed by ELOFF AJ that every case must be considered on its own merits. In this regard while a court must be ultimately satisfied that reasonable prospects do exist in the balancing exercise, it must have regard to what information the affected party who brings the application is able to present given its own position *vis-à-vis* the company.
>
> Clearly, a shareholder is likely to possess greater details of a company's financial position and its financial performance than an employee. On the other hand, employees, in particular long-standing employees, would have peculiar information of a company's performance being as it were at the centre and at the heart and soul of its operations. Their knowledge of the company history, the highs and lows of its performance, the problems and the solutions identified and their own role in any possible business rescue would be just as relevant. Without suggesting that different tests should be applied in establishing whether the threshold of reasonable prospects has been met, if the Act is to be implemented in a manner that does not disadvantage an employee as an affected party, then regard must be had both in assessing whether there are reasonable prospects and in exercising of the balance of competing rights to the different positions of the parties in relation to the company.[311]

Based on the information that the employees placed before the court to demonstrate that their employer had prospects of improving, the court granted an order to commence business rescue. This naturally suspended the application for liquidation of the company and over 75 jobs were saved. This clearly demonstrates the joint commitment from both the legislature and the courts in South Africa to uphold the rights of employees even in times of financial trouble. The Companies Act amplifies the rights and interest of employees during business rescue, which positions South Africa's business rescue procedure as a truly employee-focused regime.

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310 *The employees of Solar Spectrum Trading 83 (Pty) Ltd v Afgri Operations Ltd and Solar Spectrum Trading 83 (Pty) Ltd* (2011) 6418 para 15.

311 *The Employees of Solar Spectrum Trading 83 (Pty) Ltd v Afgri Operations Ltd and Solar Spectrum Trading 83 (Pty) Ltd* (2011) 6418 paras 17–18.

5.5.4.3 Effect on contracts generally

In order to protect the business rescue practitioner from the burden of shouldering onerous contractual obligations during business rescue, the framers of the law granted the rescue practitioner legal latitude to look at all the contracts that the company could have entered into before the commencement of business rescue and suspend or cause the cancellation of the contracts that the practitioner considers burdensome to the rescue process.

According to sections 136(2) and 136(2A) of the Companies Act, a business rescue practitioner is empowered to suspend, whether entirely, partially or conditionally, any obligation that arises under an agreement to which the company is a party at the commencement of the business rescue and will become due during the rescue proceedings.[312] This is intended to empower the business rescue practitioner to exercise business judgment to jump out of commitments that could hinder or otherwise frustrate rescue efforts.[313]

By invoking this provision and exercising this power, the practitioner could prevent a creditor from instituting action and repossessing or attaching property in the company's possession.[314]

The only exception to this power is with respect to contracts of employment or agreements to which sections 35A or section 35B of the Insolvency Act would have applied if the company had been liquidated. Neither the business rescue practitioner nor court can cancel employment contracts or agreements that are covered by sections 35A and 35B of the Insolvency Act on exchange agreements and master agreements related to over-the-counter derivatives.[315]

While interpreting the scope and import of section 136(2) of the Companies Act in *BP Southern Africa (Pty) Ltd v Intertrans Oil (Pty) Ltd,*[316] the court held:

> Interpretation starts with a textual treatment of the words in their context. The language conferring the power of suspension is pretty clear, at least on the face of it; '*any*' is notoriously a word of wide if not unlimited import, and so it would, at

312 Cassim and others, *Contemporary Company Law* 885.
313 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 469.
314 Per Fourier (AJJA) in *Cloete Murray NO and Another v FirstRand Bank Ltd T/A Wesbank* (20104/2014) [2015] ZASCA 39 para 35.
315 Fine (2020) *Market Insight, Clyde and Co. LLP* 2.
316 (34716/2016) [2016] ZAGPJHC 310; 2017 (4) SA 592 (GJ).

> least *prima facie* and unless any absurdity is thrown up, include obligations that are contractually tied with a reciprocal obligation of the creditor.
>
> [38] Also, since the section is silent about the effect that the suspension has on such an obligation, and since the Legislature knew and knows the residual Law of Contract, it must be accepted that the creditor has available, subject to the normal rules, the *exception non adimpleti contractus* and, again, if the normal rules of materiality and contractual notices apply, the creditor also has available the normal rights of cancellation.
>
> [39] Applied to the agreement under discussion, the applicant's obligation to avail product is obviously reciprocal with the first respondent's obligation to pay for it; but also with the first respondent's obligation to purchase exclusively from the applicant. So too would the applicant's obligation to avail the premises be reciprocal with the first respondent's obligation to pay the rental. In my view, the applicant's obligation to avail the equipment is also reciprocal with the first respondent's obligation exclusively to purchase products from the applicant. There may also be other sets of reciprocal obligations, but it is not necessary further to explore this point.
>
> [40] It follows that the suspension of all the first respondent's obligations entitle the applicant to withhold: product; access to the premises; and access to the equipment. The applicant may also cancel the Branded Distribution Agreement, provided the appropriate notices will have been given. However, the applicant may not simply ignore the suspension and insist on performance contrary to it.[317]

Whereas the law empowers the business rescue practitioner to suspend contracts, it does not stop the counter party from also exercising their contractual rights against the company, by, for instance, withholding provision of services to the company after the suspension of the contract. The company cannot insist on counter performance of the contract by the other party after the rescue practitioner has suspended it under section 136 of the Companies Act.

After the 2011 amendments to the Companies Act,[318] the rescue practitioner's powers to cancel contracts were significantly pruned. Section 136(2)*(b)* read together with section 136(2A) of the Companies Act[319] now provides that despite any agreement to the contrary, the business rescue practitioner may apply urgently to a court to entirely, partially or conditionally cancel, on any terms that are just and reasonable in the circumstances, any obligation of the company under an agreement to which the company was a party at the commencement of the business rescue process and would otherwise become due during the rescue process.[320]

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317 Section 87 of the Companies Amendment Act 3 of 2011.
318 Section 87 of the Companies Amendment Act 3 of 2011.
319 *ibid.*

This implies that whereas the practitioner has discretion to suspend contracts on his own, for cancellation, the practitioner must apply to court for consent. This is meant to moderate the actions of the practitioner and provide the requisite safeguard against the risk of abuse of power by the practitioner. The law also strikes a balance by providing that where a contract is suspended or cancelled, the other contractual party is entitled to claim for damages against the company for any benefit foregone because of the suspension or cancellation of the contract by the practitioner.[321]

This study argues that this provision is a double-edged sword. If used well, it can save the practitioner from onerous contracts, but if abused, it can also trigger more trouble. The business rescue practitioner must, therefore, exercise due care before invoking this power to cancel, vary or suspend contracts.

5.5.4.4 Effect on shareholders and directors

As the beneficial owners of the company, shareholders are recognised as affected persons during business rescue.[322] They are entitled to receive notices of all court proceedings and to participate in all meetings and discussions about the business rescue proceedings.[323] Section 137(1) of the Companies Act however imposes restrictions on the shareholders' right to alter the classification or status of any issued securities of the company except where such alterations are done in accordance with a court order or as contemplated in an approved business rescue plan.[324] This restriction is intended to ensure order and maintenance of the status quo. This allows the business rescue practitioner to independently address and work around the revival of the company without undue pressure from shareholders who might keep altering the status *quo* through the creation of additional securities on their shares and/or interests in the company.

Regarding directors, business rescue does not automatically terminate the mandate and tenure of directors in a company. Directors continue to exercise their functions but in terms of section 137(2)*(a)* of the Companies Act, the directors become directly

320 Section 86 of the Companies Amendment Act 3 of 2011.
321 *ibid.*
322 Section 128*(a)*(i) of the Companies Act 2008.
323 Cassim *and others, Contemporary Company Law* 887.
324 Section 137(1)*(a)*–*(b)* of the Companies Act 2008.

answerable and accountable to the business rescue practitioner. Exercise of powers by directors during business rescue is however supposed to be done with the authority and approval of the business rescue practitioner.[325] The rationale for this approach is the belief that directors are deemed to be the most familiar group with information about the company affairs and hence their role in the formulation of the business rescue strategy cannot be over emphasised.[326] However, where the director becomes uncooperative to the rescue process, the law empowers the business rescue practitioner to apply to court for an order to remove any such director whose continued stay in the company may be deemed inimical to the successful exercise of power and authority by the rescue practitioner.[327] This is intended to allow the business rescue practitioner sufficient discretion to determine whether any director is a valuable member of the rescue team.

Considering that business rescue is however supposed to be a short-term procedure, it is important for the practitioner to minimise friction with the directors and work towards cultivating a good working relationship with them such that they can support him in putting together a formidable business rescue plan that can effectively deliver the company from its financial despair to financial salvation.

5.6 The business rescue practitioner

A business rescue practitioner is a person, or a group of persons, jointly appointed to oversee a company during business rescue.[328] A business rescue practitioner has the most significant and pivotal task of superintending the business rescue process and turning the company around by developing a suitable business rescue plan and ensuring its implementation.[329] He or she is a central figure in galvanising the resuscitation of the company in a difficult financial situation.[330]

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325 Cassim and others, *Contemporary Company Law* 887.
326 *ibid*.
327 Section 137(5) of the Companies Act 2008.
328 Section 128(1)*(d)* of the Companies Act 2008.
329 Cassim and others, *Contemporary Company Law* 888.
330 Nwafor and Selala 2018 *Corporate Board: Role, Duties and Composition* 20–26.

A business rescue practitioner supervises and advises management and assumes full managerial control of the company in substitution for the board of directors and the pre-existing management of the company.[331]

The business rescue practitioner is expected to oversee and direct the ongoing conduct of the company business while at the same time attend to the restructuring of its affairs with the overarching objective of realising the objectives set out in chapter 6 of the Companies Act.[332]

The roles of a business rescue practitioner are comparable to that of a shepherd. The success of the entire business rescue process depends largely on the skills, expertise and integrity of the business rescue practitioner appointed to drive the rescue strategy.[333]

5.6.1 Appointment of business rescue practitioner

A business rescue practitioner may be appointed in three ways. First, as mentioned,[334] during voluntary commencement of business rescue by the board of directors, a business rescue practitioner must be appointed within five business days from the date when the board resolution for commencement of business rescue is adopted and registered with the CIPC.[335] In this case, the practitioner will be appointed by the directors from the list of qualified and licensed business practitioners in accordance with section 138 of the Companies Act 2008.

The second scenario is where, as discussed,[336] an affected person applies to court in accordance with section 131 of the Companies Act 2008 for an order to place the company under supervision and commence business rescue proceedings. If the court grants the application for commencement of business rescue, it will appoint the interim practitioner who had been nominated by the affected person who filed the application to take over the management of company, subject to ratification by the holders of a

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331 Section 140(1)*(a)* of the Companies Act 2008; Cassim and others*, Contemporary Company Law* 889.
332 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 394.
333 Cassim and others*, Contemporary Company Law* 889.
334 See the discussion in 5.5.2.1.
335 Section 129(3)*(b)* of the Companies Act 2008.
336 Discussed under 5.5.2.3.

majority of the independent creditors' voting interest.[337] The person nominated by the applicant must, however, meet the qualifications prescribed by section 138 of the Companies Act 2008 before the court can appoint him or her as an interim practitioner.[338]

The requirement for ratification of the interim practitioner by creditors who hold majority voting rights ensures democracy in the appointment process. It allows other creditors to validate the choice made by the affected person who filed the application for the commencement of business rescue. This is a good control because it creates an avenue for the other creditors to participate in the determination of the person who assumes control over the management of the company during business rescue.

The third scenario is where, upon application by an affected person under section 130(1)*(b)* of the Companies Act 2008, the court sets aside the appointment of a practitioner that was appointed by the company and appoints an alternative practitioner in accordance with section 130(6) of the Companies Act 2008. According to section 130(6)*(a)* of the Companies Act 2008, if, after consideration of an application under section 130(1)*(b)* of the Companies Act 2008, the court makes an order to set aside the appointment of a practitioner, the court must appoint an alternative practitioner. Such a person should satisfy the requirements of section 138, be recommended by or acceptable to the holders of majority of the independent creditors' voting interests to take over the management of the rescue process. This helps to obviate the risks associated with creating a leadership vacuum during business rescue.

If a business rescue practitioner dies, resigns or is removed from office by the court in accordance with its powers to remove a practitioner at any time on any of the grounds stipulated under section 139(2) of the Companies Act 2008, a new business rescue practitioner must be appointed by the company, where the initial appointment was by the company under section 129 or where the creditor had nominated the previous practitioner.[339]

337 Section 131(5) of the Companies Act 2008.
338 Section 131(5) and s 147 of the Companies Act 2008. Also see Cassim and others, *Contemporary Company Law* 889.
339 Section 139(3) of the Companies Act 2008.

Regardless of how a practitioner is appointed, he or she remains an officer of court and must report to the court in accordance with the applicable rules or orders made by court.[340]

5.6.2 Qualifications

The success of an insolvency regime is heavily dependent on the skills, expertise and competence of the persons who administers it.[341] It has been argued that the efficiency and fairness of a corporate reorganisation depends on the professional qualification of the person controlling the reorganisation among other requirements.[342] This is because business rescue requires services of a specialised professional, with not only personal qualities of integrity and impartiality, but also professional and practical experience in the management of businesses.[343]

It is obvious that being a business rescue practitioner is not a role that any ordinary person can assume. Business rescue practitioners are like doctors or engineers who fix troubled or sick businesses. As such, only those with specialised professional skills and practical experience should be eligible for appointment into this critical role, otherwise the objective of the entire rescue regime risks being defeated. Indeed, it is unsurprising that the framers of the Companies Act 2008 prescribed specific qualifications for the persons that are eligible for appointment as business rescue practitioners. Section 138(1)*(a)* to *(f)* of the Companies Act 2008 plainly provides that to be appointed as a business rescue practitioner, a person:

> (a) Must be a member in good standing of a legal, accounting, or business management professional accredited by the Companies Commission;
> (b) Must be licensed by the Companies Commission;
> (c) Must not be subject to an order of probation;
> (d) Must not be disqualified from holding office as a director in terms of section 69(8) of the Companies Act;
> (e) Must not have any other relationship with the company such as would lead to a reasonable and informed third party to conclude that the integrity, impartiality or objectivity of that person is compromised by that relationship;
> (f) Must not be related to a person who has a relationship contemplated in the preceding paragraph.

340 Section 140(3)*(a)* of the Companies Act 2008; Cassim and others*, Contemporary Company Law* 889.
341 Keay and Walton *Insolvency Law: Corporate and Personal* 35.
342 Hahn 2004 *Journal of Corporate Law Studies* 117, 141; Bradstreet 2010 *SA Merc LJ* 201.
343 Cassim and others*, Contemporary Company Law* 889.

Although this provision appears to be clear, by using the term a ‘person’, without limiting its meaning to only natural persons, there is a raging debate as to whether even a legal person, such as a company, can be appointed to act as a business rescue practitioner in South Africa.[344] This is particularly so because in terms of section 1 of the Companies Act 2008, a ‘person’ includes a juristic person and section 2 of the Interpretation Act[345] also provides that a ‘person’ includes a juristic person.

A deeper analysis of the qualifications which one must possess before he or she can be appointed as a business rescue practitioner points to the fact that the intention of the legislature must have been to allow only natural persons to be eligible for appointment as business rescue practitioners. For instance, the Companies Regulations, 2011 provide that for one to be appointed as a business rescue practitioner for a state-owned or a public company, he or she must be an attorney, accountant, liquidator, or business turnaround practitioner. Besides, such a person should have been admitted or registered as such for at least ten years, or must have a degree in law, commerce or business administration and have at least ten years’ experience in conducting business rescue proceedings.[346] These qualifications cannot be held by a juristic person.

Regulation 126(8) of the Companies Regulations 2011 further provide that in considering an application for a license for one to practice as a business rescue practitioner, the CIPC must be satisfied that the applicant is of good character and integrity and that his or her education and experience are enough to equip him or her with the requisite skills to perform the functions of a business rescue practitioner.

In conclusion, juristic persons are not eligible for appointment as business rescue practitioners. The duties and powers of a business rescue practitioner require personal touch, which can only be fairly provided by a qualified and experienced natural being, and not a juristic person.[347]

The debate on whether an eligible person includes juristic persons notwithstanding, the legal regime in South Africa provides a good benchmark for creating a pool of

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344 Loubser, ‘Some Comparative Aspects of Corporate Rescue in South African Company Law’ 92; Bradstreet 2010 *SA Merc LJ* 208.

345 Act 33 of 1957.

346 Loubser, ‘Some Comparative Aspects of Corporate Rescue in South African Company Law’ 93.

347 Section 140 of the Companies Act 2008.

licensed professionals that can be appointed to serve as business rescue practitioners.

5.6.3 Powers and duties of a business rescue practitioner

The Companies Act 2008 affords extensive powers to the business rescue practitioner to manage and assume full control over the company's business and to deal with its assets.[348] This was intended to facilitate unhindered movement towards the resuscitation of the ailing company.[349]The Companies Act also imposes several duties and responsibilities on the business rescue practitioner.[350]

The South African legislature did not follow the Unites States Chapter 11 approach of debtor in possession, which allows for the existing management of the company to continue in possession and management of the company as if it were not in any form of restructuring or administration.[351] The South African legislators preferred to adopt the British and Australian approach which divests the powers from previous management of the company and entrusts the property and affairs of the company into the hands of an independent business rescue practitioner to steer the rescue interventions.[352]

In the context of Chapter 6 of the Companies Act 2008, assuming full management control of the company by the practitioner, does not, however, mean that the pre-exiting management of the company is completely overthrown and displaced from the company. The pre-existing management continues to serve the company but under the authority, direction and supervision of the rescue practitioner.[353] This ensures continuity and minimizes the risk of disruption in the running of the company during the rescue process.

The powers of the business rescue practitioner are broadly split into two categories: managerial and investigative powers. Section 140(1) of the Companies Act 2008 unequivocally provides that on appointment, a business rescue practitioner assumes

348 Section 140 of the Companies Act 2008.
349 Cassim and others, *Contemporary Company Law* 893.
350 Section 140(3) of the Companies Act 2008.
351 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 406.
352 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 406; Bradstreet 2010 *SA Merc LJ* 199.
353 Cassim and others, *Contemporary Company Law* 894.

full management control of the company and takes over all powers and functions of the board and pre-existing management of the company.[354] The law erases any doubt about who takes charge of a company during business rescue, which enables the practitioner to do all such things as may be necessary or incidental to the management of the company's business.[355]

The Companies Act 2008 permits the practitioner to delegate any of his or her power or function to any person who has been a director of the company or part of its pre-existing management.[356] The rescue practitioner is also clothed with powers to remove from office any person who has been part of the company's pre-exiting management and to appoint any other eligible person to become a director of the company.[357] The practitioner's power to appoint persons into the management of the company is subject to ensuring that the appointee does not have a relationship with the company that would lead a reasonable and informed third party to question the integrity, impartiality or objectivity of the appointed person. [358]

Where the person sought to be appointed is likely to be perceived as related to the company and, hence, ineligible for appointment, the rescue practitioner is allowed to apply to court for an order approving the appointment of such otherwise questionable person so long as a sufficient explanation can be presented to court to justify the exceptional appointment.[359] I consider this approach appropriate because it subjects the practitioner's decision to appoint a related party to an extra layer of scrutiny and consideration by an impartial party. The judge also allows the practitioner the space to cause the appointment of any person he or she deems relevant to the rescue process so long as court can be convinced about the merits of the appointment.

The practitioner's other primary responsibility is to develop a business rescue plan and/or implement the rescue plan that has already been adopted by the company.[360]This is arguably the most important function of the business rescue practitioner.[361]

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354 Nwafor and Selala 2018 *Corporate Board: Role, Duties and Composition* 22.
355 *ibid*; Cassim and others*, Contemporary Company Law* 893.
356 Section 140(1)*(b)* of the Companies Act 2008.
357 Section 140(1)*(c)* of the Companies Act 2008.
358 Section 140(2) of the Companies Act 2008.
359 Section 140(2) of the Companies Act 2008.
360 Section 140(1)*(d)* of the Companies Act 2008.
361 Cassim and others*, Contemporary Company Law* 896.

The business rescue practitioner also assumes the duty to make other very important decisions in the company, such as soliciting for post-commencement financing of the company,[362] change the workforce, including negotiating new employment terms with employees, supervision and/or cancellation of existing contracts considered prejudicial to the rescue of the company[363] and whether to terminate the business rescue proceedings and convert the proceedings into liquidation proceedings.[364]

In exercising these powers, the business rescue practitioner assumes responsibility and duties of an officer of court and must act and report to court in accordance with any applicable rules or orders of court.[365] The practitioner also assumes duties and liabilities of a director of a company as set out in sections 75 to 77 of the Companies Act 2008,[366] which enjoin the business rescue practitioner to act judiciously and guard against any form of fraud, dishonesty or negligence in the discharge of his or her duties.

Section 76(3)*(c)* of the Companies Act 2008 lucidly obliges the practitioner to exercise reasonable care and skill in the performance of his or her duties. Whilst the practitioner may not be liable for an act or omission performed in good faith in the course of the exercise of his or her powers, duties and responsibilities, the practitioner may be held liable for gross negligence.[367] However, going by the persuasive English law position as stated in *Kyriss v Oldham and Others*,[368] in the absence of a special relationship, which must be specifically proved, an administrator appointed under the Insolvency Act of 1986 owes no general common-law duty of care to unsecured creditors in relation to his conduct of the administration processes. The administrator, just like a business rescue practitioner in South Africa, does not owe any special duty of care to creditors in circumstances where a director of a company would not owe such a duty to shareholders. In the absence of special circumstances, the duties of an administrator and, indeed a business rescue practitioner, are owed to the company.[369]

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362 Section 135(2) of the Companies Act 2008.
363 Section 136 of the Companies Act 2008.
364 Section 132(1)*(b)* of the Companies Act 2008.
365 Section 140(3)*(b)* of the Companies Act 2008.
366 Section 140(3)*(b)* of the Companies Act 2008.
367 *ibid*; Cassim and others*, Contemporary Company Law* 894.
368 [2004] 1 BCLC 305 (CA) 329.
369 *Kyriss v Oldham and Others* [2004] 1 BCLC 305 (CA) 329, 331; Cassim and others*, Contemporary Company Law* 894–895.

The second set of powers enjoyed by a business rescue practitioner are the investigative powers. Section 141 of the Companies Act 2008 provides that as soon as practicable after being appointed, a business rescue practitioner must investigate the company's affairs, business, property and financial situation. After having done so, he or she must consider whether there is any reasonable prospect of the company being rescued. This is a very important function, which enables the rescue practitioner to unearth facts upon which subsequent decisions are to be made about the future of the company.[370] It is also assumed that through the exercise of the investigation powers, the business rescue practitioner is able to gather information from which he or she derives content to be captured in the business rescue plan.

If, after the investigation, the practitioner concludes that there is no reasonable prospect of the company being rescued, the practitioner must timeously inform all affected persons and apply to court for an order to discontinue the business rescue proceedings and place the company into liquidation.[371]

The court will consider the application made by the rescue practitioner and will either place the company into liquidation or make any other order it considers appropriate in the circumstances, including making an order directing the practitioner to undertake any further investigations into any issue(s), reconvene creditor's meetings, explore additional possibilities of post-commencement finance.[372]

The Companies Act imposes specific statutory duties on directors of the company to not only cooperate with the business rescue practitioner during the investigations, but to also deliver all relevant books of accounts and records about the affairs of the company.[373]

Section 142(3) clearly states as follows:

> Within five business days after business rescue proceedings begin, or such longer period as the practitioner allows, the directors of a company must provide the practitioner with a statement of affairs containing, at a minimum, particulars of the following:
>
> (a) Any material transactions involved the company or the assets of the company, and occurring within 12 months immediately before the business rescue proceedings began;

370 Cassim and others*, Contemporary Company Law* 895.
371 Section 141(2)*(a)* of the Companies Act 2008.
372 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 414.
373 Section 142(1) of the Companies Act 2008.

(b) Any court, arbitration or administrative proceedings, including enforcement proceedings, involving the company;
(c) The assets and liabilities of the company, and its income and disbursements within the immediately preceding 12 months;
(d) The number of employees, and any collective agreements or other agreements relating to the rights of employees;
(e) Any debtors and their obligations to the company; and
(f) Any creditors and their rights or claims against the company.

This only confirms the hypothesis that from a legal perspective, the Companies Act sufficiently empowers the business rescue practitioner to undertake the requisite investigation from which relevant information is expected to be obtained to facilitate a holistic diagnostic review of the company and its business and to make the necessary recommendations.

Section 142(2)*(c)*(ii) of the Companies Act further guides the business rescue practitioner. If, during the investigations, there is evidence that points to the possibility that in the dealings of the company before the business rescue proceedings began, there was reckless trading, fraud or some other form of contravention relating to the company, he or she must forward the evidence to the appropriate authority for further investigation and possible prosecution. Moreover, he or she must direct the management to take any necessary steps to rectify the matter, including recovering any misappropriated assets of the company.

The law does not require the business rescue practitioner to be the one to undertake the prosecution of the offending directors or members of management, which in my considered view was a smart move. Prosecution of offending directors and undertaking all the remedial measures by him or her would create an extra burden which could potentially hamper the business practitioner's ability to concentrate on the core goal of rescuing the company from the imminent risk of closure.

5.6.4 Remuneration of the practitioner

Remuneration of the business rescue practitioner is one of the silent factors that may influence how the rescue process progresses. It is important to have a clear mechanism for determining the remuneration to be paid to the rescue practitioner. Absence of a clear basis for the determination of the fees payable to the business rescue practitioner may even affect the impartiality and independence of the practitioner.[374]

In the South African legal regime, there are various ways through which the business rescue practitioner's remuneration may be determined.[375] The remuneration can be determined through an agreement between the practitioner and the company or a committee of creditors, or by a resolution passed by creditors,[376] or in accordance with the tariff laid down in the Companies Regulations, 2011.[377] In practice, however, business rescue practitioners charge in accordance with the tariffs set out in regulation 128 of the Companies Regulations, 2011.[378]

In terms of regulation 128 of the Companies Regulations, 2011, the tariffs chargeable by practitioners depend on whether the company is classified as a small, medium, large, or state-owned company. The basic remuneration may not exceed R1250 per hour and is limited to a maximum of R15625 per day, inclusive of Value Added Tax (VAT), in case of a small company; R1500 per hour limited to a maximum of R18750 per day inclusive of VAT in case of a medium company; or R2000 per hour, limited to a maximum of R25000 per day inclusive of VAT in case of a large company or a state-owned company.[379] In addition to the above standard rates and fees, practitioners are also permitted to propose an agreement providing for further remuneration calculated on a contingency basis.[380]The contingency could be stipulated as the adoption of a business rescue plan or within a particular time or the inclusion of any particular matter within the plan or the attainment of any specific result or a combination of results relating to the business rescue proceedings.[381]

Subjecting the fees payable to the occurrence of a contingency event or action may appear complex because it is speculative in nature. However, one of the justifications

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374 Cassim and others*, Contemporary Company Law* 891.
375 *ibid.*
376 Sections 143(2) and 145(1)*(a)* of the Companies Act 2008.
377 Section 143(1) and (6) of the Companies Act 2008; Cassim and others*, Contemporary Company Law* 892.
378 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 423.
379 Regulation 128 of the Companies Regulations, 2011; Cassim and others*, Contemporary Company Law* 892.
380 Section 143(2) of the Companies Act 2008.
381 Section 143(2)*(a)* and *(b)* of the Companies Act 2008; Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 423; Cassim and others*, Contemporary Company Law* 892.

for permitting a contingency-based fee is that it provides the practitioner with an added incentive to successfully implement a business rescue plan.[382]

The law has some in-built safety measures to guard against abuse of this provision. For instance, section 143(3) of the Companies Act requires that any agreement for a contingency-based fee must first be approved by the holders of a majority of the creditor's voting interests[383] and approved by the holders of the majority of the voting rights of the shareholders entitled to a portion of the residual value of the company on winding-up, who are present and voting at the relevant meeting where such a decision is taken.[384]

Even if the agreement for a contingency based fee is approved by the creditors and shareholders, any creditor or shareholder who voted against the agreement may apply to court within ten business days after the date of the voting on the proposal for an order setting aside the agreement on the ground that the agreement is not just and equitable or that the remuneration provided for in the agreement is egregiously unreasonable in view of the financial circumstances of the company.[385] These controls adequately balance the interests of the business rescue practitioner to be well remunerated without unduly reducing what is due to the creditors and the residual beneficiaries of the company.

In the recent case of *Caratco (Pty) Ltd v Independent Advisory (Pty) Ltd*[386] (*Caratco*), the court was called upon to determine whether an agreement for the payment of a special fee for the remuneration of a business rescue practitioner outside of what is provided for under section 143 of the Companies Act is void for lack of legality and/or contrary to public policy.

The salient facts of *Caratco* were as follows. Caratco (Pty) Ltd was a creditor and a related party to Galaxy Jewellers (Pty) Ltd, a financially distressed company. Galaxy Jewellers (Pty) Ltd entered into business rescue, and two directors of the Independent Advisory (Pty) Ltd, the respondents, were appointed as the joint business rescue practitioners. As part of the remuneration agreement, the directors of Galaxy Jewellers

382 Cassim and others*, Contemporary Company Law* 892.
383 Section 143(3)*(a)* of the Companies Act 2008.
384 Section 143(3)*(b)* of the Companies Act 2008.
385 Section 143(4) of the Companies Act 2008.
386 Case no. 982/18[2020] ZASCA 17.

(Pty) Ltd, who were also directors in Caratco (Pty) Ltd, entered into a 'success fee' agreement with the respondent, wherein they consented to pay the respondents, R2 million upon the successful conclusion of the rescue of Galaxy Jewellery (Pty) Ltd.

The parties had agreed not to include the success fee in the business rescue plan. Instead, they agreed that the joint practitioners would invoice the applicant, Caratco (Pty) Ltd for the agreed success fee of R2 million.

After the successful rescue of Galaxy Jewellers (Pty) Ltd, the respondents invoiced Caratco (Pty) Ltd for the success fee. However, Caratco (Pty) Ltd challenged the legality of the agreement for allegedly being contrary to section 143 of the Companies Act and contrary to the public policy. After an unsuccessful application in the High Court, Caratco (Pty) Ltd lodged an appeal to the Supreme Court of Appeal. Caratco (Pty) Ltd relied on three main grounds. First, it was contended that the special fee agreement was illegal claiming that the fees that were agreed upon were outside the acceptable parameters as prescribed under section 143 of the Companies Act and should be declared void. Secondly, it was argued that the joint practitioners had breached their responsibilities and duties in terms of section 140(3)*(b)* of the Companies Act 2008. Thirdly, it was averred that the success fee agreement was contrary to public policy, as far as the practitioners subverted the democratic vote of most creditors and breached their duty to act independently and impartially towards the company by entering into the success fee agreement with it.

In a well-reasoned judgment by Cachalia JA, court found that the special fee agreement was not invalid, illegal, or otherwise contrary to public policy and dismissed a further application for leave to appeal.

The court held that section 143 of the Companies Act 2008 only applies to the remuneration of practitioners by the company under business rescue and does not deal with fee arrangements concluded between practitioners and third parties. It was held that there is nothing in section 143 of the Companies Act 2008 to suggest that an agreement not falling within its ambit is void. Moreover, the Companies Act 2008 does not penalise the conclusion of such agreements nor does it contain language entitling a court to draw an inference that the lawmaker intended to invalidate such agreements. The court also noted that Caratco (Pty) Ltd did not contend and was unable to make out a case that the fee that it had freely negotiated and agreed upon with the business rescue practitioner was either unjust, inequitable, or egregiously unreasonable as envisaged in section 143(4) of the Companies Act 2008. Finally, the public policy defence was also without any merit.[387]

It is clear that as long as the practitioner fairly negotiates with the company and ensures that the requisite approvals envisaged under section 143 are obtained, a remuneration agreement for a contingency fee is lawful and can be paid. Moreover, section 143(5) of the Companies Act 2008 clearly states that to the extent that the business rescue practitioner's remuneration and expenses are not fully paid, the practitioner's claim rank in priority to the claims of all other secured and unsecured creditors.

This is further evidence that the legislature and the courts in South Africa are alive to the fact that business rescue practitioners are pivotal in the rescue process. Unless they are well remunerated and their claims secured, rescue efforts might be jeopardised to the detriment of many.

5.7 Financing of business rescue in South Africa

It has already been noted[388] that funding business rescue proceedings is one of the biggest inhibitors to successful business rescue. In stressing the importance of post-commencement finance, scholars have argued as follows:

> One of the important requirements for recovering business is the access to finance. Successful restructuring is dependent on two factors-–meeting the liquidity needs and obtainment of post-petition financing. Metaphorically, Westbook and Gottlieb put the relationship between access to financial facilities and restructuring as: 'Liquidity is the life blood of reorganization.' The major purpose of reorganization is to protect viable but distressed companies and thus to realise the interest of the concerned parties through healing the business entity. In order to continue its business operations and pay its debts as they come due, a company in restructuring often needs to secure substantial amounts of additional liquidity and capital. In times

387 *Caratco (Pty) Ltd v Independent Advisory (Pty) Ltd* case no. 982/18 [2020] ZASCA 17 para 31.
388 See the discussion under 4.8.2.

> of financial crisis and credit crunch the difficult goal to convince lenders in the viability of the distressed company becomes even harder if not impossible.[389]

It has also been argued that the viability of a business in rescue depends on the availability of post-commencement finance as this often defines the possibility of successfully weathering out of its financial conundrum.[390] Therefore, in structuring any corporate rescue legal framework, clear provisions should be made on financing of the distressed business out of its financial distress. Financing the rescue efforts is an indispensable component in corporate turnaround.[391]Post-commencement finance facilitates the rescue of companies and makes it possible for them to continue trading until they return to normal operations.[392]

For South Africa, the framers of the Companies Act of 2008 tried to pick some commendable lessons from Chapter 11 of the US Bankruptcy Code and created a statutory framework that facilitates super-priority post commencement financing.[393]

Section 135(2) of the Companies Act 2008 expressly provides that during its business rescue proceedings, the company may obtain financing other than as contemplated in subsection (1) and any such financing:

(a) May be secured to the lender by utilizing any assets of the company to the extent that it is not otherwise encumbered; and

(b) Will be paid in the order of preference set out in subsection (3)(b).

Subsection 3 of section 135 of the Companies Act 2008 provides:

> After payment of the practitioner's remuneration and expenses referred to under section 143, and other claims arising out of the costs of the business rescue proceedings, all claims contemplated-
>
> (a) In subsection (1) will be treated equally, but will have preference over-
>
> (i) all claims contemplated in subsection (2), irrespective of whether or not they are secured; and
>
> (ii) all unsecured claims against the company; or

389 Vriesendorp and Gramatikov (2010) *INSOL International Survey* 8; Westbrook and Gottlieb 2009 American BIJ 10; Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 205.

390 Pretorius and Wanya 2013 *SAJESB* 168.

391 Calitz and Freebody 2016 *De Jure* 265, 269.

392 *ibid.*

393 Cassim and others*, Contemporary Company Law* 883.

(b) In subsection (2) will have preference in the order in which they were incurred over all unsecured claims against the company.

This means that the business rescue practitioner is mandated to use any of the unencumbered assets of the company as security for financing of the rescue activities. Some scholars[394]have questioned the adequacy of this provision, especially in view of the fact that it appears to only allow the practitioner to use the unencumbered assets of the company; yet usually, by the time a company enters business rescue it will barely have valuable equity or any unencumbered assets to pledge to providers of rescue finance.

Scholars and judges[395] have widely debated the import of this provision. Some judges initially argued that post-commencement credit enjoys super priority over all pre-commencement creditors, including the secured creditors, while others have consistently maintained that the law as captured in section 135 of the Companies Act 2008 only gives post-commencement credit priority over pre-insolvency unsecured creditors.[396]

The reservations about the adequacy of this provision and the practical challenges associated with obtaining post-commencement finance notwithstanding, the legislature recognised post commencement finance as critical. Therefore, providing for it under section 135 is a positive step. It confirms that the legislature is already converted in thought towards anchoring post-commencement finance in the South African law.

Secondly, by categorising unpaid staff salaries and wages as part of post-commencement finance, a further incentive is created for employees to continue working for the company. Employees have a reasonable expectation that if they support the business rescue practitioner in the successful turnaround of the company,

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394 Stoop and Hutchison 2017, 273.

395 Cassim and others, *Contemporary Company Law* 883.Kgomo J in *Merchant West Working Capital Solutions (Pty) Ltd v Advanced Technologies and Engineering Company (Pty) Ltd* (13/12406 [2013] ZAGPJHC 109; *Redpath Mining South Africa v Marsden* (18486/2013) [2013] ZAGPJHC 148.

396 Van der Linde 'Company and Insolvency Law update' 2014 Annual Banking Law Update 15; Delport and others, *Henochsberg on the Companies Act 71 of 2008* 478(10)– (12); Calitz and Freebody 2016 *De Jure* 265, 273.

their unpaid arrears will enjoy preference, even if the company is later placed in liquidation.[397]

5.8 The business rescue plan

Development and preparation of a business rescue plan is one of the primary deliverables of the business rescue practitioner.[398] A business rescue plan is the most important component of the business rescue proceedings because once approved and adopted by the affected persons, it is what is expected to deliver the 'second chance' to the company to trade out of its financial distress.[399]

The practitioner is not expected to prepare the plan on his or her own. The law clearly provides that the practitioner must prepare the plan after consulting with the creditors, other affected persons and the management of the company.[400] In *Hlumisa Investment Holdings (RF) Ltd and Another v Van der Merwe NO and Others,*[401] the court ruled on the requirement for consultation of affected persons during the preparation of the business rescue plan as anchored in section 150(1) of the Companies Act 2008. The applicants, who were holders of about five percent of the shares in African Bank Investment Limited, the company that had been placed under business rescue, argued that the Respondents, the joint business rescue practitioners, who had been appointed to manage the company, did not meaningfully consult with them during the preparation of the business rescue plan. Therefore, the applicants moved the court to suspend the holding of a meeting to consider the business rescue plan until after the business rescue practitioner had meaningfully consulted and provided them with the source documents, which they considered critical in the preparation of the business rescue plan.

Thobane J, ruled, *inter alia,* that it is clear from a simple reading of section 150(1) of the Companies Act 2008 that the applicants, being affected persons, had a right to be consulted during the preparation of the business rescue plan. The judge further noted

397 Section 135(4) of the Companies Act 2008; Cassim and others, *Contemporary Company Law* 884.
398 Section 140(1)*(d)*(i) of the Companies Act 2008.
399 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 497.
400 Section 150(1) of the Companies Act 2008.
401 Case no. 77351/2015 [2015] ZAGPPHC 1055.

that the respondents did not dispute that there was no consultation with the applicants as contemplated under section 150(1) of the Companies Act, but they insisted that they informed all creditors and shareholders of what was happening. The judge instructively stated:

> There is a clear distinction between informing and consulting. With regard to consulting, Rogers J had the following to say in *Scalabrini Centre Cape Town and Others v Minister of Home Affairs and Others* 2013 (3) SA 531(WCC), '… There are two points to emphasize from the cases; (a) At a substantive level, consultation entails a genuine invitation to give advice and a genuine receipt of that advice. (see *R v Secretary of State for Social Services, Ex parte Association of Metropolitan Authorities* [1986] 1 ALL ER 164(QB) at 167G-H; *Hayes and Another v Minister of Housing, Planning and Administration, Western Cape and Others* 1999 (4) SA 1229 (WC) at 1242C-F). Consultation is not to be treated perfunctorily or as a mere formality (*Port Louis Corporation v Attorney-General of Mauritius* [1965] AC 1111(PC) at 1124D-F). This means *inter alia* that engagement after the decision-maker has already reached his decision or once his mind has already become 'unduly fixed' is not compatible with true consultation (*Sinfield and Others v London Transport Executive* [1970] 2 All ER 264 (CA) at 269C-E). [b] At the procedural level, consultation may be conducted in any appropriate way determined by the decision-maker unless a procedure is laid down in the legislation. However, the procedure must be one which enables consultation in the substantive sense to occur. This means that sufficient information must be supplied to the consulted party to enable it to tender helpful advice; sufficient time must be given to the consulted party to enable it to provide such advice; and sufficient time must be available to allow the advice to be considered (*Association of Metropolitan Authorities supra* at 167H-J; *Hayes supra* at 1242C-1243B).[402]

As a result, the judge granted the application and postponed the holding of the meeting for consideration of the subject business plan until after the applicants had been sufficiently consulted and provided with the required information. Therefore, a practitioner should consult and share all the requisite information with the affected persons during the preparation and development of a business rescue plan. As a precursor to the distributions to creditors and shareholders under the business rescue plan, it is critical that proper and effective exchange of information occurs between the practitioner and the affected persons.[403]

In section 150(2) of the Companies Act 2008, the legislature clearly provided that the business rescue plan must contain all the information reasonably required to assist the affected persons to decide whether to accept or reject the business rescue plan.

402 *Hlumisa Investment Holdings (RF) Ltd and Another v Van der Merwe NO and Others* case no. 77351/2015 [2015] ZAGPPHC 1055 para 22.

403 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 498.

The law provides the minimum information that should be included in every business rescue plan.[404] This is intended to ensure that all the relevant information is included to enable the affected persons to make informed decisions before rejecting or approving the plan.[405]

The Companies Act 2008 clearly provides that the business rescue plan must be divided into three critical parts. Part A must include the Background details,[406] Part B, the proposals being made,[407] and Part C, the assumptions and conditions upon which the success of the plan is predicated.[408]

In Part A, the following background details must be included:

(i) A complete list of all the material assets of the company, as well as an indication as to which assets were held as security by creditors when the business rescue began;[409]

(ii) A complete list of creditors at the start of the business rescue, together with an indication as to which creditor would qualify as secured, statutory, and preferential or concurrent, and an indication of which of the creditors have proved their claims;[410]

(iii) The probable dividend that would be received by creditors in their specific classes, if the company were to be placed in liquidation;[411]

(iv) A complete list of the holders of the company's issued securities;[412]

(v) A copy of the written agreements concerning the remuneration of the practitioner;[413]
A statement whether the business rescue plan includes any proposal made informally by a creditor of the company.[414]

In Part B, the business rescue plan must contain the proposals and cover at least the following issues:

(i) The nature and duration of any moratorium for which the business plan makes provision;[415]

404 Section 150(2) of the Companies Act 2008.
405 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 498.
406 Section 150(2)*(a)* of the Companies Act 2008.
407 Section 150(2)*(b)* of the Companies Act 2008.
408 Section 150(2)*(c)* of the Companies Act 2008.
409 Section 150(2)*(a)*(i) of the Companies Act 2008.
410 Section 150(2)*(a)*(ii) of the Companies Act 2008.
411 Section 150(2)*(a)*(iii) of the Companies Act 2008.
412 Section 150(2)*(a)*(iv) of the Companies Act 2008.
413 Section 150(2)*(a)*(v) of the Companies Act 2008.
414 Section 150(2)*(a)*(vi) of the Companies Act 2008.
415 Section 150(2)*(b)*(i) of the Companies Act 2008.

(ii) The 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, or another company;[416]

(iii) The ongoing role of the company, and the treatment of any existing agreements;[417]

(iii) The property of the company that is to be available to pay creditors' claims in terms of the business rescue plan;[418]

(v) The order of preference in which the proceeds of property will be applied to pay creditors if the business rescue plan is adopted;[419]

(vi) The benefits of adopting the business rescue plan as opposed to the benefits that would be received by creditors if the company were to be placed in liquidation;[420] and

(vii) The effect that the business rescue plan will have on the holders of each class of the company's issued securities.[421]

Part C of the business rescue plan must provide for the assumptions and conditions, which must be fulfilled before the business plan can be implemented. This part must include the following key aspects:

(i) A statement of the conditions that must be satisfied, if any, for the business rescue plan to come into operation and be fully implemented;[422]

(ii) The effect, if any, that the business rescue plan contemplates on the number of employees, and their terms and conditions of employment;[423]

(iii) The circumstances in which the business rescue plan will end;[424] and

(iv) 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 business plan is adopted.[425]

The proposed business rescue plan must conclude with a certificate from the business rescue practitioner stating that the information provided appears to be true, accurate,

416 Section 150(2)*(c)*(iv) of the Companies Act 2008.
417 Section 150(2)*(b)*(iii) of the Companies Act 2008.
418 Section150(2)*(b)*(iv) of the Companies Act 2008.
419 Section150(2)*(b)*(v) of the Companies Act 2008.
420 Section 150(2)*(b)*(vi) of the Companies Act 2008.
421 Section 150(2)*(b)*(vii) of the Companies Act 2008.
422 Section 150(2)*(c)*(i) of the Companies Act 2008.
423 Section 150(2)*(c)*(ii) of the Companies Act 2008.
424 Section 150(2)*(c)*(iii) of the Companies Act 2008.
425 Section 150(2)*(c)*(iv) of the Companies Act 2008.

complete and up to date, and that the projections provided are estimates made in good faith based on information and assumptions set out in the statement.[426]

In accordance with section 150(5) of the Companies Act 2008, the business rescue plan must be published within a period of twenty five business days from the date of commencement of the business rescue proceedings, or any such longer time as may be approved by either the court or by a holder of the majority of the creditors' voting rights.

After preparing and publishing the business rescue plan, the business rescue practitioner must, within ten days from the date of publication of the plan, convene and preside over a meeting of creditors and any other holders of a voting interest in the company to consider the plan.[427] The practitioner must give notice of at least five business days to all affected persons eligible to attend and participate in the meeting.[428] The rationale for these timelines is to allow the affected persons sufficient time to prepare for the meeting, which, as accurately captured by the sub- title to section 151, is intended to 'determine the future of the company.'

At the meeting, section 152(1) of the Companies Act 2008 expressly mandates the business rescue practitioner to introduce the proposed business rescue plan for consideration by the creditors and, if applicable, by the shareholders of the company. The legislature went at length to specifically prescribe that at the meeting, the practitioner must:

> (a) Introduce the proposed business rescue plan for consideration by the creditors, and if applicable, by the shareholders;[429]
>
> (b) Inform the meeting whether the practitioner continues to believe that there is a reasonable prospect of the company being rescued;[430]
>
> (c) Provide an opportunity for the employees' representatives to address the meeting;[431]
>
> (d) Invite discussion, and entertain and conduct a vote, on any motions to (i) amend the proposed plan, in any manner moved and seconded by holders of creditors' voting interests, and satisfactory to the practitioner; or (ii) direct the

426 Section 150(4) of the Companies Act 2008.
427 Section 151(1) of the Companies Act 2008.
428 Section 151(2) of the Companies Act 2008.
429 Section 152(1)*(a)* of the Companies Act 2008.
430 Section 152(1)*(b)* of the Companies Act 2008.
431 Section 152(1)*(c)* of the Companies Act 2008.

practitioner to adjourn the meeting to revise the plan for further consideration;[432] and

(e) Call for a vote for preliminary approval of the proposed plan, as amended if applicable, unless the meeting has first been adjourned in accordance with paragraph (d)(ii).[433]

To be approved, the proposed business rescue plan must be supported by the holders of more than 75 percent of the creditors' voting interests that were voted and by at least 50 percent of the independent creditors' voting interest, if any, that were voted.[434]

In terms of section 152(4) of the Companies Act 2008, a business rescue plan that has been adopted is binding on the company, on each creditor and on every holder of securities of the company, whether or not that person was present at the meeting, voted in favour of the plan or, in the case of creditors, had proven his or her claim against the company, and the company, under the leadership of the business rescue practitioner, must work towards implementing the plan as adopted.[435]

Where the business rescue plan is not adopted as contemplated under section 152 of the Companies Act 2008, the legislature provided a detailed procedure under section 153 of the Companies Act 2008 to guide the parties as to what should happen. The general guidance being that the practitioner may attempt to seek a vote of approval from the relevant holders of voting interest in the company, and where this proves unworkable, the practitioner is obliged to advise the meeting of the option to apply to the court for an order to set aside the results of the vote by the holders of the voting interest or shareholders, on the ground that the vote was inappropriate.[436] Where the practitioner fails to take the requisite steps to get the approval, the law empowers any affected person present at the meeting to do so.[437]

Where all efforts by the practitioner and any other affected person to obtain approval of the business rescue plan fail, the practitioner is required to promptly file a notice of the termination of the business rescue proceedings.[438] This would certainly be an

432 Section 152(1)*(d)* of the Companies Act 2008.
433 Section 152(1)*(e)* of the Companies Act 2008.
434 Section 152(2) of the Companies Act; Cassim and others, *Contemporary Company Law* 906.
435 Section 152(4)–(5) of the Companies Act 2008.
436 Section 153(1) of the Companies Act 2008.
437 Section 153(2) of the Companies Act 2008.
438 Section 153(5) of the Companies Act 2008; Cassim and others, *Contemporary Company Law* 909.

unfortunate end to the rescue efforts and would trigger an application for the winding-up of the company by either the practitioner, a creditor, or the company itself.[439]

5.9 Strengths and weaknesses of the South African rescue framework

Considering the state in which the South African legal framework on corporate rescue was before 2008,[440] it would be dishonest for anyone not to acknowledge the plain truth that chapter 6 of the Companies Act reflects a vast improvement in the South African rescue framework.[441] There is overwhelming evidence that the provisions of chapter 6 of the Companies Act contain most of the internationally recognised salient features of an effective and modern corporate rescue framework.[442] This was a culmination of deliberate efforts by the government of South Africa to build on existing models from the developed economies such as the US, Canada, UK and Australia to give South African companies a refined legal framework that speaks to the local circumstances in the country. [443] But like all legal frameworks, some weaknesses have also been identified in the regime.

5.9.1 Strengths of the framework

At the risk of repeating what has already been discussed,[444]the following are some of the notable positive features or strengths of the South African rescue regime.

Ease of entry into rescue procedure is one of the key features for determining the adequacy of any rescue framework.[445] As has already been argued,[446] Chapter 6 provides a flexible procedure through which companies in financial distress can enter into business rescue. Entry can either be voluntary through a resolution passed by the directors[447] or compulsorily through a petition to court by any affected person.[448] This

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439 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 537.
440 See the discussion under 5.3.
441 Bradstreet 2010 *SA Merc LJ* 195.
442 See the discussion under 5.5; Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 554.
443 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 555.
444 See the discussion in 5.5 and 5.7.
445 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 555.
446 See the discussion under 5.5.2.
447 Section 129(1) of the Companies Act 2008.
448 Section 131(1) of the Companies Act 2008.

is a big strength in the South African rescue framework because the law opened the doors for eligible companies to enter into rescue without enduring a lot of procedural hurdles as was the case during the era of judicial management.[449]It is now easier for the company directors, upon realising that the company is financially distressed, to place it under business rescue at the earliest possible moment, which increases the chances for the rescue practitioner to succeed in resuscitating the company.

Section 133 of the Companies Act 2008 provides yet another strong feature about the South African regime. As was argued,[450] the moratorium enjoyed by companies during business rescue in South Africa is automatic and comes into force from the date of commencement of the rescue process.[451] This guarantees companies undergoing corporate rescue protection against disruptive proceedings by uncooperative third parties, which enables the business rescue expert to concentrate on measures to resuscitate the company and its business.[452]

Chapter 6 also adequately protects the rights of employees of companies undergoing business rescue.[453] Employees are recognised as the lifeblood of any business operations. The framers of the Companies Act 2008 made this very clear when they categorised employment contracts as essential for the success of the rescue efforts[454] and hence not open to the risk of termination or unilateral variation by the rescue practitioner.[455] In addition, employees are also statutorily recognised as affected persons, with a myriad of rights during rescue,[456] including the right to petition court to cause their employer to enter into business rescue[457] as well as participating in the development and consideration of the business rescue plan.[458]

The other strength of this procedure is that it provides a clear mechanism for discharging the company from all its pre-commencement debts after implementation of the business rescue plan.[459] This creates legal motivation to company directors to

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449 See the discussion under 5.3.1.
450 See the discussion in 5.5.4.1
451 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 565.
452 Cassim and others*, Contemporary Company Law* 879.
453 See the discussion in 5.5.4.2.
454 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 565.
455 Section 136(2)*(a)* of the Companies Act 2008.
456 See the discussion in 5.5.4.2.
457 *The Employees of Solar Spectrum Trading 83 (Pty) Ltd v Afgric Operations Ltd and Solar Spectrum Trading 83 (Pty) Ltd* [2012] ZAGPPHC 359.
458 Section 144(3) of the Companies Act 2008.
459 Section 152(4) of the Companies Act 2008.

look at rescue procedure as a truly redeeming process, which if well undertaken, can bring them total relief from the shock of debt enforcement. In addition, the provision creates an obligation on all company creditors to actively participate in the rescue process and cooperate with the rescue expert by ensuring that their claims and interests are well taken care of during the preparation, consideration and implementation of the business rescue plan.[460] For in terms of section 152(4) of the companies Act, once a business rescue plan is adopted and implemented, no pre-commencement creditor can be allowed to enforce their debt against the company. This was confirmed by Kgomo J in *Merchant West Working Capital Solutions (Pty) Limited v Advanced Technologies and Engineering Company (Pty) Limited and Another*[461] when he stated:

> The applicant admits that it is bound by the adopted business rescue plan. It has not disputed the applicability of section 152(4) of the Act. That being the case, I find that the applicant has no legal right or locus standi to request this court to order a relief that is in conflict with the business rescue plan. To do would in my considered view be rendering nugatory section 152(4) of the Act and thus the business rescue proceedings would also be rendered pointless.[462]

The recognition and provision of options for the business rescue practitioner to obtain rescue finance is yet another outstanding feature in the South African rescue regime.[463] Post-commencement finance is one of the most important aspects of business rescue proceedings.[464] By making it clear in section 135 of the Companies Act that the company may obtain financing during business rescue and that the funds obtained shall enjoy preferential ranking ahead of other creditors, the framers of the South African framework are commended for breathing life in the procedure.[465] It is argued that this provision allows the business rescue practitioner latitude to use the unencumbered assets of the company or if all are encumbered, to engage with existing creditors and persuade them to advance additional funds to oil the rescue efforts. This is resourceful to the practitioner in sourcing for funds to finance the continued

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460 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 538.
461 2013 JDR 1019 (GSJ) para 31.
462 *Merchant West Working Capital Solutions (Pty) Limited v Advanced Technologies and Engineering Company (Pty) Limited and Another* 2013 JDR 1019(GSJ) 31 para 74.
463 See the discussion under 5.7.
464 Cassim and others, *Contemporary Company Law* 882.
465 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 575.

operations of the company during rescue and minimise the risk of the proceedings suffering a preventable stillbirth.

The last notable strength in the South African regime is in the manner in which the law empowers the business rescue practitioner to cramdown on dissenting creditors during the process for consideration and approval of the business rescue plan.[466] Cramdown is the process by which creditors are forced to accept a reorganisation or business rescue plan, even against their wishes.[467]The right to cramdown dissenting creditors is recognised as a critical feature in any effective rescue framework, without which it becomes difficult for the rescue expert to overcome objections from selfishly uncooperative creditors, who may, for no collective objectives, choose to oppose the proposed business rescue plan.[468] Cramdown is said to have the incidental effect of discouraging creditors from resisting or holding out for better treatment and it allows the business rescue practitioner to obtain approval of the rescue plan even when the same is opposed by a few disgruntled creditors.[469]

Section 152(4) of the Companies Act in no uncertain terms provides that a business rescue plan that has been adopted by the creditors is binding on the company, on each creditor and every holder of securities of the company, whether such person was present at the meeting and voted in favour or against the adoption of the plan.[470]

5.9.2 Weaknesses of the rescue framework

As already argued,[471] the framers of Chapter 6 of the Companies Act 2008 did a commendable job in ensuring that the provisions contained therein reflect a deliberate attempt to ensure that the rescue framework contains all the critical features of an efficient and modern rescue system. This makes it extremely difficult for one to find any clear weakness in the law. However, some issues, which are presented below, could be improved upon to further engender the rescue culture in South Africa.

466 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 575.
467 Cassim and others, *Contemporary Company Law* 902.
468 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 575.
469 Cassim and others, *Contemporary Company Law* 902.
470 Cassim and others, *Contemporary Company Law* 902.
471 See the discussion under 5.5.

(a) **Lack of clarity on when the practitioner may re-appoint or delegate powers**

The Companies Act gives a lot of powers[472] to the business rescue practitioner[473] and whilst this might be seen as necessary for the proper execution of the rescue tasks, there are concerns that the law ought to have provided stronger safeguards against potential abuse of power by some business rescue practitioners.[474] For instance, the law widely empowers the business rescue practitioner to exercise full management control of the company in substitution for its board and the pre-existing management.[475] The law goes on to provide that the practitioner may delegate any of his or her power or function to any person who was part of the board or pre-existing management of the company.[476] The Act does not give any specific criteria or prescribe any circumstances under which the business rescue practitioner may exercise these powers and neither does it require the practitioner to exercise such powers in consultation with any other person.[477]

Whilst it is understood that the framers of the law must have done all this in good faith to give the practitioner wide discretion to enable him or her to independently manage the rescue process,[478] the manner in which the Act grants such broad powers to the practitioner may sometimes be counterproductive,[479] especially where the person appointed is not well experienced. Although the law provides sufficient measures to ensure that the person appointed to become a business rescue practitioner is not only a person with good character and integrity but also possessed with sufficient education and experience to handle the task at hand,[480] it is still possible that a practitioner may abuse his or her powers or functions and end up exposing the process to a risk of failure.

It is recommended that the powers of the practitioner to delegate his or her powers and functions to any person who was part of the board of the company or pre-existing

472 Section140 of the Companies Act 2008.
473 Mikovhe 2018 *Michigan BELR* 101, 117.
474 Mikovhe 2018 *Michigan BELR* 101, 117.
475 Section140 of the Companies Act 2008.
476 Section140(1)*(a)* and *(b)* of the Companies Act 2008.
477 Section 140(1)*(a)* and *(b)* of the Companies Act 2008.
478 See the discussion under 5.6.
479 Mikovhe 2018 *Michigan BELR* 101, 117.
480 Section138(1)*(a)–(f)* of the Companies Act 2008; Regulation 126(8) of the Companies Regulations 2011; See also discussion under 5.6.2.

management of the company should be better moderated by prescribing clear circumstances under which he or she may delegate his or her powers and functions to such otherwise conflicted persons. This is especially important considering that in circumstances where the company enters into business rescue voluntarily, it is the same directors and managers of the company who will have selected and appointed the business rescue practitioner. There is a risk that an unethical practitioner could make an unwritten deal with the company directors such that once he or she is appointed, the directors or management officers will be re-appointed back or delegated specific powers to continue running the company during the rescue process on specific terms and conditions. This might defeat the purpose for which the legislature included section 140(1)*(a)* into the Companies Act 2008 to provide that upon entry into business rescue, the practitioner assumes full management control of the company in substitution for its board and pre-exiting management.

One can argue that this risk is well taken care of by the already existing limitation in section 140(2) of the Companies Act, which requires the practitioner to first obtain court's approval before appointing a person as part of the management of the company or as an advisor to the practitioner, if that person has any other relationship with the company in such a way that would lead a reasonable person to conclude that the integrity, impartiality or objectivity of that person is compromised. However, this risk would be better managed if the law had clearly stated that being a board member or part of the pre-existing management of the company at the time entry into business rescue shall, *ipso facto*, render such a person related to the company and hence render his or appointment automatically subject to court's approval. Currently, it is not clear if every director or member of the pre-existing management of the company is deemed to be a related party and hence appointment or delegation of power to such a person is always subject to court's approval. It would be helpful to have a clear set of guidelines stipulating how the practitioner is expected to exercise his discretion to appoint or delegate his or her powers or functions during business rescue.[481]

This study recommends that consideration should be made to improve this provision by subjecting all appointments or delegation of power or function to any director or officer of the pre-existing management of the company by the practitioner to court's

[481] Bradstreet 2010 *SA Merc LJ* 212.

approval, the same way it is for persons related to the company.[482] This would cure this risk and further improve the process.

(b) **Ambiguity as to whether a corporate body can be appointed as a practitioner**

It was argued[483] that by section 138(1) of the Companies Act 2008 using the noun 'person' in the description of persons that are eligible for appointment as business rescue practitioners, the legislature created a possibility for a juristic person to be appointed as a business rescue practitioner in South Africa, since the statutory definition of a 'person' under the Companies Act includes both natural persons, legal persons and corporations.[484]

Considering the nature of roles, powers and functions exercised by a business rescue practitioner, it is inconceivable that a juristic person can serve as business rescue practitioner.[485] The practitioner is the central figure in galvanising the resuscitation of the financially distressed company,[486] and the success of any insolvency regime is heavily dependent on the abilities, skills and expertise of those who administer it.[487] Although some scholars[488] argue that there might be no practical problem if a company with well- qualified directors is appointed as a practitioner, since the directors would be able to execute the functions and duties of the practitioner for and on behalf of the company, this would present accountability challenges, since the companies Act bestows upon the practitioners specific duties, functions and powers which can only best be personally executed by the office holder and not by its officers.

The good thing is that the risk of having a juristic person appointed was substantially reduced when the Companies Regulations 2011 prescribed the qualifications which must be satisfied before one can be appointed as business rescue practitioner.

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482 Section 140(2) of the Companies Act 2008.
483 See the discussion under 5.6.2.
484 Section1 of the Companies Act 2008; Loubser, 'Some Comparative Aspects of Corporate Rescue in South African Company Law' 92.
485 See the discussion under 5.6.3.
486 Mpofu, Nwafor and Selala 2018 Corporate Board: Role, Duties and Composition 21.
487 Bradstreet 2010 SA Merc LJ 201; Keay and Walton, *Insolvency Law: Corporate and Personal* 35.
488 Mpofu and others 2018 *Corporate Board: Role, Duties and Composition* 21.

The foregoing notwithstanding, it is recommended that for avoidance of any doubt, this ambiguity should be completely removed by amending section 138 of the Companies Act by adding pronoun 'natural' before person. This will clearly exclude corporate bodies from the category of persons eligible for appointment as business rescue practitioners and end the diversionary debate on whether a corporate body can indeed discharge the roles, powers and ethical obligations of a business rescue practitioner, which for all intents and purposes can only best be assumed by a natural person and not a corporate soul.

(c) The fees charged are high

The general corpus of the rescue framework is bent on facilitating adequate remuneration of the business rescue practitioner and as was already noted,[489] the law adequately guides on how the practitioner's fees can be determined.[490] The Companies Regulation 2011 outlines the remuneration tariffs and fees which may be charged by practitioners.[491] However, the standard tariffs set out under the regulations are high and cannot be afforded by the Small and Medium Enterprises (SMEs).[492] Although the Company regulations tried to mitigate this risk by structuring the fees in such a way that the hourly rate payable depends on whether the company is a small, medium-sized or a large or state-owned company, it is argued that this did not solve this problem. The rates are still high for the SMEs.[493] For instance, under the Regulations, a business rescue practitioner is entitled to a maximum rate of USD 88 per hour to a maximum of USD 1,110.97 per day in case of a small company, USD 106.65 per hour, to a maximum of USD 1,333.16 per day in the case of a medium-sized company and a maximum rate of USD 142.20 per hour to a maximum of USD 1,777.55 per day in case of a large or state-owned company.[494]

Considering that SMEs are recognised as the lifeblood of the South African economy and the most at risk of financial distress,[495] with some of them having an average

489 See the discussion under 5.6.4.
490 Section 143 of the Companies Act.
491 Cassim *and others, Contemporary Company Law* 892.
492 Mikovhe 2018 *Michigan BELR* 101, 117.
493 *ibid.*
494 Mikovhe 2018 *Michigan BELR* 101, 117.
495 Shakeel K, Namfanelo M and Agesan R 'How South African SMEs can survive and thrive post COVID-19'

monthly turnover of less than US 1,130 per month,[496] it is beyond doubt that the standard tariffs set in the regulations are beyond the reach of most SMEs in South Africa. Moreover, SMEs across South Africa represent more than 98 percent of the businesses, employ between 50 to 60 percent of the country's workforce across all sectors and are estimated to be responsible for a quarter of the job growth in the private sector.[497]

Due to the high fees charged by business rescue practitioners, it is probable that many otherwise salvageable and useful SMEs are silently dying from preventable causes, just because they cannot afford the cost of entry into business rescue.

The study recommends that if the Companies Act is to achieve its objective of promoting the development of the South African economy by encouraging entrepreneurship and enterprise efficiency as well as reaffirm the concept of companies as a means of achieving economic and social benefits,[498] it is critical that the fees chargeable by business rescue practitioners, especially in respect of SMEs, should be further reduced below the current threshold to attract more financially distressed SMEs to embrace business rescue.

(d) Lack of clarity on how success is measured

According to reports from the Companies and Intellectual Property Commission (CIPC), from May 2011 when the Companies Act 2008 came into force up to 31st October 2020, 3,818 business rescue proceedings have been commenced in South Africa, of which 1,521 are said to be active, 446 entered liquidation, 297 were nullified, 28 were set aside, 675 substantially implemented and 851 terminated.[499] During the same period, May 2011 to October 2020, only 446 companies underwent

https://www.mckinsey.com/~/media/McKinsey/Featured%20Insights/Middle%20East%20and%20Africa/How%20South%20African%20SMEs%20can%20survive%20and%20thrive%20post%20COVID%2019/How-South-African-SMEs-can-survive-andthrive–_.–post–_.–COVID–_.–19.pdf (Date of use: 17 October 2021).

496 Mikovhe 2018 *Michigan Business and Entrepreneurial Law Review* 101, 117.

497 Shakeel K, Namfanelo M and Agesan R '*How South African SMEs can survive and thrive post COVID-19*' https://www.mckinsey.com/~/media/McKinsey/Featured%20Insights/Middle%20East%20and%20Africa/How%20South%20African%20SMEs%20can%20survive%20and%20thrive%20post%20COVID%2019/How-South-AfricanSMEscansurviveandthrivepostCOVID19.pdf (Date of use: 17th October 2021).

498 Section. 7*(b)* and *(d)* of the Companies Act 2008.

499 CIPC, 'Business Rescue Proceedings Status Report' (31 October 2020).

liquidation.[500] These figures confirm that business rescue has over the years been embraced as a better alternative procedure for dealing with financial distress in South Africa than liquidation. This is certainly a good trend.

Whilst the success of business rescue as a lifeline is important to virtually every stakeholder in the value chain, including employees, creditors, financiers and shareholders, it is still not clear how and when business rescue may be seen to be achieved.[501] There is an apparent lack of clarity on what constitutes a successful business rescue, and this continues to create uncertainty about the efficacy of the entire Chapter 6 of the Companies Act 2008.[502]

The framers of the law tried to focus business rescue procedure to facilitate the rehabilitation of a financially distressed company by either allowing the temporary supervision of the company to develop and implement a rescue plan that maximises the likelihood of the company continuing in existence on a solvent basis or, if that is not possible, to manage the affairs of the financially distressed company to achieve better returns for the company's creditors or shareholders than would result from the immediate liquidation of the company. However, the law does not sufficiently provide a criterion for measuring success on either of the alternative objectives.

This challenge is further compounded by the fact that whereas the Companies Act 2008 states that business rescue seeks to facilitate the rehabilitation of financially distressed companies, the omission to provide a clear definition of the word 'rehabilitation' in the law creates uncertainty in measuring success of rescue efforts, since different parties may have divergent views on what amounts to a successful rehabilitation of a company.

I recommend that a clear definition of what is meant by rehabilitation of financially distressed company should be provided and clear measures for determining success or failure of the rehabilitation proceedings should be incorporated in the law. This will eventually create certainty in the minds of users and might further create impetus for adoption of business rescue.

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500 CIPC, 'Business Rescue Proceedings Status Report' (31 October 2020).
501 Conradie and Lamprecht 2018 *SAJEMS* 1.
502 Conradie and Lamprecht 2018 *SAJEMS* 4.

(e) Exclusion of shareholders in approving voluntary entry into rescue

It has already been noted[503] that in terms of section 129(1) of the Companies Act 2008, the discretion to voluntarily place a company into business rescue is vested in the board of the company and in deciding to do so, the directors have no obligation to consult and/or obtain approval of the shareholders.

This approach must have been informed by the general belief that directors, more than shareholders, are usually the first to know when the company is in trouble. Therefore, it was important to empower them to decide to place the company under business rescue without necessarily having to obtain shareholder's approval, which could end up delaying the process.[504] Notwithstanding the benefits of easy and early entry into business rescue, authorising directors to make a resolution to commence business rescue without first obtaining shareholder's approval is a weakness in the South African rescue procedure.

A resolution for voluntary commencement of business rescue, if not well founded, can trigger an application by an affected person to court and have the company immediately placed under liquidation, especially where the company is proved to be insolvent with no reasonable chances of survival.[505]This can have far-reaching consequences on the company.[506]

From whichever angle one looks at it, placing a company under business rescue is apparently a major decision about the future of a company so much that fair business practice would require, as a matter of course, that no such decision is taken without prior notice and approval of the shareholders, who are the owners of company and hence the primary internal beneficiaries or losers of a successful or failed business rescue attempt, respectively. Whereas a successful rescue can potentially revive the value of shares held by the respective shareholders, the reverse is also true.[507] An unsuccessful attempt to place a company under business rescue can trigger its immediate liquidation, where an affected person, which includes a shareholder,[508]

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503 See the discussion under 5.5.2.1

504 Loubser, 'Some Comparative Aspects of Corporate Rescue in South African Company Law' 51.

505 Section130(5)*(c)*(i) of the Companies Act 2008; Cassim and others, *Contemporary Company Law* 872.

506 Watson and Cason 2016 Without Prejudice 4.

507 Loubser 2008 *SA Merc LJ* 372.

508 Section128(1)*(a)*(i) of the Companies Act 2008; Cassim and others, *Contemporary Company Law* 867

applies to court to set aside the resolution to voluntarily commence business rescue proceedings.[509]

The law should have provided a mechanism through which directors would first seek approval of the shareholders before passing a resolution to place a company under business rescue. This would go a long way in facilitating the achievement of the objective to nurture an efficient rescue of financially distressed business in a manner that balances the rights and interests of all stakeholders.[510]

In the current digital era, a general meeting to consider such urgent matters could even be convened virtually and the requisite approval granted electronically, which negates the fears that seeking shareholders' approval would cause unnecessary delays. This would significantly minimise the apparent shock that shareholders get when they receive notice of a decision by directors to place their company under business rescue, and the associated costs that shareholders end up enduring to challenge unjustified placement of their companies under business rescue by directors without their (shareholders') acquiescence.[511]

In *Griessel and Another v Lizemore and Others,*[512] the respondent passed a resolution on behalf of the board of directors placing the company under business rescue, without the knowledge and approval of the shareholders and his co-director. This was in spite of the co-director and shareholder having attended a meeting of shareholders three days before, where his fellow shareholders had rejected his proposal to place the company under business rescue. Lizemore's argument was that he did not have to notify the other shareholders of his intention to pass a director's resolution, since at that time, he was the sole director of the company and could, in accordance with section 129(1) of the Companies Act 2008, unilaterally resolve to begin business rescue proceedings. Lizemore's claim to be the sole director was premised on his failure to disclose to the applicant, Griessel that he (Lizemore) had refused to sign on the earlier member's resolution wherein Griessel had been appointed as a co-director in the company along with Lizemore. It became obvious in court that Lizemore was

509 Section130(1)*(a)* of the Companies Act 2008; *Finance factors CC v Jayesem (Pty) Ltd and 2 Others* 2013 ZAKZDHC 45.
510 Section7*(j)* of the Companies Act 2008.
511 *Griessel and Another v Lizemore and Others* 2015/24751[2015] ZAGPJHC 187.
512 *ibid.*

trying to use business rescue as a strategy for his own personal benefit and not the interest of the company or creditors.

While emphasizing the need for directors to exhibit good faith in their decision to place a company in business rescue, Splig J stated:

> The various requirements for placing a company under business rescue and when it will be taken out of business rescue presupposes, in the case of a director's resolution under section 129(1) that the resolution is taken in good faith. This arises from a number of considerations… the most obvious is the requirement that there must be a legitimate business purpose for resolving to place the company under business rescue…moreover a requirement of good faith is implicit in the scheme of Chapter 6 which seeks to balance the interest of affected parties including creditors and employees… In my view, bad faith will be demonstrated if, for instance, the intention of the directors in passing a section 129(1) resolution is found to be an abuse… [513]

To mitigate the above challenges, it is proposed that whereas the law authorises directors to pass a resolution for voluntary commencement of business rescue without obtaining shareholder's approval, it would be prudent for the board of directors, once it forms an opinion, on reasonable grounds, that the company is financially distressed, to first deliver a notice to shareholders as the primary internal stakeholders, informing them of the company's financial state before any resolution under section 129(1)*(a)* of the Companies Act 2008 is passed.

Once the shareholders are given prior notice, it is expected that the board would get a chance to gauge the feelings and comments of the shareholders on the options available to the company before any definitive decision is taken. This is certainly not to suggest that section 129 of the Companies Act 2008, in its current format, gives the shareholders any legal powers to direct the board as to whether to or not pass a resolution to place the company under business rescue. It is however argued that if this requirement can be added under the law, shareholders will be in a better position to guide the directors on the future of the company before a major decision like its placement under business rescue is made. This will minimise the need for shareholder(s) to again file an application to set aside the resolution for voluntary commencement under section 130(1)*(a)* of the Companies Act 2008, since they will have at least had prior opportunity to provide their input in the process.

513 *Griessel and Another v Lizemore and Others* 2015/24751[2015] ZAGPJHC 187 paras 82–84.

The foregoing argument is further fortified by the fact that section 129(7) of the Companies Act 2008 does not specifically state that the envisaged notice must be sent to all affected persons at the same time. Hence, the board can strategically choose to first give the notice to shareholders before sharing it with creditors and other affected persons.[514] Moreover, the law does not prescribe any sanction for directors not giving this notice,[515] which arguably means that even giving it to shareholders before other affected persons may not be fatal.

Since the placement of a company into business rescue is a serious decision about the life, future, and value of a company, and considering that shareholders, and not necessarily the directors, are the residual claimants of the assets of the company, it is recommended that consideration is made to amend the procedure in section 129 by making shareholders' approval a mandatory pre-condition before directors can cause the company to voluntarily commence business rescue proceedings.

5.10 Conclusion

This chapter commenced by tracing the history of corporate rescue in South Africa, noting that corporate rescue was first introduced in South Africa through the Companies Act of 1926, which ushered in judicial management.[516] Although judicial management was supposed to be a rescue procedure through which distressed companies could be saved from the perilous effects of liquidation, its efficacy as a rescue procedure remained questionable, even after several attempts to reform and improve it. A detailed analysis of judicial management exposes its weaknesses and shows why it was never embraced as an effective corporate rescue procedure.[517] Some of the factors which undermined the efficacy of judicial management as a corporate rescue procedure include over reliance on the court to determine applications for judicial management and the strict requirement for applicants for orders of judicial management to prove that there was a reasonable probability that

514 Section 128(1)*(a)* of the Companies Act 2008.
515 Cassim and others*, Contemporary Company Law* 869.
516 Loubser, 'Some Comparative Aspects of Corporate Rescue in South African Company Law' 139.
517 Discussed under 5.3–5.4.

the company would become a successful concern after undergoing judicial management and eventually settle the creditor's claims.[518]

The challenges of the judicial management procedure did not dampen the spirit of business rescue in South Africa. The Government pursued the reform processes that heralded the introduction of Chapter 6 in the Companies Act 2008, which sought to update and modernise the legal regime on corporate rescue in South Africa. The chapter analysed the key features of South Africa's business rescue procedure, including the definition of business rescue in section 128(1)*(b)* of the Companies Act 2008, the purposes and policy objectives, which revealed that this development was in line with the objective of the Companies Act 2008.[519]

During the business rescue proceedings, the Companies Act 2008 empowers different stakeholders to exercise control over the rescue proceedings, through determining who is appointed to become the business rescue practitioner, as well as participating in the preparation of the business rescue plan. It has been argued that save for the limited involvement of shareholders in the decision to voluntarily place financially distressed companies under business rescue,[520]Chapter 6 sufficiently preserves the rights of employees, creditors, and directors of the company during the rescue process, thereby rendering chapter 6 of the Companies Act 2008 largely an inclusive corporate rescue procedure.[521]

The Companies Act 2008 embodies many of the features of an effective rescue regime, by giving companies in rescue an automatic moratorium against legal proceedings.[522] This allows the practitioner to effectively take charge of the company without disruption from claimants. Similarly, the Companies Act 2008 allows the business rescue practitioner to use the unencumbered assets of the company[523]as security to obtain capital to fund the rescue activities. The Companies Act 2008 also prescribes clear qualifications for any person to be appointed as a business rescue practitioner.[524] This protects the integrity of the regime and minimises the risk

518 Discussed under 5.3–5.4.
519 Section 7*(k)* of the Companies Act 2008.
520 See discussion under 5.9.2(e).
521 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 551.
522 Section 133 of the Companies Act 2008.
523 Section 135 of the Companies Act 2008.
524 Section 138 of the Companies Act 2008.

associated with inept persons taking over the management and control of frail companies during business rescue.

The chapter also examined the process for the development of a business rescue plan, and how the law empowers the practitioner, in consultation with other affected persons, to ensure that the rescue plan can heal the company of its financial distress. The Companies Act 2008 provides clear rules on how a business plan should be considered by the affected parties, including a possibility for cramming down on dissenting creditors.[525]

The chapter concludes with a discussion on the strengths and weaknesses of the South African rescue framework. It observes that although chapter 6 of the Companies Act 2008 significantly improved the rescue framework in South Africa, some legislative loopholes, which need to be reformed to fully realise the innumerable benefits of corporate rescue, exist.

The discussion in this chapter has painted a clear picture of the state of the legal and regulatory framework on corporate rescue in South Africa, including the areas for possible improvement. The chapter has provided the requisite context to the next chapter on the analysis of Uganda's corporate rescue framework in comparison to the South African regime.

525 Neil, *Turnaround Management and Corporate Renewal: A South African Perspective* 140.

CHAPTER SIX
ANALYSIS OF UGANDA'S CORPORATE RESCUE REGIME

6.1 Introduction

This chapter presents an analysis of the law on corporate rescue in Uganda. The chapter commences with an account of the development of corporate rescue in Uganda, which focuses on both the informal rescue mechanisms under the Companies Act 1 of 2012[1] (the Companies Act 2012) and the formal corporate rescue procedures under the Insolvency Act 14 of 2011[2] (the Insolvency Act 2011). It will be argued that although the Insolvency Act 2011 introduced administration as the primary formal corporate rescue procedure in Uganda, the Companies Act 2012 also retained a window for other informal rescue procedures such as compromises and arrangements, so much so that even after the coming into force of the Insolvency Act 2011 on 1 July 2013,[3] the informal procedures under the Companies Act 2012 still continue to play a complimentary role in rescue processes in Uganda.

The chapter observes that the informal rescue measures are largely contractual in nature,[4]and their successful implementation depends on the affected company's ability to persuade its creditors and directors to contractually agree on positions that may be deemed necessary for purposes of improving the company's financial situation.[5]

The discussion advances into a detailed analysis of the formal corporate rescue procedures under the Insolvency Act 2011.[6] This entails a structured discussion of the provisions of the Insolvency Act 2011 and the Insolvency Regulations 35 of 2013 (the Regulations) on both provisional administration and administration procedures, including the commencement procedure, the duties and functions of both the provisional administrator and the administrator as well as the effects of both provisional administration and administration on the company, directors, shareholders, creditors and employees.

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1 See the discussion under 6.3.
2 This is discussed under 6.4.
3 The Insolvency Act 2011 (Commencement) Instrument 25 of 2013.
4 Nyakairu and Kakongi, 'Uganda: A 101 Guide to Insolvency and Business Rescue in Uganda' https://www.mondaq.com/insolvencybankruptcy/973362/a-101guidetoinsolvencyandbusinessrescueinuganda (Date of use 11 April 2021) 1.
5 Nerima *Uganda Insolvency Law Handbook* 56.
6 See the discussion under 6.4.

The chapter also highlights the weaknesses of Uganda's corporate rescue procedure,[7] and includes a comparative analysis of the Ugandan legal regime with that of South African corporate rescue[8] as set out in Chapter 5. Despite the attempt by the Government of Uganda to reform the Insolvency law regime in Uganda through the enactment of the Insolvency Act 2011, the chapter points out that the framers of the law did not adequately capture the salient stimulants for a successful corporate rescue framework.[9] It also examines the weaknesses associated with administration that have rendered it unattractive both to the ailing companies and their creditors, thereby accounting for its dismal use as a viable rescue procedure for the financially distressed companies in Uganda.[10]

The identified weakness of the Ugandan regime shall form part of the research findings which will guide the discussions on the recommendations in Chapter 8.

6.2 Overview of the Legal regime on corporate rescue in Uganda

As was previously alluded to, Uganda's legal regime is largely benchmarked on the English Common law system.[11] This is primarily attributed to Uganda's inescapable historical ties to its former colonial masters, the British, and the general laxity by the Government of Uganda[12] just like most post-colonial African Governments, to break away from the colonial dogmas and develop their own laws to suit their unique socio-economic circumstances.[13]

Fortunately, in 1996, the Government of Uganda, through the Uganda Law Reform Commission(ULRC) took up the task and embarked on the implementation of the Commercial Justice Reform Program (the CJRP), which sought to put in place legal and policy measures to support the private sector to operate efficiently within an environment in which both commercial transactions and commercial justice are

7 This is discussed under 6.7.
8 See the discussion under 6.7.
9 This is discussed under 6.7.
10 See the discussion under 6.7
11 See the discussion in 3.2.1.
12 Bakibinga, *Companies Law in Uganda* 3.
13 Settles 'The Impact of Colonialism on African Economic Development' (1996) University of Tennesse Honors Thesis Project 13.

respected.[14] The CJRP team and the Uganda Law Reform Commission undertook a comprehensive study on Company law and eventually issued the *Uganda Law Reform Commission (ULRC) Study Report on Company Law*,[15] which formed the basis for the subsequent drafting and enactment of the Companies Act 2012. During 2004, the ULRC issued yet another very important report entitled *A study report on Insolvency Law*,[16] which contains the source material that was used for the Insolvency Bill, which later metamorphosed into the Insolvency Act 2011.

Both the Companies Act 2012 and the Insolvency Act 2011 contain provisions that seek to increase the survival rate of companies in financial distress.[17] However, whilst the procedures on arrangement, reconstruction, restructuring and compromises which are contained in the Companies Act 2012[18] provide an avenue for companies faced with financial challenges to negotiate and agree with their creditors, and possibly wiggle out of their financial dilemmas, these measures are largely informal and hinged on voluntary approval by the concerned parties.[19] They are not strictly recognised as corporate rescue procedures. However, for the sake of completeness of the discussion on the legal landscape on corporate rescue in Uganda, these informal rescue procedures will be briefly highlighted.[20]

On the flipside, the Insolvency Act 2011, which is the primary law on insolvency proceedings in Uganda, makes extensive provision for provisional administration and administration as the formal corporate rescue procedures in Uganda.[21] As this is the bedrock of this chapter, the pros and cons of these procedures are set out and their functional efficacy and deficiencies as corporate rescue procedures in Uganda are assessed.[22]

14 Uganda Law Reform Commission, *Study Report on Company Law* ULRC Publication No.35 (2004) xiii.
15 *ibid*.
16 Uganda Law Reform Commission, *Study Report on Insolvency Law* ULRC Publication No.13 (2004).
17 Nyombi, Kibandama and Bakibinga 2014 *JBL* 652–653.
18 Sections 234–236 of the Companies Act 2012.
19 Nyakairu and Kakongi, 'Uganda: A 101 Guide to Insolvency and Business Rescue in Uganda. Available at 'https://www.mondaq.com/insolvencybankruptcy/973362/a-101-guide-to-insolvency-and-business-rescue-in-uganda (Date of use: 11 April 2021).
20 See the discussion in 6.2.1.
21 Part VI of the Insolvency Act 2011.
22 See the discussion under 6.7.

6.3 Informal corporate rescue procedure

As mentioned,[23] corporate rescue entails any major intervention necessary to avert the eventual failure of a company.[24] The intervention may be informal or formal,[25] so long as it can give the ailing company a new lease of life, beyond the normal managerial or operational processes.[26]

Due to the rigidity that is often associated with pursuing formal processes, business expedience may sometimes necessitate the use of unconventional approaches to achieve the desired objective. This also applies to corporate rescue. Although the Insolvency Act 2011 provides for provisional administration and administration as the formal corporate rescue procedures for financially distressed companies in Uganda, the players often resort to informal rescue procedures, outside of the mainstream Insolvency law framework, to address their corporate challenges.[27] It is reported that for most troubled companies, entering formal insolvency procedure is a course of last resort, only pursued when informal strategies have been exhausted and proven ineffective.[28]

Informal corporate rescue procedures may be broadly defined as measures which a company faced with imminent financial distress may institute outside the often rigid, lengthy, and time-consuming formal statutory insolvency processes, to achieve a flexible opportunity to resolve its troubles.[29] Informal rescue measures are usually employed during the early stages of corporate failure and are normally undocumented.

Informal rescue measures are often not expressly provided for in the extant legislation but are resorted to as a matter of exigency to resolve financial distress.[30] Informal rescues commonly involve informal negotiations between the debtor and the creditors

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23 See the discussion in 4.2.
24 Belcher, *Corporate Rescue* 12; Finch 2010 *JBL* 502; Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 197.
25 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 199.
26 Finch, *Corporate Insolvency Law* 243; Shadman 2015 *The Northern University Journal of Law* 57, 59.
27 Nyakairu and Kakongi, 'Uganda: A 101 Guide to Insolvency and Business Rescue in Uganda' 1. Available at https://www.mondaq.com/insolvencybankruptcy/973362/a-101-guide-to-insolvency-and-business-rescue-in-uganda (Date of use 11 April 2021).
28 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 244.
29 Chidi and Babalola 2019 Nigeria Redeemer's *University Law Journal* 445, 450.
30 *ibid*.

on an individual basis; however, known models for collective informal procedures exist, such as the London Approach,[31] which has been widely recognised as having enabled notable informal workouts.[32]

The informality of these procedures however accounts for the dearth of authority and statistics on their use of informal corporate rescue measures in Uganda. It is however a known fact that before most companies resort to formal rescue procedures, they will have first attempted to informally engage their creditors, bankers and/or shareholders through one of the informal rescue measures discussed below.

6.3.1 Contractual or out-of-court restructuring

This measure involves changing the composition and structure of the asset and debt portfolio of a company to minimise risk and optimise its performance.[33] Out-of-court debt restructuring involves changing the composition and/or the structure of the assets and liabilities of the company in financial difficulty, without resorting to a full judicial intervention with the objective of promoting efficient restoration of growth and minimise the costs associated with the debtor's financial difficulties.[34] Restructuring activities may include measures that restructure the debtor's business operations, also referred to as 'operational restructuring', and measures that seek to restructure the debtor's finances, also referred to as 'financial restructuring'.[35]

This informal procedure is usually commenced when the directors of the company in financial distress, upon recognising that the company is faced with a serious problem, reach out to its stakeholders, mainly the creditors, and mutually discuss measures through which they can amicably agree to achieve a win-win solution for both parties.[36] The procedure helps the company to conserve its business value while preserving the

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31 The 'London Approach' is a non-statutory and informal framework that was introduced in the 1970s in London, with the support of the Bank of England, to provide a mechanism through which distressed entities and their creditors can resolve their interests through voluntary cooperation and coordination between the lenders and the borrowers, without having to resort to formal or statutory procedures- see Bo *Comparative Insolvency Law: The pre-pack Approach in corporate Rescue* 23.

32 Too 2019/2020 *African Journal of Commercial Law* 24.

33 Nerima, *Uganda Insolvency Law Handbook* 55.

34 Garrido, 'Out-of- Court Debt Restructuring A World Bank Study' 1.

35 *ibid;* Nerima, *Uganda Insolvency Law Handbook* 55.

36 Too 2019/2020 *African Journal of Commercial Law* 27.

interests of its stakeholders, including the general body of creditors, shareholders, employees and the community.[37]

In most cases, once a company openly seeks support from its stakeholders at an early stage, an agreement can be reached on how to deal with the challenge at hand. The creditors and the debtor may, for instance, agree to enter into a restructuring plan or work out an arrangement through which the immediate cause of the company's troubles may be safely addressed before it is too late.[38]

Using this approach, companies faced with imminent financial distress usually enter into agreements with their creditors, wherein the parties agree to reschedule the debt/loan obligations, change the maturity dates for the most burdensome debt instruments(roll-over), alter interest rates, abandon default penalties, waive interest or even agree on debt-equity swaps.[39] These kind of negotiations and agreements often happen informally between lenders and borrowers; although the discussions are largely contractual, they are very much encouraged by governments and the sector regulators.[40]

For instance, following the outbreak of the global COVID-19 pandemic, on 14 April 2020, the Bank of Uganda, the regulator of the financial and banking sector in Uganda, issued guidelines on credit relief and loan restructuring measures for all supervised financial institutions during the COVID-19 pandemic,[41]entitled 'Guidelines on Credit Relief and loan restructuring measures for supervised financial institutions (SFI) during the COVID-19 pandemic'. The key objectives of the credit relief measures were twofold: (i) to enable borrowers to cope with the adverse impact of the COVID-19 pandemic on their ability to repay loans; and (ii) to mitigate the risks that may be faced

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37 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 244.

38 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 244; Omar 2005 Corporate Rescue 251.

39 Nerima, *Uganda Insolvency Law Handbook* 56.

40 Too 2019/2020 *African Journal of Commercial Law* 25; Armour and Deakin, 'Norms in Private Bankruptcy: The 'London Approach' to the Resolution of Financial Distress' (2000) University of Cambridge ESRC Working Paper No 173. Available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=258615..

41 Guidelines on Credit Relief and loan restructuring measures for supervised financial institutions (SFI) during the COVID19 pandemic. Bank of Uganda Circular No. DGv.121 dated 14 April 2020. Available at https://sb4uplatform.com/wpcontent/uploads/2020/05/BOUGuidelinesonCreditReliefandLoanRestructuring.pdf. (Date of use: 25 January 2021).

by lenders because of their borrowers' failure to honour their loan obligations due to the COVID-19 pandemic.[42]

The guidelines allowed supervised financial institutions to restructure borrowers' loans for periods of up to twelve months. The Central Bank also required financial institutions to suspend the insistence on payment of arrears as a pre-condition for loan restructuring. The Bank also granted exceptional permission to provide loan repayment moratoriums to borrowers affected by the COVID-19 pandemic.[43]

In September 2020, the Bank of Uganda reported that 893,018 applications had been approved by financial and credit institutions in Uganda.[44] During his appearance before the Budget Committee of Parliament on 25 January 2021, Uganda's Minister of Finance, Planning and Economic Development, Hon. Matia Kasaija, stated that loans worth seven trillion Ugandan shillings (approximately 28 Million South African Rand) had been rescheduled by commercial banks as a result of the adverse effects of COVID-19 on businesses in Uganda.[45]

Informal as these loan restructurings might have been, arguably, if it were not for such administrative interventions, many of the affected borrowers could have defaulted on their loan obligations, which could have triggered a wide range of debt recovery proceedings, such as foreclosures and sale of company assets and eventually accelerated their forced journey to insolvency and possibly liquidation.

Restructuring may also entail the ailing company making hard operational decisions, such as the disposal of some of its less strategic business assets to raise new funds

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[42] Mugume A 'BOU Advertorial on CR Measures to Safeguard FS and Cushion against EI of COVID-19' Published on 25 May 2020. Available at Bou.or.ug/bou/bouwebsite/bouwebsitecontent/MediaCenter/press_releases/2020/May/BoUAdvertorial_CRMeasures-toSafeguardFSandCushionagainstEIofCOVID19.

[43] Guidelines on Credit Relief and loan restructuring measures for supervised financial institutions (SFI) during the COVID-19 pandemic. Bank of Uganda Circular No. DGv.121 dated 14th April 2020Available at https://sb4uplatform.com/wpcontent/uploads/2020/05/BOU-–Guidelines-on-Credit-Relief-and-Loan-Re-structuring.pdf. (Date of use: 25 January 2021) 1.

[44] *The Daily Monitor* 7 September 2020 'All banks have restructured loans apart from one-BOU'. Available at https://www.monitor.co.ug/uganda/business/finance/al-banks-have-restructured-loans-apart-from-one-bou-1934486 (Date of use: 18 January 2021).

[45] Karugaba 2021 New Vision 11.

to support short term liquidity pressures or even hive down some of its business units, in consideration for cash.[46]

Although there are no official reports about how many companies utilise these informal approaches to prolong their corporate life in Uganda, undoubtedly companies utilise these options to avoid insolvency and the formal proceedings. However, for these measures to be viably implemented, companies must reach out to their creditors, lenders, and other stakeholders at the earliest possible moment to discuss practical ways through which they can address their debt or liquidity-related concerns.[47]

Informal workouts are encouraged because they are negotiated and concluded without strict formality. This ensures flexibility and ease of adaption to the specific needs of the debtor.[48] For example, if the cause of financial distress was imminent failure to honour a loan repayment schedule, and the company approaches the bank long before the loan goes into arrears, the bank can easily approve a request for a loan reschedule or even consider approving a top-up loan to the borrower to help it fund its other pressing financial needs.[49]

Secondly, informal workouts usually happen before default has occurred; they are negotiated among parties that have a history of mutual business relationship. This makes it easy for the parties to negotiate the arrangement with less suspicion and without involving third parties like lawyers or external debt collectors, which minimises costs and time spent during the negotiation for say, an instalment payment agreement or a loan reschedule.[50] Similarly, negotiating a settlement deal at an early stage using the informal approaches saves the debtor from the risks associated with bad publicity that usually characterises formal insolvency proceedings.[51]

6.3.2 Compromises or arrangements

A company that is faced with imminent risk of financial distress may pursue a compromise or an arrangement with its creditors or shareholders or members to

46 Nerima, *Uganda Insolvency Law Handbook* 56.
47 Nerima, *Uganda Insolvency Law Handbook* 56.
48 Garrido, 'Out-of-Court Debt Restructuring; A World Bank Study' (2012) 9.
49 *ibid*.
50 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 244.
51 *ibid.*

manage its financial or structural challenges.[52] A compromise is a debtor's partial payment coupled with the creditor's promise not to claim the rest of the amount due or claimed.[53] An arrangement, on the other hand, is a debtor's agreement with creditors for the settlement, satisfaction or extension of time for payment of a debt.[54] An arrangement, also referred to as a scheme of arrangement in some jurisdictions such as England,[55] may include a reorganisation of the share capital of a company by the consolidation of shares of different classes or by the division of shares into different classes.[56] Arrangements may also be used to effect compromises and moratoria with creditors, or restructure debts owed to any class of creditors.[57]

In Uganda, compromises and arrangements are a historical Company law procedure that was introduced through the Companies Act Cap 110, as a formal alternative procedure to winding up or liquidation of financially distressed companies.[58] The provisions on compromises and arrangements under the Companies Act Cap 110 were the same as what was contained in the English Companies Act of 1948, which was the blueprint for Uganda Companies Act Cap 110.[59]

It was mentioned previously[60] that the procedure through which any proposed compromise or arrangement could be pursued under section 207 of the Companies Act Cap 110 was cumbersome.[61] There is no record that it was ever used to rescue any company in Uganda for the over 30 years while the Companies Act Cap 110 was in force.[62] One of the probable reasons why arrangements and compositions remained unattractive under the Companies Act Cap 110 was because no provision was made for a moratorium against legal proceedings against the company during this procedure.[63]

52 Section 234 of the Companies Act 2012.
53 Garner, *Black's Law Dictionary* 326.
54 Garner, *Black's Law Dictionary* 123.
55 Section 895 of the UK Companies Act 2006; Finch and Milman, *Corporate Insolvency Perspectives and Principles* 409.
56 Finch and Milman, *Corporate Insolvency Perspectives and Principles* 410.
57 *ibid.*
58 Section 207 of the Companies Act Cap 110 of 1961.
59 Bakibinga, *Companies Law in Uganda* 3.
60 See the discussion in 4.2.
61 Uganda Law Reform Commission Report (2004) 14.
62 *ibid.*
63 Uganda Law Reform Commission Report (2004) 14.

The above practical limitations notwithstanding, compromises and arrangements are generally recognised as an avenue through which a company and its creditors can enter into an informal deed, agreement or compromise, under which the company can agree to pay its creditors portions of the debt over an agreed period.[64]This, arguably, explains why, in spite of its unattractiveness, the framers of the Companies Act 2012 found it necessary to retain this procedure as one of the options available to a company faced with financial distress in Uganda.[65] It is expected that in an appropriate case, instead of a company enduring liquidation or winding up proceedings, or the rigorous corporate rescue proceedings under the Insolvency Act 2011 such as administration, a company can manage its financial challenges by entering into an arrangement or a compromise with its creditors.

Compromises and arrangements are regarded as an informal rescue procedure because by their very nature, they are supposed to be pursued informally through commercial negotiations. They entail contractual acceptance between the company and its creditors, with court only getting involved to guide on the procedure for convening the meeting and to validate what the parties have mutually agreed upon.[66]

Section 234(2) of the Companies Act 2012 specifically provides that before a compromise or arrangement can be deemed binding on creditors other than those that directly negotiated and signed the compromise or arrangement, or if it is to have any effects on the rights of any debenture holder,[67] the court must sanction it.[68]

It is not automatic that when the application is made to the court, the proposed compromise or arrangement will be approved. The court must be satisfied that the proposed compromise or arrangement is reasonable and fair. The compromise or arrangement must also adequately ensure that no minority group is disregarded by the majority, that each class of creditors is reasonably represented in the meeting, that the majority who voted in favour of the compromise acted in good faith, that the

64 Omar and Gant 2016 *Insolvency Law Journal* 43.
65 Section 234 of the Companies Act 2012.
66 *ibid.*
67 Section 235(2) of the Companies Act 2012.
68 Nerima, *Uganda Insolvency Law Handbook* 59.

procedure followed before the adoption of the arrangement was proper and that the requisite notices were sent out to all parties entitled to receive such notices.[69]

In the English case of *Cape Plc and Others, Re Companies Act 1985*,[70] Justice David Richards held:

> The function of the court in considering whether to exercise its discretion to sanction a scheme of arrangement is summarised in the often-cited passage from Buckley on Companies Act (14th ed pp 473-474), which is derived from the judgment of the Court of Appeal in *In re Alabama, New Orleans, Texas and Pacific Junction Railway Co* [1891] 1 Ch 213 and *In re English, Scottish and Australian Chartered Bank* [1893] 3 Ch 385:
>
> 'in exercising its power of sanction the court will see, first, that the provisions of the statute have been complied with, second that the class was fairly represented by those who attended the meeting and that the statutory majority are acting bona fide and are not coercing the minority in order to promote interests adverse to those of the class whom they purport to represent, and thirdly, that the arrangement is such as an intelligent and honest man, a member of the class concerned and acting in respect of his interest, might reasonably approve.
>
> The court does not sit merely to see that the majority are acting bona fide and thereupon to register the decision of the meeting, but, at the same, the court will be slow to differ from the meeting, unless either the class has not been properly consulted, or the meeting has not considered the matter with a view to the interests of the class which it is empowered to bind, or some blot is found in the scheme'.[71]

Court will not simply sanction any arrangement placed before it.[72] However, once the court sanctions the arrangement or compromise, it becomes binding on all creditors, or the class of creditors, or the members, or class of members as the case may be, and the company or the liquidator and contributories.[73]

In Uganda, there is unfortunately no record of any compromise or arrangement that has been attempted or achieved.[74] This is probably because of the cumbersome approval procedure, which significantly waters down the informality otherwise expected in this procedure.

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69 *ibid*; *Re Alabama, New Orleans, Texas and Pacific Junction Rly Co* (1891) 1 Ch. D 213.
70 [2006] EWHC 1446.
71 *Cape Plc and Others, Re Companies Act 1985* [2006] EWHC 1446 (Ch) para 8.
72 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 411; *Re Indah Kiat International Finance* [2016] EWHC 246.
73 *ibid.*
74 Nerima, *Uganda Insolvency Law Handbook* 60.

It is argued that if the government is indeed committed to engendering the use of informal rescue procedure in Uganda, outside the formal insolvency procedures, deliberate measures must be taken to remove the existing procedural roadblocks to the negotiation and approval of compromises and arrangements. Considering that compromises and arrangement are purely commercial dealings involving parties with capacity to contract with the aid of their professional advisors, the law should be flexible enough to allow companies to engage, negotiate and contractually agree with their stakeholders, including creditors and members, on workable compromises and arrangement that may be deemed capable of facilitating recovery of the company from its troubles without enduring the often-costly court processes. This is especially important because compromises and arrangements are not entirely restricted to the already insolvent companies.[75] For purposes of transparency and accountability to the public, the law can retain a requirement for the company, after entering any such arrangements or compromises, to file a report or a copy of the agreement with the company's registry in accordance with the existing filing obligations and procedures under the Companies Act 2012.

If compromises and arrangements are to be made attractive as an informal and contractual based procedure, the existing procedure must be relaxed by removing the requirement for the court to prescribe hard rules for convening creditors' meetings or even sanctioning the actual compromise or arrangement. The fairness that court is expected to bring into the procedure should be left as a residual remedy of recourse, which any affected party can resort to in accordance with the already existing ordinary civil dispute resolution mechanism.[76] The Constitution of the Republic of Uganda already provides that the High Court shall have unlimited original jurisdiction in all matters,[77] and under the Judicature Act[78] and the Civil Procedure Act,[79] there are already well-defined windows for any person who might be aggrieved in the process of negotiating a compromise or arrangement to seek for redress from the court.

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75 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 412–413.
76 The Civil Procedure Code Act Cap 71; The Civil Procedure Rules SI 71-1.
77 Article 131(1) of the Constitution of Uganda 1995.
78 Cap 13 of the Laws of Uganda.
79 Cap 71 of the Laws of Uganda.

Lessons can be learnt from the approach that was adopted in section 155 of the South African Companies Act 71 of 2008. The lawmakers removed the mandatory requirement for court to approve and prescribe the procedure for convening of the creditors meeting to consider a proposed compromise or arrangement[80] and sanctioning of the compromise or arrangement approved by the creditors or members,[81] the same way it is currently provided for under Uganda's Companies Act 2012.[82] The framers of the South African Companies Act 71 of 2008 only retained the requirement for the company to give notice of the proposed arrangement or compromise to every creditor or member of the company[83] and the Companies and Intellectual Property Commission (the CIPC),[84] which is the equivalent to the Uganda Registration Services Bureau (the URSB). Although section 155(7) of the South African Companies Act 2008 retained the requirement for the company to apply for a court order to sanction the proposed compromise or arrangement, this requirement is not mandatory.[85] Where the creditors or members unanimously approve the proposed compromise or arrangement, no court sanction is necessary.[86]

This study recommends that in Uganda, the court's involvement should either be completely removed, except where one of the affected parties feels unfairly treated, or provision should be relaxed to only leave court with the residual power to sanction the compromise or arrangement in special circumstances where not all creditors and/or members approve the transaction. Additionally, considering the formality with which compromises and arrangements go through before they are approved by the creditors or members as the case may be, it would be necessary to provide some tangible incentive to companies that subject themselves to these procedures, by for instance affording them benefits such as a moratorium against legal proceedings during the period of implementation of the approved schedule of settlement or implementation of the terms and conditions of the compromise or arrangement. This

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80 Section 311(1) of the Companies Act 61 of 1973.
81 Section 311(2) of the Companies Act 61 of 1973.
82 Section 234(2) of the Companies Act 2012.
83 Section 155(2)*(a)* of the Companies Act 2008.
84 Section 155(2)*(b)* of the Companies Act2008.
85 Section 155(7)(a) of the Companies Act 2008.
86 Section 155(8) of the Companies Act 2008; Kastrinou and Jacobs 'Pre-insolvency procedures: A United Kingdom and South African perspective' in Parry and Omar (eds) *Reimagining Rescue*. INSOL Europe, Nottingham, 107.

will go a long way in attracting companies and creditors to embrace compromises and arrangements, before resorting to the formal rescue procedures.

6.4 Formal corporate rescue under the Insolvency Act 2011

As already observed,[87] one of the prominent policy objectives behind the reformation of Insolvency law in Uganda was the need to promulgate a new law on insolvency that goes beyond merely amending and patching up the existing law. The goal was to come up with a new law that seek to inherently engender the rehabilitation, as opposed to punishment and stigmatisation of insolvent companies.[88]This policy objective was achieved when Parliament introduced specific procedures on corporate rescue, notably provisional administration and administration into the Insolvency Act 2011.[89] These procedures are the primary statutory alternative remedies to liquidation of insolvent companies in Uganda.[90] Unlike the informal procedures that can be resorted to by the company and creditors without necessarily involving the court, the corporate rescue procedures under the Insolvency Act 2011 are pursued through formal proceedings. This process is discussed below.

6.4.1 Provisional administration

Provisional administration is a corporate rescue procedure through which a financially distressed company agrees to reach a settlement with its creditors, and appoints an independent person referred to as a provisional administrator, to temporarily take over the management of the company to see it through its financial challenges.

As its name suggests, provisional administration is a temporary procedure; it is designed to hold a business together while plans are made either to put in place a financial restructuring plan to rescue the company or to sell the business and its assets to produce a better result to creditors than through a liquidation.[91] Provisional administration is one of the procedures that was introduced by the Government of

87 See the discussion in 3.2.3.
88 Uganda Law Reform Commission Report (2004) 9.
89 Sections 138–174 of the Insolvency Act 2011.
90 Nyombi, Kibandama and Bakibinga 2014 *JB*L 659.
91 Per Mubiru J in *Uganda Telecom Limited v Ondoma Samuel t/a Alaka and Company Advocates* High Court Misc. Application No.0012 of 2018.

Uganda in the Insolvency Act 2011, as an alternative route through which financially distressed companies can resolve their challenges, without necessarily resorting to liquidation and winding up.[92]

There is a dearth of literature about the history of provisional administration in Uganda. Even the Uganda Law Reform Commission study report on Insolvency law 2004, which contained the initial recommendations that formed the basis for the Insolvency Bill 2004, is silent on the policy objective behind the introduction of provisional administration in Uganda's corporate insolvency regime.[93]

It is, however, clear that provisional administration was one of the proposals in clauses 146–168 of the Insolvency Bill 2004.[94] Provisional administration was designed to be the primary route through which companies seeking to enter into administration must first undergo for a limited period, in anticipation that upon convincing its creditors about its debt settlement proposal and potential for survival, the creditors will approve its rescue plan and allow it to enter full administration. After implementation of the agreed debt settlement plan as captured in the administration deed, the company would survive and possibly be handed back to its owners.

There is no documented account of what transpired in Parliament during the discussion and debate prior to the passing of the Insolvency Bill 2004, but what is apparent is that the 9th Parliament of Uganda approved the Insolvency Bill 2004 in its original form. On the 23 September 2011, the Insolvency Act was published in the Uganda Gazette as the Insolvency Act no. 14 of 2011. In accordance with section 1 of the Insolvency Act 2011, on 21 June 2013, the Hon. Minister of Justice and Constitutional Affairs, issued a statutory instrument[95], which indicated 1 July 2013 as the date when the Insolvency Act 2011 would come into force. It has since been in force without any amendment.

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92 Nyombi, Kibandama and Bakibinga, 2014 JBL 660.

93 *Uganda Law Reform Commission Report* (2004), Available at https://www.ulrc.go.ug/sites/default/files/ulrc_resources/Insolvency%20Law%20%20body_0.pdf .(Date of use: 12 April 2021).

94 Uganda Law Reform Commission Report (2004) annex 1 53–156. Available at https://www.ulrc.go.ug/sites/default/files/ulrc_resources/Insolvency%20Law%20%20body_0.pdf (Date of use: 12 April 2021).

95 The Insolvency Act 2011 (Commencement) Instrument 25 of 2013.

Part VI of the Insolvency Act 2011 provides for administration in respect of companies. Sections 139 to 161 of the Insolvency Act 2011 contain provisions on provisional administration. In *Uganda Telecom Limited v Ondoma Samuel t/a Alaka and Company Advocates*[96] Mubiru J of the High Court of Uganda summarised the import of provisional administration when he instructively held:

> Under section 140 of the Insolvency Act 2011, it is evident that provisional administration is a rescue mechanism for insolvent companies which allows them to carry on running their business in order to stabilize the company's position and maximise its chances of continuing in business as an alternative to liquidation or a precursor to it. A company seeks provisional administration with the aim of; ensuring its survival and the whole or any part of its undertaking as a going concern or securing a more advantageous realisation of its assets than would be effected in a liquidation. The procedure is designed primarily to deal with situations where there is an urgent need to protect the value of a business from enforcement action by unpaid creditors. It is designed to forestall action or obtain moratorium by having an administrator appointed. If, however, it is not possible for the company and its business to continue in existence, the administrator's task is to ensure a better return for the company's creditors and members than would result from an immediate winding up of the company.[97]

Provisional administration can be referred to as a rescue mechanism by which a company can forestall its slide into receivership or liquidation[98] by agreeing to settle all the creditors' claims and ceding its management powers into the hands of a provisional administrator, specifically appointed to drive the rescue agenda.

It is, however, important to note that not every company is eligible to enter into provisional administration. A company must satisfy certain conditions before it can be eligible to commence provisional administration proceedings. First, the company must have reason(s) to believe that it is or will be unable to pay its debts within the meaning of section 3 of the Insolvency Act 2011.[99] As noted earlier,[100] section 3 of the Insolvency Act 2011 provides that a company is presumed to be unable to pay its debts if it has failed to comply with a statutory demand,[101] if execution proceedings against the company in respect of a judgment debt has been returned unsatisfied in

96 High Court Misc. Application No.0012 of 2018.

97 *Uganda Telecom Limited v Ondoma Samuel t/a Alaka and Company Advocates* High Court Misc. Application No.0012 of 2018 para 1.

98 Nerima, *Insolvency Law Handbook* 60.

99 Section 139(2) of the Insolvency Act 2011.

100 See the discussion under 3.3.

101 Section 139(1)*(a)* of the Insolvency Act 2011.

whole or in part,[102] or if all or substantially all the property of the company are in the possession or control of a receiver or some other person enforcing a charge over the company property.[103]

Unless a company can demonstrate that it is faced with actual or imminent risk of inability to pay its debts or of insolvency as it is broadly referred to, it is not eligible to pursue provisional administration. This is precisely because by its very nature, provisional administration is a rescue procedure meant to facilitate the diagnosis, treatment, and recovery of companies with symptoms of sickness and not for use by healthy companies. Hence, just like doctors do not treat healthy human beings without any known ailment, a financially healthy company with no signs and symptoms of financial difficulty or distress cannot enter provisional administration.

Secondly, before a company can appoint a provisional administrator, it must acknowledge its debts and pass a special resolution agreeing to make a settlement with its creditors.[104] This is a critical step because it enables the company to own up to its failings by acknowledging its indebtedness and committing to enter into a settlement with its creditors.[105] This gives the creditors confidence that the company is not just using provisional administration as a tactic to evade its responsibility, but it is rather done as a necessary vehicle to facilitate its orderly reorganisation, restructuring and recalibration with the hope that it will regain its normalcy and capacity to pay its debts and resume usual operations.

6.4.2 Appointment of the provisional administrator

A provisional administrator of a company is appointed by means of a special resolution of the board.[106] Before the board of directors can exercise its powers to appoint a provisional administrator, the company must first, by special resolution, agree that the company needs to make a settlement with all its creditors.[107]

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102 Section 139(1)*(b)* of the Insolvency Act 2011.
103 Section 139(1)*(c)* of the Insolvency Act 2011.
104 Section 139(3) of the Insolvency Act 2011.
105 *ibid.*
106 Section 139(1) of the Insolvency Act 2011.
107 Section 139(3) of the Insolvency Act 2011.

According to the Companies Act 2012, a company resolution is said to be a special resolution when it has been passed by a majority of not less than three-fourths of its members entitled to vote in person or where proxies are allowed, by proxy, at a general meeting of which notice specifying the intention to propose the resolution as a special resolution has been duly given.[108] A company is supposed to give its members at least 21 days' notice before convening a meeting.[109] In some circumstances, it is permissible for such meetings to be held at shorter notice. For example, an annual general meeting requires all the members entitled to vote at such annual general meeting to agree to any reduced notice period. In the case of any other meeting, where a majority of the members holding not less than 95 percent in nominal value of the shares, approval of holding of such a meeting can be at shorter notice.[110]

In Uganda, unlike in South Africa,[111] a decision to place a company under provisional administration must first be considered and approved by a majority of the company members and not just the directors.[112] The members must, by a special resolution, agree that the company needs to make a settlement with its creditors before they can authorise the directors to appoint a provisional administrator.[113]

It is important to note that the law requires the members of the company to agree that the company needs to reach a settlement, and not just to make an undertaking that the company will make a settlement with its creditors. This arguably means that it suffices if the members recognise the need to pay the debts, although they may not necessarily have the capacity to pay the debts at the time of confirming their need to make a settlement. Therefore, right from the start, companies are supposed to resort to provisional administration not as a ploy to defeat their creditors' actions, but rather as a necessary procedure to facilitate the realisation of the members' intention or commitment to settle the company creditors' claims. The record must show that provisional administration is intended to be used as a vehicle to enable the company

108 Section 148(1) of the Companies Act 2012.
109 Section 140(1) of the Companies Act 2012.
110 Section 140(4) of the Companies Act 2012.
111 See the discussion in 5.5.2.1.
112 Section 139(3) of the Insolvency Act 2011.
113 *ibid*.

to achieve a better return to the creditors, and not merely to help the company to achieve an objective which may be adverse to the interests of the creditors.

In terms of section 139(1) of the Insolvency Act 2011, after the members have passed the requisite special resolution to authorise the placement of the company under provisional administration, the board of directors must also proceed to convene a board meeting and pass a special resolution to appoint a specific person to become a provisional administrator for the company. While exercising its discretion to appoint a provisional administrator, the board must ensure that the person appointed is eligible to act as an insolvency practitioner in Uganda.[114] A person is not eligible to be appointed to act as an insolvency practitioner, which includes a provisional administrator,[115] unless he or she is a lawyer, an accountant or a chartered secretary who is a registered member of the relevant professional body and he or she has offered adequate security or professional indemnity for the proper performance of his or her duties as an insolvency practitioner in Uganda.[116]

In addition, the board must satisfy itself that at the time when the appointment of a provisional administrator is made, the company has not gone into liquidation.[117] In terms of section 93(2) of the Insolvency Act 2011, liquidation of a company is taken to commence at the time of presentation of the petition for liquidation, even if no actual order of liquidation has been made by court. In this regard, it is crucial for the directors to undertake a preliminary assessment to confirm that no liquidation petition for the winding up of the company has been filed in a competent court of law in Uganda against the company before appointing a provisional administrator.

6.4.3 Commencement of provisional administration

After the company has agreed to make a settlement with its creditors and the board appointing a provisional administrator, the law provides that the company must petition the court for an interim order before provisional administration commences.[118] The

114 Section 204 of the Insolvency Act 2011.
115 Section 203(1)*(b)* of the Insolvency Act 2011.
116 Section 204 of the Insolvency Act 2011; reg 200 of the Regulations.
117 Section 139(5) of the Insolvency Act 2011.
118 Section 139(4) of the Insolvency Act 2011.

appointment of a provisional administrator only takes effect after the interim protective order has been made by the court.[119]

Regulation 135 of the Regulations prescribes in detail the form and procedure to be followed while making the petition for an interim protective order. The petition must be made to the High Court[120] within fourteen working days from the date when the board of directors passes a special resolution to enter into a settlement with its creditors and appoints a provisional administrator.[121] The petition must contain the following minimum details:

(a) A statement by the petitioner on whether the company is or is likely to be unable to pay its debts and justification for the belief;[122]
(b) A statement of the assets and liabilities of the company;[123]
(c) The name of the shareholders and contributories of the company;[124] and
(d) A statement of the company's solvency, details of any prior professional relationship that the proposed provisional administrator has had with the company to which he or she is appointed as provisional administrator.[125]

The Regulations[126] further provide that the petition shall be accompanied with the following mandatory requirements:

(a) A special resolution filed with the registrar of companies mandating the company to make a settlement with creditors and appointing a provisional administrator;[127]
(b) Proof that the proposed provisional administrator is willing to act as a provisional administrator for the company;[128]
(c) The proposed settlement and a report of the provisional administrator on the proposed settlement;[129] and

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119 Section 142(1) of the Insolvency Act 2011.
120 In terms of s 254 of the Insolvency Act 2011, only the High Court has jurisdiction to entertain matters concerning companies.
121 Regulation 135(1) of the Regulations.
122 Regulation 135(2)*(a)* of the Regulations.
123 Regulation 135(2)*(b)* of the Regulations.
124 Regulation 135(2)*(c)* of the Regulations.
125 Regulation 135(2)*(d)* of the Regulations.
126 Regulation 135(3) of the Regulations.
127 Regulation 135(3)*(a)* of the Regulations.
128 Regulation 135(3)*(b)* of the Regulations.
129 Regulation 135(3)*(c)* of the Regulations.

(d) Audited accounts of the company for the year preceding the petition.[130]

The petition must be supported by an affidavit sworn by a director, secretary, or other principal officer of the company. It must contain statements verifying the facts in the petition including a statement regarding the company's financial position, pointing to the fact that the company is or is likely to become unable to pay its debts. It must also contain a confirmation that the company has agreed to a settlement with its creditors and of any other matter which, in the opinion of the company, will assist the court in deciding to make the order.[131]

The court determines the petition based on the strength of the information disclosed in the petition and the affidavit presented by the petitioning company.[132] The company should clearly demonstrate and furnish the court with all relevant information showing how the proposed provisional administration will assist the company to achieve its survival and the whole or any of its undertakings as a going concern or a more advantageous realisation of the company's assets than would be achieved in a liquidation.[133]

A petition for an interim protective order must be served on some stakeholders. They include a receiver of any of the property of the company, if one has been appointed; any provisional liquidator of the company where there are pending winding-up or liquidation proceedings; and/or the person appointed as a provisional administrator or any other person who, and to the knowledge of the petitioner, has distrained against the company or any of its assets.[134] Moreover, at the hearing of the petition, any director of the company, a person on whom the petition was served, and with the permission of court, any other person who may appear to have an interest in the company or the petition, may be allowed to appear.[135] This leaves the window wide open for any interested party to appear and either support or oppose the petition for an interim order, including creditors. The law further allows any person who was

130 Regulation 135(3)*(d)* of the Regulations.
131 Regulation 136 of the Regulations.
132 *Deox Tibeingana v Vijay Reddy* High Court Misc. Case No. 286 of 2019 5.
133 Section 140(1)*(b)* of the Insolvency Act 2011.
134 Regulation 137 of the Regulations.
135 Regulation 138 of the Regulations.

served with the petition or who was granted leave to appear in the proceedings, to file his or her affidavit and forward evidence as he or she may deem necessary to back his or her support or opposition to the petition.[136]

The court then proceeds to hear and determine the application for an interim order inter parties, based on the facts, the law and on the strength of the evidence provided by the parties. It is not automatic that the court will always grant an application for an interim protective order and allow the company to commence provisional administration.[137]The company must convincingly demonstrate to court that the decision to place the company under provisional administration is made in good faith and for the benefit of the general body of creditors, otherwise the court may decline to grant the order.[138]

As was noted by Ssekaana J in a personal insolvency case, *Deox Tibeingana v Vijay Reddy,*[139] an interim protective order is issued on concrete grounds of the debtor making a meaningful arrangement with his or her creditors. The court further referred with approval to the earlier holding by Madrama J in the case of *In the Matter of Maria K. Mutesi, Bankruptcy Petition No. 5 of 2011* that:

> proceedings in bankruptcy are meant to compulsorily administer a person's estate for the benefit of his or her creditors generally. The primary objective of bankruptcy law is to administer the estate of an insolvent so as to enable him or her pay his or her debts. The law facilitates a fair and equal distribution of available property of the petitioner among the creditors. Secondly, the object of the law is to free the debtor of his or her debts in order that the debtor may make a fresh start as soon as the debtor is discharged by the court. Thirdly, bankruptcy proceedings enable the court and the official receiver and the creditors as well to establish the reasons of the insolvency of the debtor and presumably deter people from rashly incurring debts which they are unable or unwilling to pay.[140]

In this case, the applicant, Deox Tibeingana, an advocate of the High Court in Uganda, applied for an interim protective order to forestall enforcement proceedings that had been instituted against him by the respondent, who was his former client. By the time the application was filed in court, the respondent had obtained a warrant of arrest against the applicant for the recovery of a judgment debt of over USD 250,000. In his

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136 Regulations 139 and 142 of the Regulations.
137 *Deox Tibeingana v Vijay Reddy* High Court Misc. Case No. 286 of 2019 5.
138 *ibid.*
139 High Court Misc. Case No. 286 of 2019.
140 High Court Misc. Case No. 286 of 2019, 5.

application, the applicant stated that he had enough resources, assets and capacity to pay all his creditors and remain afloat but needed time of about six months to reorganise his business and to dispose of his assets at market value without pressure and interruption from his creditors.[141] The respondent vehemently opposed the application on the grounds that the application lacked merit and was a nullity in law as far as the applicant did not show to the court a list of his creditors, the amounts he owed them and the property or business streams from which he intended to generate the money he intended to use in settling the respective debtors' claims during the period of the arrangement.[142]

In dismissing the application, Ssekaana J held, *inter alia*, that considering that an interim protective order can afford a debtor a certain amount of freedom, including the suspension of the creditors' right to commence or continue enforcing any legal and execution proceedings against the debtor and his or her property, except with leave of the court, an undeserved application should be disallowed at once if it is obvious that the motive is to attain a collateral objective of granting protection to an undeserving debtor.[143] He emphasised that the court must always remember that an interim order is not an end to itself and before granting it, the court must be satisfied that it will facilitate the consideration and implementation of the debtors' proposed arrangement.[144]

Therefore, provisional administration is not a viable option for a company that has already crossed the red line and has become hopelessly insolvent, without any tangible plan to fix its problems and settle its creditor's claims. Companies should consider provisional administration at the earliest possible moment, otherwise the court may not grant the interim protective order, if doing so might be helping an undeserving company to forestall its creditor's debt enforcement actions.[145]

Once the court grants the application for the interim protective order, provisional administration of the company shall be deemed to commence immediately, and the

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141 *Deox Tibeingana v Vijay Reddy* High Court Misc. Case No. 286 of 2019, 2.
142 *Deox Tibeingana v Vijay Reddy* High Court Misc. Case No. 286 of 2019, 4.
143 *Deox Tibeingana v Vijay Reddy* High Court Misc. case no. 286 of 2019, 7–8.
144 *Deox Tibeingana v Vijay Reddy* High Court Misc. case no. 286 of 2019, 7–8.
145 *Deox Tibeingana v Vijay Reddy* High Court Misc. cause no. 286 of 2019, 7–8.

provisional administrator must lodge a copy of his or her appointment and a copy of his or her consent to act as such with the official receiver and the registrar of companies.[146] Thereafter, the company will be deemed to be officially under provisional administration.[147]

The provisional administrator must call a creditors' meeting within five working days from the date of commencement of the provisional administration.[148] The provisional administrator must ensure that within that period, a public notice is published and that each known creditor of the company receives an individual written notice of not less than two working days indicating the date of the commencement of the provisional administration, the provisional administrator's full name, his or her physical address and day-time telephone number.[149]

At the company creditors' meeting, the creditors may, by a majority resolution, remove the provisional administrator appointed by the company from office and in lieu thereof appoint another person of their choice to become the provisional administrator and shall on the day of his or her appointment, give notice of his or her appointment to the court, the registrar of companies and the official receiver.[150] This shows that whilst the decision to place a company under provisional administration is vested solely in the company members, the decision to appoint and name a provisional administrator is in the hands of the company's board of directors. Provisional administration only commences after the court has made an interim protective order, but the creditors have the last say over who eventually becomes the provisional administrator. If the creditors are not comfortable with the person appointed by the company and approved by the court, section 146(4) of the Insolvency Act 2011 gives the creditors a right of veto to remove such provisional administrator and in lieu thereof to appoint their own preferred insolvency practitioner to oversee the provisional administration. Arguably, this is a good safety control that allows the creditors to determine who superintends over the provisional administration.

146 Section 142(2) of the Insolvency Act 2011.
147 Section 142(1) of the Insolvency Act 2011.
148 Section 146(1) of the Insolvency Act 2011.
149 Section 146(2) of the Insolvency Act 2011.
150 Section 146(4) of the Insolvency Act 2011.

6.4.4 Legal consequences of provisional administration

Like all other rescue procedures, provisional administration is intended to provide an ailing company with breathing space to achieve a turnaround or structured exit. It is designed to hold a business together while plans are formulated either to put in place a financial restructuring plan to rescue the company or to sell the business and/or its assets to produce a better result for the creditors than a liquidation.[151]

To achieve this objective within the limited period of provisional administration, the commencement of provisional administration naturally triggers a wide range of changes in the company and affects the rights of its stakeholders.

First, provisional administration suspends the exercise of powers, duties and functions by the company, its directors and secretary[152] and in lieu thereof, vests all such powers, functions and duties into the hands of the person appointed as a provisional administrator.[153] As the person entrusted with the legal mandate to steer the ailing company out of its financial distress, the provisional administrator must assess the operations of the company and its business. If he or she finds that certain functions, powers or duties can best be undertaken by the company or any of its directors or secretary, he or she may authorise the execution of such function, power or duty by the company, director or secretary.[154]

The suspension of the company directors' powers and duties during provisional administration is premised on the general belief that the company and its directors are usually responsible for its financial challenges,[155] and should as such give way to the impartial insolvency practitioner to take charge of the management of the company.

In the performance of his or her duties, the provisional administrator is empowered to carry on the company's business and to manage its property and affairs.[156] He or she

151 Per Musa Ssekaana J in the matter of *Sunshine Agro Products Limited* Misc. Application No. 344 of 2019, 5.
152 Section 155(1) of the Insolvency Act 2011.
153 Section 153(1) of the Insolvency Act 2011.
154 Section 153(1) of the Insolvency Act 2011.
155 Farrar JH, 2001 *Canterbury LR* 99.
156 Section153(1)*(a)* of the Insolvency Act 2011.

is mandated to perform any function and to exercise any power that the company or any of its directors or secretary would perform or exercise if the company was not in provisional administration.[157] He or she has the power to change the company's registered office or registered postal address,[158] to remove from office a director of the company,[159] to appoint a person as director, whether to fill a vacancy or not,[160] and to call any meeting of the shareholders or creditors of the company.[161]

Secondly, the commencement of provisional administration imposes a general freeze (a moratorium) on all legal and enforcement actions against the company and its property.[162] The moratorium is intended to provide breathing space to the provisional administrator to concentrate on discharging his or her mandate to achieve the purpose of provisional administration without having to constantly fend off court battles or individual creditor's demands.[163] Specifically, section 143(1)*(e)* and (f) of the Insolvency Act 2011 instructively provides that during provisional administration:

> (e) A receiver of any property of the company shall not be appointed; and
> (f) Except with the provisional administrator's written consent or with the leave of the court and in accordance with such terms and the court may impose-
> (i) Steps shall not be taken to enforce any charge over any of the company's property;
> (ii) Proceedings, execution or other legal process shall not be commenced or continued and distress shall not be levied against the company or its property; and
> (iii) No other transaction shall be carried out in respect of any registered or unregistered property of the company.

It is apparent that provisional administration immunizes the company from literally all forms of enforcement actions and proceedings, including the enforcement of any security interest or right under hire purchase, retention of title and chattel leasing agreements.[164] Secured creditors and other claimants can only commence their enforcement or recovery actions either with approval of the provisional administrator or with leave of the court.[165] Considering the transitory nature of provisional

157 Section 153(1)(b) of the Insolvency Act 2011.
158 Section 153(1)(c) of the Insolvency Act 2011.
159 Section 153(1)(d) of the Insolvency Act 2011.
160 Section 153(1)(e) of the Insolvency Act 2011.
161 Section 153(1)(f) of the Insolvency Act 2011.
162 Nyombi, Kibandama and Bakibinga 2014 *JBL* 660.
163 *ibid.*
164 Nyombi, Kibandama and Bakibinga 2014 *JBL* 660.
165 Section 143(1)(f) of the Insolvency Act 2011.

administration, it is unlikely that any claimant, secured or otherwise, can reasonably obtain the requisite approval from the provisional administrator or leave from the court during provisional administration.[166]

While providing guidance on the extent of the moratorium provided to companies during provisional administration in *Uganda Telecom Limited v Ondoma Samuel t/a Alaka and Company Advocates*,[167] Mubiru J of the High Court of Uganda held:

> Therefore, according to section 143(1)(f)(ii) of the Act, provisional administration puts an immediate ring fence around the company and its assets so that no creditor can start or continue any action to recover their debt. Except with the provisional administrator's written consent or with the leave of court and in accordance with such terms as the court may impose, proceedings, executions or other legal processes cannot be commenced or continued, and distress cannot be levied against the company or its property.[168]

The moratorium provided during provisional administration is to be only an interim and temporary regime, intended to facilitate the creation of breathing space while the company, under new management of the provisional administrator, seeks to achieve any of the purposes of provisional administration.[169] The moratorium on the enforcement of debts and rights, proprietary or otherwise, against the company is necessary so as to give the provisional administrator time to formulate proposals and lay them before the creditors for consideration and approval.[170] This issue is discussed again under the section on adequacy of the moratorium provided to companies in administration.[171]

6.4.5 Duties and powers of a provisional administrator

The commencement of provisional administration automatically shifts the control and management powers in the company and its property from the company directors to the provisional administrator.[172] This is intended to assist the provisional administrator

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166 Goode, *Principles of Corporate Insolvency Law* 441.
167 High Court Misc. Application No.0012 of 2018.
168 *Uganda Telecom Limited v Ondoma Samuel t/a Alaka and Company Advocates* High Court Misc. Application No.0012 of 2018 paras 15–20.
169 Section 140 of the Insolvency Act 2011.
170 Per Nicholls LJ in *Atlantic Computer Systems Plc* [1992] Ch 504 para 30.
171 See the discussion in 6.5.2(b).
172 Section 141(a) of the Insolvency Act 2011.

to effectively undertake a diagnostic review of the state of affairs in the company and make a well-informed proposal for consideration by the creditors.[173]

As the principal role player in the rescue efforts during provisional administration, the Insolvency Act 2011 prescribes two broad categories of duties for a provisional administrator, namely fundamental duties[174] and general duties.[175] It is assumed that duties which the framers of the law categorised as fundamental represent the core roles and functions, which every provisional administrator must primarily focus on before paying attention to the general duties.

Section 140(1) of the Insolvency Act 2011 provides that the fundamental duties of a provisional administrator are as follows.

> (a) To investigate the company's business, property, affairs and financial circumstances; and
> (b) To exercise his or her powers in a manner which he or she believes on reasonable grounds to be likely to achieve one or more of the following outcomes-
> (i) The survival of the company and the whole or any part of its undertaking as a going concern;
> (ii) The approval of an administration deed under section 150; and
> (iii) A more advantageous realisation of the company's assets than would be effected in a liquidation.

These duties bolster the argument that provisional administration was primarily incorporated under the Insolvency Act 2011 as a rescue procedure to be used by companies to find solutions to their financial challenges and to possibly prolong their corporate life. Where this is not possible, the purpose of provisional administration, just like business rescue procedure in South Africa,[176] is to facilitate a more beneficial disposal of the irredeemable company's assets for the general benefit of its creditors than through outright liquidation.[177]

Section 141 of the Insolvency Act 2011 provides that without prejudice to section 140 of the Insolvency Act 2011, which provides for the fundamental duties of the

173 Nyombi, Kibandama and Bakibinga 2014 *JBL* 660.
174 Section 140(1) of the Insolvency Act 2011.
175 Section 141 of the Insolvency Act 2011.
176 Section 128(1)(b)(iii) of the Companies Act 2008.
177 Section 140(1)(b)(iii) of the Insolvency Act 2011; Nyombi, Kibandama and Bakibinga 2014 JBL 660.

provisional administrator, a provisional administrator shall perform other functions and duties specified in the legislation, which include to:

> (a) Take custody and control of all the property to which the company appears to be entitled.
> (b) Keep company money separate from other money held by or under the control of the provisional administrator.
> (c) Keep, in accordance with the generally accepted accounting procedures and standards, full accounts and other records of all receipts, expenditure and other transactions relating to the company and retain the accounts and records for not less than six years after the administration ends.

The Insolvency Act 2011[178] further bestows upon the provisional administrator a wide range of powers intended to facilitate effective and seamless performance of his or her statutory duties. Section 153(1) of the Insolvency Act 2011 lucidly provides that a provisional administrator may, in the performance of his or her duties:

> (a) Carry on the company's business and manage the company's property and affairs.
> (b) Perform any function and exercise any power that the company or any of its directors or secretary would perform or exercise if the company was not in provisional administration.
> (c) Change the company's registered office or registered postal address.
> (d) Remove from office a director of the company.
> (e) Appoint a person as director, whether to fill a vacancy or not; and
> (f) Call any meeting of the shareholders or creditors of the company.

In addition, the law expressly provides that in the exercise of his or her powers, a provisional administrator is deemed to act as a company's agent, with full powers to represent the company in any negotiations and to commit the company in legal transactions.[179]

Whilst it is commendable that the law clothed the provisional administrator with all these duties and powers, it is implied that he or she must use these powers to aid the management of the company with the objective of facilitating the attainment of the objectives of provisional administration;[180] to rescue the company as a going concern, or the approval of an administration deed or the attainment of a better return for

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178 Section 153 of the Insolvency Act 2011.
179 Section 153(2) of the Insolvency Act 2011.
180 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 315.

creditors.[181] Moreover, as an appointee of the court and by necessary implication an officer of the court, the provisional administrator must act in good faith, with impartiality, loyalty and he or she must not act dishonourably or unfairly.[182] Failure by the provisional administrator to discharge his or her duties or to exercise his or her powers in accordance with the professional standard expected of a reasonable provisional administrator[183] may be a ground upon which the court may grant any appropriate orders against the provisional administrator, including an order for his or her removal from office.[184]

6.4.6 The provisional administrator's proposal as a key deliverable

By its very nature, provisional administration was created to be a transitory procedure. It is intended to allow the provisional administrator a limited period of time, not exceeding thirty days[185] to complete an investigation into the company's business, property, affairs and financial circumstances and produce a report with proposals to be considered by creditors.[186] The provisional administrator must call and convene a creditors' meeting to consider his or her investigation report and the resultant proposals within not more than ten working days from the date of commencement of the provisional administration.[187]

Whether or not the time given to a provisional administrator to undertake all these tasks is enough is certainly open to debate. The framers of the law recognised that this period may not always be enough and made explicit provision for a possibility for the provisional administrator, in exceptional circumstances, to apply to the court for extension of time beyond the statutory thirty days and/or to extend the period within which the provisional administrator may present his or her proposal to the creditors for consideration.[188]

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181 Section 140(1)*(b)* of the Insolvency Act 14 of 2011; Nyombi, Kibandama and Bakibinga 2014 *JBL* 660.
182 Finch and Milman *Corporate Insolvency; Perspectives and Principles* 316.
183 *African Banking Corporation of Botswana Ltd v Kariba Furniture Manufacturers (Pty) Ltd and Others* (228/2014) [2015] ZASCA 69 paras 35–38.
184 Sections 173–174 of the Insolvency Act 2011.
185 Section 145(1)*(a)* of the Insolvency Act 2011.
186 Section 147(1) of the Insolvency Act 2011.
187 Section 145(2) of the Insolvency Act 2011.
188 Section 145(3) of the Insolvency Act 2011.

Unfortunately, neither the Insolvency Act 2011 nor the Regulations provide any guidance on what could possibly constitute exceptional circumstances to warrant granting of an application for extension of time. Regulation 204, however, allows the application of the Civil Procedure Rules to proceedings under the Insolvency Act 2011 and the regulations in respect of any matter which is not specifically provided for. The courts in Uganda have invariably held that what constitutes 'exceptional circumstances' is left to the court's unfettered discretion.[189] A provisional administrator may, as such, apply to the court for extension of time within which to complete these processes, for so long as he or she can adduce cogent evidence to prove that he or she has been prevented by exceptional circumstances to adhere to the timelines set in the Insolvency Act 2011.

In the Australian case of *Harrisons Pharmacy Pty Limited (Administrators Appointed) (Receiver and Managers Appointed),*[190] while considering an application for extension of time within which to convene a creditors' meeting, Farrell J held that court has jurisdiction to make orders extending the period for convening a creditors' meeting, but this discretion must be exercised in accordance with known principles.

> In exercising this jurisdiction, the Court must have regard to the objects of Part 5.3A of the Act which seeks to maximise the chance of the company, or as much as possible, of its business, continuing in existence; or if that is not possible, to achieve a better return for the company's creditors and members than would result from an immediate winding up of the company.
>
> The approach to be taken by court in applications of this type is well settled. The power to extend the time for convening a meeting is one that should be exercised as of course. *ABC Learning Centres Limited in the matter of ABC Learning Centres Limited; application by walker (No 5) [2008] FCA 1947* at [8] per Emmet J. The Court must strike an appropriate balance between the expectation that administration will be a relatively speedy and summary matter and the requirement that undue speed should not be allowed to prejudice sensible and constructive actions directed towards maximising the return for creditors and any return for shareholders: *Re Diamond Press Australia Pty Ltd* [2001] NSWSC 313 at [10].[191]

189 *Boney M Katatumba v Waheed Karim* SCCA N. 27 of 2007; *Hon. Sam Njuba v Hon. Sitenda Sebalu Application No. 1 of 2012* [2013] EACJ 1.

190 [2013] FCA 458.

191 In the matter of *Harrisons Pharmacy Pty Limited (Administrators Appointed) (Receiver and Managers Appointed* [2013] FCA 458 paras 10–11.

In another Australian case, *Autodom Limited*,[192] Mckerracher J, held that the factors which may justify an extension of time include the size and scope of the business; a large number of employees with complex entitlements; a complex corporate group structure and intercompany loans; a lack of access to corporate financial records; the need for time to assess thoroughly any proposal for a Deed of Company arrangement; whether the extension would allow the sale of a business as a going concern; and whether additional time is likely to enhance the return for unsecured creditors.[193]

It is evident that in Uganda, factors such as delays in receiving the requisite information about the company's financial and operational circumstances, including the full list of the company's creditors, debtors and values of the company's assets, which are critical details upon which a sound proposal is based, may be reasons that the provisional administrator may put forward in support of his or her application to the court for an extension of time, and which the court would consider in making its determination.[194]

The above reasons notwithstanding, the provisional administrator must be able to demonstrate to court that he or she has taken serious steps to exercise his or her powers to ensure that he completes his or her investigations timeously.[195] This emphasises the fact that time is of the utmost in any corporate rescue intervention.

Although the law is explicit that within ten working days from the date of commencement of the provisional administration or within such period as the court may prescribe, the provisional administrator must call for a creditors' meeting to consider his or her proposals.[196] A provisional administrator's proposal is essentially a report or presentation which sets out the scheme for achieving the purpose of the provisional administration.[197]

192 [2012] FCA 1393.
193 *Autodom Limited* [2012] FCA 1393 para 14.
194 Section 145(3) of the Insolvency Act 2011; reg 204 of the Regulations.
195 Sections 153 and 156 of the Act.
196 Section 147(1) of the Insolvency Act 2011.
197 Regulation 145(1) of the Regulations.

To ensure adequate notification to the creditors, the law obliges the provisional administrator to give a public notice of not less than five working days and a written notice of the meeting to each known creditor of the company.[198] The law further provides that the notice to the creditors shall be accompanied by the following salient details:

(a) A report by the provisional administrator about the company's business, property, affairs and financial circumstances.[199]
(b) A statement of the provisional administrator's opinion and the reasons for the opinion on the interests of the company's creditors in the event of the company's execution of an administration deed, the creditors' interests on the termination of the provisional administration and the creditors' interest in the event of the company's liquidation.[200]
(c) A statement showing the details of the proposed deed, where an administration deed is proposed.[201]

Regulation 145(2) of the Regulations proceeds to elicit that the proposal shall include the following additional details:

(a) The full name and registered address of the company.
(b) Details relating to his or her appointment as a provisional administrator.
(c) An account of the circumstances giving rise to the appointment of the provisional administrator.
(d) A summary of the statement of the company's affairs, and details of the financial position of the company, with the provisional administrator's comments, if any.
(e) A statement of how it is envisaged the purpose of the administration will be achieved and how it is proposed that the provisional administration shall end.
(f) Such other information as the administrator thinks necessary to enable the creditors to decide whether or not to vote for the adoption of the proposal.

To ensure holistic discussion and consideration of the proposal, regulation 146(2) of the Regulations provides that the notice to attend the creditors' meeting must also be sent to any director/s or officer of the company, including (a) person/s who has/have been directors or officers of the company in the past, whose presence at the meeting, in the opinion of the provisional administrator, may be necessary. Although the provisional administrator's proposal is primarily supposed to be considered and/or approved by the company creditors, and not the company or its officers, the requirement to invite some of the critical directors

198 Section 147(2) of the Insolvency Act 2011.
199 Section 147(3)*(a)* of the Insolvency Act 2011.
200 Section 147(3)*(b)* of the Insolvency Act 2011.
201 Section 147(3)*(c)* of the Insolvency Act 2011.

and officials of the company to be present during the creditors' meeting helps to validate the assumptions, findings and the corrective measures proposed by the provisional administrator.

The provisional administrator or, in his or her absence, a person nominated by him or her in writing, is mandated to be the chair of the creditors' meeting.[202] In the event that the meeting does not conclude, it may be adjourned to a date not being more than seven days from the date when the first meeting was convened.[203]

The meeting must be conducted in accordance with the detailed rules contained in the Third Schedule to the Insolvency Act 2011.[204] At the end of the meeting, creditors may resolve that the company executes an administration deed, or that the provisional administration should end or that the company should be liquidated.[205]

It is expected that where the creditors are satisfied by the proposal presented by the provisional administrator, they will pass a resolution authorising the company to execute an administration deed. The Insolvency Act 2011[206] requires that the deed must specify the following details:

(a) The proposed administrator of the deed. The creditors may resolve to maintain the provisional administrator to continue serving as the administrator of the company but may also propose any other eligible insolvency practitioner of their choice.
(b) A list of the property of the company available to pay the creditors' claims.
(c) The nature and duration of any moratorium period provided in the deed.
(d) The extent to which the company is to be released from its debts.
(e) The conditions, if any proposed for the deed to come into operations and continue in operation.
(f) The circumstances under which the deed terminates.
(g) The order in which proceeds of realising the property referred to in the deed are to be distributed amongst the creditors.
(h) The date, which shall not be later than the day the administration begins, on or before which claims that are admissible under the deed shall have arisen.

202 Section 148(1) of the Insolvency Act 2011; reg146(3) of the Regulations.
203 Section 148(2) of the Insolvency Act 2011.
204 Section 148(1) of the Insolvency Act 2011.
205 Section 148(3) of the Insolvency Act 2011.
206 Section 149 of the Insolvency Act 2011.

6.4.7 Execution of an administration deed

After consideration of the provisional administrator's proposal during the creditors' meeting, if the creditors are satisfied with the remedial measures and the rescue plan presented by the provisional administrator, the creditors may pass a resolution authorising the company to execute an administration deed with the proposed administrator.[207] An administration deed is a binding agreement signed between the company and the administrator on behalf of the creditors, detailing how the company affairs will be managed during the period of administration, with the objective of maximising the chances of the company, or as much as possible, of its business to continue as a going concern, or to provide a better return for the creditors than an immediate winding up of the company or both.[208]

An administration deed is signed by the company and the proposed administrator to formalise the parties' commitment to the attainment of the objective of administration.[209] Its terms constitute an agreement between the company and its creditors.[210] In *Uganda Telecom Limited v Ondoma Samuel t/a Alaka and Company Advocates,*[211] Mubiru J held:

> Under section 148(3) of the Act, a creditors' meeting may resolve that the company executes an administration deed as specified in the resolution. This is in the nature of a binding agreement between the company and its creditors about payment of all, or part of, its debts over an agreed period of time, designed to either salvage the company or distribute the company's assets.[212]

The law requires that immediately after the creditors' resolution to execute an administration deed is made, the company and the proposed administrator must execute the deed.[213] Otherwise, in terms of section 150(2) of the Insolvency Act 2011, the administration deed is deemed to have become binding on the company, its

207 Section 148(3) of the Insolvency Act 2011.
208 Per Ssekaana J in *Sunshine Agro Products Limited (in administration)* Misc. Application No. 344 of 2019 5.
209 Section 150(1) of the Insolvency Act 2011.
210 Nerima, *Uganda Insolvency Law Handbook* 78.
211 High Court Misc. Application No.0012 of 2018.
212 *Uganda Telecom Limited v Ondoma Samuel t/a Alaka and Company Advocates* High Court Misc. Application No.0012 of 2018 para 25.
213 Section 150(2) of the Insolvency Act 2011.

directors, secretary, shareholders, administrator and creditors within 21 days from the date when the creditors' meeting approved execution of the deed.

With respect to creditors, an administration deed binds all the company's creditors in relation to all claims arising on or before the day specified in the deed,[214] which is usually the date of commencement of the provisional administration.[215] All creditors so bound may not commence or continue execution proceedings or other legal processes or levy distress against the company or its property, except with leave of the court and in accordance with the terms as the court may impose.[216] The execution of an administration deed, by operation of law ends provisional administration and immediately triggers the commencement of administration.[217]

6.5 Administration as a formal rescue procedure

As noted above,[218] once the creditors are convinced by the provisional administrator that based on his or her diagnostic review of the affairs of the company, there are reasonable grounds to believe that the company is likely to be rescued as a whole or any part of its undertaking may be saved as a going concern, or that the company and its assets can be more advantageously realised through administration than liquidation, the creditors will naturally agree to commit the company into an administration deed. This changes the legal character of the rescue procedure from provisional administration to administration.[219]

6.5.1 Meaning and commencement of administration

The Insolvency Act 2011 and the Regulations are silent on the meaning of the concept 'administration'. Generally, 'administration' may be defined as the substantive formal corporate rescue procedure that a company enters into following the creditors' approval of the provisional administrator's proposal and the passing of a creditors'

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214 Section 164(1) of the Insolvency Act 2011.
215 Per Mubiru J in *Uganda Telecom Limited v Ondoma Samuel t/a Alaka and Company Advocates* High Court Misc. Application No.0012 of 2018 para 4.
216 *ibid.*
217 Section 162(2) of the Insolvency Act 2011.
218 See the discussion under 6.4.6.
219 Section 162(1) of the Insolvency Act 2011.

resolution authorising the company and the proposed administrator to execute an administration deed.[220]

Administration is a formal insolvency procedure designed to give an ailing company an opportunity to reorganise its affairs through the execution of an administration deed between the company and the administrator, with the prior approval of the creditors.[221] It entails the appointment of an insolvency practitioner by the creditors to act as the administrator of the company with the specific task of implementing the administration deed and later hand back the company to its shareholders.[222]

The creditors will normally prefer to have the same person who worked as the provisional administrator to continue serving as the administrator, but the creditors are at liberty to propose a different person, if they so resolve.[223] However, considering that administration is intended to facilitate the implementation of the terms of the administration deed, business prudence requires that the provisional administrator who conducted the diagnostic investigation about the company and made the proposal that culminated into the administration deed should be left to supervise and oversee its implementation.[224]

According to section 162(1) of the Insolvency Act 2011, administration commences with the execution of an administration deed by the company in a general meeting.[225] In terms of section 138 of the Companies Act 2012, a general meeting is any meeting of the shareholders of a company other than the annual general meeting. This implies that after the creditors have approved the provisional administrator's proposal and resolved that an administration deed should be executed,[226] the provisional administrator must timeously exercise his or her powers to call for a shareholder's (members) meeting[227] to consider and to approve the creditor's resolution for entry into administration.

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220 Nyombi, Kibandama and Bakibinga2014 *JBL* 660.
221 *ibid;* Nyakairu and Kakongi mondaq.com/insolvencybankruptcy/973362/a–101–guide– to–insolvency–and–business–rescue–in–Uganda (Date of use: 22 February 2021).
222 *ibid.*
223 Section 149*(a)* of the Insolvency Act 2011.
224 Section 165 of the Insolvency Act 2011.
225 Nerima *Uganda Insolvency Law Handbook* 78.
226 Section 148(3)*(a)* of the Insolvency Act 2011.
227 Section 153(1)*(f)* of the Insolvency Act 2011.

If the members approve the creditors' resolution, the company will proceed to execute the administration deed with the proposed administrator. In accordance with section 162(2) of the Insolvency Act 2011, the appointment of the administrator shall take effect on the date of execution of the administration deed.

The administrator will immediately after the commencement of the administration send to each creditor of the company a written notice of the execution of the deed,[228] give a public notice of the execution of the deed,[229] and deliver written notice of the execution of the deed to the official receiver, the court and the registrar of companies.[230] Unlike provisional administration, which commences after the court has issued an interim protective order,[231] administration does not require the court's approval. The court, the official receiver and the registrar of companies are just given notice of the execution of the administration deed.[232]

6.5.2 Legal effects of administration

By its very nature, administration is designed to help businesses in financial distress to remain intact and to protect their property against disruptive enforcement and recovery actions that could jeopardise efforts by the administrator to resuscitate the business or the company.[233] This is what the framers of the Insolvency Act 2011 sought to achieve when they included section 164, which summarises the legal effect of administration.[234] It reads:

> **164. Effect of Administration.**
>
> (1) An administration deed shall bind:
>
> (a) the company;
>
> (b) the company's directors and secretary;
>
> (c) the company's shareholders;

228 Section 163*(a)* of the Insolvency Act 2011.
229 Section 163*(b)* of the Insolvency Act 2011; reg 149 of the Regulations.
230 Section 163*(c)* of the Insolvency Act 2011.
231 Section 142(1) of the Insolvency Act 2011.
232 Section 163 of the Insolvency Act 2011.
233 Per Onguto JL in *Nakumatt Holdings Ltd High Court of Kenya* Insolvency case no. 10 and 13 of 2017 para 33.
234 Nyombi, Kibandama and Bakibinga 2014 *JBL* 659.

(d) the administrator; and

(e) all the company's creditors in relation to claims arising on or before the day specified in the deed.

(2) Subject to subsection (3), a person bound by a deed shall not-

(a) Make an application for the liquidation of the company or proceed with an application; and

(b) Except with the leave of the court and in accordance with the terms as the court may impose:

(i) take steps to enforce any charge over any of the company's property; and

(ii) commence or continue execution proceedings or other legal process or levy distress against the company or its property.

(3) Subsection (2) shall not prevent a secured creditor from exercising a power of enforcement of a charge over company property, except where the deed provides for it in relation to the secured creditor who voted in favour of the resolution for the execution of the deed.

A reading of the provision clearly shows that the inclusion of administration was deliberately done to create a safe harbour procedure for companies whose shareholders show commitment to work with the creditors to keep the ailing business running with the hope of helping it recover and regain capacity to pay its debts and possibly be handed back to its owners. This is in line with Policy recommendation No. 1(a) in the *Uganda Law Reform Commission Study report on Insolvency law in Uganda*,[235] which emphasised that a balance should be struck to provide for adequate punishment of the insolvent to deter others from recklessly ditching their business into insolvency, while at the same time emphasise rehabilitation of the insolvents so as to allow them to resume a productive role in the economy after insolvency.[236]

This explains why, in terms of section 164(1) of the Insolvency Act 2011, once an administration deed is approved and signed between the company and the administrator, it becomes binding on all parties, who would otherwise be eligible to dispute it or commence other disruptive proceedings. This helps the administrator to

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235 Uganda Law Reform Commission Report (2004) 9.

concentrate on the core objective of administration: to ensure effective implementation of the terms of the administration deed within the agreed timelines.[237]

The following are the salient features of administration in Uganda.

(a) Suspends the commencement of liquidation proceedings

Under normal circumstances, a number of parties,[238] including the company itself, any of its directors, shareholders, creditors, contributories and the official receiver, can petition the court for an order to appoint a liquidator to wind-up its affairs, if it can be proved to the satisfaction of the court that the company is unable to pay its debts.[239] Subjecting a company to liquidation proceedings can, however, trigger a lot of misery for its stakeholders, including, sometimes, the very person who instigated the commencement of liquidation proceedings. The primary objective of administration is to allow the administrator to oversee the implementation of the administration deed for the benefit of the general body of creditors, with the expectation that the ailing company may, after paying off all the creditors, be handed back to its owners. Thus, it was necessary for the legislature to legally protect companies in administration and their assets from the risks associated with the commencement or continuation of liquidation proceedings against the company while in administration.[240]

In terms of section 164(2) of the Insolvency Act 2011, upon execution of an administration deed, the company is protected from liquidation proceedings. The law forbids a person bound by the administration deed from making or proceeding with an application for the liquidation of the company.[241] With this provision in the law, and considering that it is crafted in mandatory terms, it is easier for an administrator to defeat any application for liquidation by a creditor or any other persons, after the commencement of administration.

In terms of section 143(1)(b) of the Insolvency Act 2011, provisional administration also suspends the functions and powers of any liquidator who could have already been appointed in respect of the company. This means that the supremacy of administration

[237] Section 165 of the Insolvency Act 2011.
[238] Section 92(1) of the Insolvency Act 2011.
[239] Section 92(2)– (3) of the Insolvency Act 2011.
[240] Section 164(1) of the Insolvency Act 2011.
[241] Section 162(2)*(a)* of the Insolvency Act 2011.

over liquidation proceedings also extends to situations where administration commences after the company had already entered liquidation.[242]

Consequently, where the company is facing liquidation proceedings, one of the legally acceptable ways through which the company can successfully defeat these proceedings is by resolving to place the company under provisional administration. For this to happen, the company must however be able to demonstrate to the court that it is willing to settle the creditors' claims and that the company has potential to recover from its financial challenges and regain its financial potency.[243]

(b) Activates a moratorium in favour of the company

The framers of the Insolvency Act 2011 clothed the property of a company in administration with general immunity against enforcement action by any person bound by the administration deed.[244] This was intended to ensure that the administrator is not left at the mercy of creditors and other claimants who would otherwise keep asserting their individual rights against the same property that the administrator could be banking on to realise the collective objectives of administration.[245]

Section 164(2)*(b)*(i) of the Insolvency Act 2011 clearly provides that a person bound by the deed of administration shall not, except with leave of the court and in accordance with the terms as the court may impose, take steps to enforce any charge over any of the company property.

The Insolvency Act 2011 does not define what 'steps to enforce' means. However, it is generally understood that 'steps to enforce' encompass any act of enforcement, such as the act of repossession, the act of sale or any other act which to some degree interferes with the company's enjoyment of its property or property in its possession or inhibits the administrator's use of such property in the conduct of the company business.[246] In *Bristol Airport Plc v Powdrill,*[247] Sir Nicolas Browne-Wilkinson, while expounding the import of paragraph 43 of the Schedule B of the English Insolvency Act of 1986, which is *pari materia* with section 164(2)*(b)*(i) of the Insolvency Act 2011,

242 Section 143(1)*(c)* of the Insolvency Act 2011.
243 Section 139(3) of the Insolvency Act 2011.
244 Section 164(2)*(b)* of the Insolvency Act 2011.
245 Goode, *Principles of Corporate Insolvency* 423.
246 Goode, *Principles of Corporate Insolvency* 429.
247 [1990] Ch.744, 758; Goode, *Principles of Corporate Insolvency* 429*.*

held that the underlying purpose of this provision is to preclude the taking of steps, which might impair the administrator's ability to manage the company, use its property and carry through the purpose or purposes for which the administration order was made free from interference by creditors.[248]

Actions such as asserting a lien or a right of detention, or a threat to enforce against a company asset, which have the potential to affect the administrator's quiet enjoyment or deployment of the company assets towards furthering the objective of administration are not permissible and must only be done with the leave of the court.[249] Conversely, it is argued that this provision does not prohibit creditors from taking preparatory steps such as serving a demand notice or a reminder for payment, which do not, directly impair the administrator's right to use the company property.[250] 'Property' is broadly defined to include money, goods, things in action, proceeds, land and includes every description of property wherever it is situated, obligations, interest, whether present, future, vested or contingent, arising out of or incidental to property.[251] Therefore, company property includes virtually all property in lawful possession of the company, irrespective of whether the company has legal or equitable or possessory rights over it. Hence, even if the property in issue is held by the company under a hire purchase agreement or under a retention of title agreement, the unpaid seller cannot repossess the property without leave of the court.[252]

In the English case of *Fashoff (UK) Limited v Linton*[253] the court refused to grant leave to companies that had supplied a company in administration trading stock under a contract which contained a retention of title clause.[254] By the time the suppliers of the impugned goods lodged their claims with the administrator, the goods had long been resold to other parties and were no longer in control or possession of the administrator. The court noted, among other things, that the law vests in the court wide discretion to determine whether to grant leave to a creditor seeking for leave. However, in exercising its discretion, the court must be guided by the fact that the purpose of

248 *Bristol Airport Plc v Powdrill* [1990] Ch.744, 758.
249 Section 164(2)*(b)* of the Insolvency Act 2011.
250 Goode, *Principles of Corporate Insolvency Law* 430.
251 Section 2 of the Insolvency Act 2011.
252 *Re Atlantic Computers Systems Plc* (1992) Ch 505.
253 [2008] EWHC 537.
254 *Fashoff (UK) Limited v Linton* [2008] EWHC 537 para 114.

instituting the procedure of administration under the Insolvency Act 2011 is to procure the rehabilitation and survival of the company as a going concern or, failing that, to secure a more advantageous realisation of its assets.[255]

The moratorium enjoyed by companies during administration also extends to all execution proceedings and other legal processes and distress proceedings against the company and its property.[256] The Insolvency Act 2011 does not define what 'legal process' means but in England from which this provision was copied, it is generally not limited to proceedings by a creditor only.[257] The phrase is said to cover not only civil proceedings in a court of law, but also actions such as advertisement of a petition for winding up of the company, commencement of criminal proceedings against the company or any other judicial and quasi-judicial proceedings, including actions such as arbitration proceedings as well as proceedings for revocation of a license by a regulator.[258]

This point was subject of judicial consideration by the High Court of Justice in England in the matter of *Frankice (Golders Green) Limited, Hudson and Others v The Gambling Commission*,[259] which involved an application for direction by administrators of Agora Group, the contention resided in whether the moratorium enjoyed by companies in administration extends to protecting such companies against proceedings by a panel of adjudicators constituted by a regulator to hear an alleged breach of a license obligation by the company, where such proceedings could result into revocation of the company's license.[260]

The question for determination by the court was whether in terms of paragraph 43(6) of Schedule B1 of the Insolvency Act 1986, which is in *pari materia* with section 164(2)*(b)*(ii) of the Insolvency Act 2011, this constitutes a 'legal process', which cannot be instituted or continued against a company in administration without the consent of the administrator or without the permission of the court.[261]

255 Per Toulmin CMG in *Fashoff (UK) Limited v Linton* [2008] EWHC 537 para 102.
256 Section 164(2)*(b)*(ii) of the Insolvency Act 2011.
257 Goode, *Principles of Corporate Insolvency Law* 436.
258 *ibid; Hudson v Gambling Commission* [2010] ALL ER 59.
259 [2010] EWHC 1229(Ch).
260 *Hudson v Gambling Commission* [2010] ALL ER 59 para 19.
261 *Hudson v Gambling Commission* [2010] ALL ER 59 para 36.

The administrators argued that the nature of the proceedings that were to be undertaken by the Gambling Commission were legal proceedings covered by the moratorium accorded to companies in administration.[262] On the flipside, the Gambling Commission argued that the process they intended to undertake was an administrative process, to be done in a fair way to determine whether or not the companies' directors were guilty of any breach of their license obligation.[263]

While describing what legal process means, the court held:

> First, it is clear that legal process and legal proceedings are not confined to claims by creditors against the company; they include claims against the company by third parties, see: *BioSource Technologies v Axis Genetics* [2000] 1 BCLC 286. Second, it is plain that legal process and legal proceedings are not confined to civil proceedings. Criminal proceedings are also caught by the moratorium, see: *Rhondda Waste* [2001] Ch 57, where a prosecution for breach of environmental regulations was permitted against the company, though the court plainly held that criminal proceedings were caught by the moratorium. Thirdly, it is plain that the relevant legal process or legal proceedings are not confined to proceedings before a court of law. It covers proceedings before tribunals, before arbitrators and before statutory adjudicators.[264]

The court concluded that the nature of the procedure and the circumstances under which the regulatory panel of the Gambling Commission was likely to make its decision made the process to fall within the description of a 'legal process' which was barred by the moratorium.[265] Court further took cognisance of the fact that allowing the regulatory procedure to continue was likely to jeopardize the administrator's chances of concluding a going concern sale of the company and hence found it necessary to stop the Gambling Commission from undertaking its processes during administration.[266]

This case demonstrates that this provision, properly interpreted and applied by the court, can surely save companies in administration from all forms of procedure, unless it can be proved to the satisfaction of the court that allowing such proceedings would not inhibit the administrator's exercise of power to implement the objectives of the administration deed.

262 *Hudson v Gambling Commission* [2010] ALL ER 59 para 36.
263 *Hudson v Gambling Commission* [2010] ALL ER 59 para 39.
264 Per Norris J in *Hudson v Gambling Commission* [2010] ALL ER 59 para 38.
265 Per Norris J in Hudson v Gambling Commission [2010] ALL ER 59 para 47.
266 *Hudson v Gambling Commission* [2010] ALL ER 59 para 57.

In Uganda, a reading of section 164 of the Insolvency Act 2011 shows that unlike in England, the moratorium accorded to companies in administration only binds the company, the company's directors, secretary, shareholders, administrator and creditors of the company.[267] This implies that a third party who is not a creditor, such as a customer, employee, regulator or a licensing authority, can legally commence or continue with proceedings against a company in administration, even if doing so might affect the prospect of administration, actions that would clearly be barred by the moratorium provided to companies in administration under English law.[268]

It is also important to note that even for creditors and other claimants, the law still leaves a window for such persons to seek for leave from the court. If one can present cogent explanation and evidence to persuade the judge that the intended enforcement or legal process is necessary, the court can authorise the commencement or continuation of such processes against the company and its property.[269]

There has been limited litigation over the provisions of the Insolvency Act 2011 in Uganda. This has denied the courts in Uganda the opportunity to guide users on the factors that the court would consider before granting or denying leave to a creditor. Since English decisions are of persuasive value to Ugandan courts,[270] it is expected that a court faced with an application for leave to commence or continue any enforcement or other legal process or proceedings against a company in administration, including provisional administration, would find the guidance that was provided by Nicholls LJ in the English *locus classicus* case of *the Atlantic Computer Systems Plc*[271] handy.

The brief facts of that case follow. Atlantic Computer systems Plc had hired a set of computers from a leasing company, under a lease and hire purchase arrangement. Following its entry into administration, the Atlantic computer systems could not continue making any payments to the leasing company, which, under the lease and hire purchase agreements, constituted a default event which entitled the lessor to

267 Section 143(1) of the Insolvency Act 2011.
268 Goode, *Principles of Corporate Insolvency Law* 436.
269 Section 143(2) of the Insolvency Act 2011.
270 Section 14(2)*(b)*(i) of the Judicature Act 13 of 1996; Waiswa *A Concise Workbook on Fundamentals of Commercial Law in Uganda* 7.
271 [1992] Ch.504, 542–544.

terminate the lease and the hire purchase agreement and demand for repossession of the computers. When the lenders sought for consent from the administrators, they declined to consent to the request for approval to exercise their contractual right to terminate the head leases and to repossess the computers.[272] The administrators argued that the lenders' request was impermissible as far as it would defeat the objective of administration.[273]

After a detailed analysis of the import of section 11(3) of the English Insolvency Act 1986,[274] which is in *pari materia* with Uganda's section 143 of the Insolvency Act 2011, Nicholls J of the Court of Appeal, rejecting the lenders' application for leave to terminate and repossess the computers, among other things, held that a judicial exposition of the purpose for which the prohibition on commencing or pursuing proceedings was imposed, and how this affects actions in the first category, can be found in the judgment of Lord Justice James in *In re David Lloyd and Co* (1877) 6 Ch.D. 339, 344:

> These sections in the Companies Act, and the corresponding legislation with regard to bankrupts, enabling the Court to interfere with actions, were intended, not for the purpose of harassing, or impeding, or injuring third persons, but for the purpose of preserving the limited assets of the company or bankrupt in the best way for distribution among all the persons who have claims upon them. There being only a small fund or a limited fund to be divided among a great number of persons, it would be monstrous that one or more of them should be harassing the company with actions and incurring costs which would increase the claims against the company and diminish the assets which ought to be divided among all the creditors. But that has really nothing to do with the case of a man who for the present purpose is to be considered as entirely outside the company, who is merely seeking to enforce a claim, not against the company, but to his own property. The position of a mortgagee under such circumstances is, to my mind, exactly similar to that of a man who said, 'You are in possession of my property by way of trespass, and I want to get it back again.' A landlord might say, 'You have property under lease from me; you have broken the covenants of the lease, and I have a right of re-entry in consequence of that breach.' The company ought not, because it has become insolvent or has been minded to wind up its affairs, to be placed in a better position than any other lessee with regard to his lessor. So, with regard to a mortgagee. The mortgagee says, 'There is some property upon which I have a certain specific charge, and I want to realise that charge. I have nothing to do with the distribution of your property among your creditors, this is my property.' Why a mortgagee should be prevented from doing that I cannot understand. Power was given to the court to interfere with actions by restraining them or not allowing them to proceed, but this power was given because it was understood that the court would exercise it with a due regard to the rights of third persons, persons who were

272 *Atlantic Computer Systems Plc* [1990] Ch.504 para 52.
273 *Atlantic Computer Systems Plc* [1990] Ch.504 paras 67–68.
274 *Atlantic Computer Systems Plc* [1990] Ch.504 para 73.

> not members of the company, and who had not to come in and claim to share in the distribution of the company's assets among the creditors, and who were not therefore quasi parties to the winding-up proceedings. The court would have due regard to the rights of independent persons. A mortgagee is, to my mind, such an independent person

Nicholls LJ further held that in deciding whether to grant leave to take steps to enforce security against a company in administration and if so, on what terms, the court should have in mind the following twelve guidelines.[275]

> (1) It is in every case for the person who seeks leave to make out a case for him to be given leave.
>
> (2) The prohibition in section 11(3)(c) and (d) is intended to assist the company, under the management of the administrator, to achieve the purpose for which the administration order was made. If granting leave to a lessor of land or the hirer of goods (a 'lessor') to exercise his proprietary rights and repossess his land or goods is unlikely to impede the achievement of that purpose, leave should normally be given.
>
> (3) In other cases when a lessor seeks possession, the court has to carry out a balancing exercise, balancing the legitimate interests of the lessor and the legitimate interests of the other creditors of the company: see per Peter Gibson J. in *Royal Trust Bank v Buchler* [1989] BCLC 130, 135. The metaphor employed here, for want of a better, is that of scales and weights. Lord Wilberforce adverted to the limitations of this metaphor in *Science Research Council v Nassé* [1980] AC 1028, 1067. It must be kept in mind that the exercise under section 11 is not a mechanical one; each case calls for an exercise in judicial judgment, in which the court seeks to give effect to the purpose of the statutory provisions, having regard to the parties' interests and all the circumstances of the case. As already noted, the purpose of the prohibition is to enable or assist the company to achieve the object for which the administration order was made. The purpose of the power to give leave is to enable the court to relax the prohibition where it would be inequitable for the prohibition to apply.
>
> (4) In carrying out the balancing exercise great importance, or weight, is normally to be given to the proprietary interests of the lessor. Sir Nicolas Browne-Wilkinson V.-C. observed in *Bristol Airport Plc v Powdrill* [1990] Ch. 744, 767D-E that, so far as possible, the administration procedure should not be used to prejudice those who were secured creditors when the administration order was made in lieu of a winding up order. The same is true regarding the proprietary interests of a lessor. The underlying principle here is that an administration for the benefit of unsecured creditors should not be conducted at the expense of those who have proprietary rights which they are seeking to exercise, save to the extent that this may be unavoidable and even then, this will usually be acceptable only to a strictly limited extent.
>
> (5) Thus, it will normally be a sufficient ground for the grant of leave if significant loss would be caused to the lessor by a refusal. For this purpose, loss comprises any kind of financial loss, direct or indirect, including loss by

[275] Goode, *Principles of Corporate Insolvency Law* 442–443.

reason of delay, and may extend to loss which is not financial. But if substantially greater loss would be caused to others by the grant of leave, or loss which is out of all proportion to the benefit which leave would confer on the lessor, that may outweigh the loss to the lessor caused by a refusal. Our formulation was criticised in the course of the argument, and we certainly do not claim for it the status of a rule in those terms. At present we say only that it appears to us the nearest we can get to a formulation of what Parliament had in mind.

(6) In assessing these respective losses, the court will have regard to matters such as: the financial position of the company, its ability to pay the rental arrears and the continuing rentals, the administrator's proposals, the period for which the administration order has already been in force and is expected to remain in force, the effect on the administration if leave were given, the effect on the applicant if leave were refused, the end result sought to be achieved by the administration, the prospects of that result being achieved, and the history of the administration so far.

(7) In considering these matters it will often be necessary to assess how probable the suggested consequences are. Thus, if loss to the applicant is virtually certain if leave is refused, and loss to others a remote possibility if leave is granted, that will be a powerful factor in favour of granting leave.

(8) This is not an exhaustive list. For example, the conduct of the parties may also be a material consideration in a particular case, as it was in the Bristol Airport case. There leave was refused on the ground that the applicants had accepted benefits under the administration and had only sought to enforce their security at a later stage: indeed, they had only acquired their security as a result of the operations of the administrators. It behoves a lessor to make his position clear to the administrator at the outset of the administration and, if it should become necessary, to apply to the court promptly.

(9) The above considerations may be relevant not only to the decision whether leave should be granted or refused, but also to a decision to impose terms if leave is granted.

(10) The above considerations will also apply to a decision on whether to impose terms as a condition for refusing leave. Section 11(3)(c) and (d) makes no provision for terms being imposed if leave is refused, but the court has power to achieve that result. It may do so directly, by giving directions to the administrator: for instance, under section 17, or in response to an application by the administrator under section 14(3), or in exercise of its control over an administrator as an officer of the court. Or it may do so indirectly, by ordering that the applicant shall have leave unless the administrator is prepared to take this or that step in the conduct of the administration. Cases where leave is refused but terms are imposed can be expected to arise frequently. For example, the permanent loss to a lessor flowing from his inability to recover his property will normally be small if the administrator is required to pay the current rent. In most cases this should be possible, since if the administration order has been rightly made the business should generally be sufficiently viable to hold down current outgoings. Such a term may therefore be a normal term to impose.

(11) The above observations are directed at a case such as the present where a lessor of land or the owner of goods is seeking to repossess his land or goods because of non–payment of rentals. A broadly similar approach will be applicable on many applications to enforce a security: for instance, an application by a mortgagee for possession of land. On such applications an

> important consideration will often be whether the applicant is fully secured. If he is, delay in enforcement is likely to be less prejudicial than in cases where his security is insufficient.
>
> (12) In some cases, there will be a dispute over the existence, validity or nature of the security which the applicant is seeking leave to enforce. It is not for the court on the leave application to seek to adjudicate upon that issue, unless (as in the present case, on the fixed or floating charge point) the issue raises a short point of law which it is convenient to determine without further ado. Otherwise, the court needs to be satisfied only that the applicant has a seriously arguable case.[276]

In Uganda, the moratorium enjoyed by companies under administration does not extend to restricting the right of secured creditors from enforcing their charges against company property. Section 164(3) of the Insolvency Act 2011 unequivocally provides that:

> Subsection (2) shall not prevent a secured creditor from exercising a power of enforcement of a charge over company property, except where the deed provides for it in relation to the secured creditor who voted in favour of the resolution for the execution of the deed.

The Insolvency Act 2011 defines a 'secured creditor' in broad terms to mean a creditor who holds in respect of a debt or obligation charge over property.[277] A 'charge' is also defined to mean an interest in a chattel paper, a document of title, goods, an intangible, money, a negotiable instrument or a security created or provided by a transaction that in substance secures payment or performance of an obligation, without regard to the form of the transaction or the identity of the person who has title to the collateral and includes a mortgage or lien.[278]

With these kinds of broad definitions of a charge and security in the Insolvency Act 2011, many creditors would qualify as 'secured creditors' in Uganda; therefore, they would not be barred from exercising their enforcement rights against the property of companies in administration, without any need for leave from the court. To obviate this challenge, it is important for the person appointed to act as a provisional administrator to undertake deliberate steps to persuade and seek support from all creditors, including the secured creditors, to approve the administration deed, such that upon its

276 *The Atlantic Computer Systems Plc* [1992] Ch.505 paras 81–85.
277 Section 2 of the Insolvency Act 2011.
278 Section 2 of the Insolvency Act 2011.

execution, all creditors, including the secured creditors, do not enforce against the company property.

This is specifically important because for most trading companies in Uganda, by the time that they show signs of financial distress, they will have most probably pledged virtually all their core assets to lenders. Unless such secured creditors support the administration procedure and agree to defer their right of enforcement, all the valuable assets of the company will be sold or otherwise removed from the control of the administrator, thereby leaving the administrator with no assets to use in turning around the company.

6.4.3 Function of the administrator

An administrator has one statutory function: to supervise the implementation of the administration deed.[279] While preparing an administration deed, it is important for the parties to ensure that all critical matters are provided for in the deed, including the duration of administration, the procedure for variation of the deed as well as rules on how the administrator will fund the administration procedure.

The administrator is also empowered to call for a creditor's meeting at any time during administration.[280] The meeting could be called for purposes of discussing any issues of relevance to the administration procedure, including providing creditors with status reports about the progress made,[281] as well as consulting them on any critical matters such as a proposal to vary the administration deed.[282]

What is surprising is that the legislature did not specifically provide the powers of an administrator. Considering the enormity of tasks expected to be performed by the administrator, it would make sense for the law to expressly provide what the administrator can or cannot do. By necessary implication, it is presumed that as the person who takes over the management of a company from the provisional administrator immediately after the administration deed is executed, the administrator

279 Section 165 of the Insolvency Act 2011.
280 Section 166(1) of the Insolvency Act 2011.
281 Regulation 151 of the Regulations.
282 Section 167 of the Insolvency Act 2011.

is clothed with the same powers as those entrusted to the provisional administrator.[283] For the avoidance of doubt, it is recommended that consideration should be made by the legislature to appropriately include a clear provision in the Insolvency Act 2011 detailing the powers and duties of the administrator, in the same manner in which it is done in respect of a provisional administrator. This will mitigate the risks associated with the apparent lacuna in the law.

6.5.4 Eligibility for appointment as a provisional administrator or administrator

One of the concerns which the reformers of the insolvency regime in Uganda sought to address by means of the Insolvency Act 2011 was the need to improve professionalism amongst individuals who are appointed to manage insolvencies.[284] It was noted that a person who should preside over any insolvency as a receiver, manager, liquidator, or administrator must be honest, independent and generally beyond reproach, and should be able to understand the complexity of commerce, the intricacies of insolvency and the laws governing insolvency.[285]

In this regard, it was recommended that insolvency practitioners should be regulated; and insolvency practice should be restricted to accountants; auditors and advocates recognised and regulated by their respective professional bodies.[286] These recommendations were adopted and incorporated into the Insolvency Act 2011.[287] Section 204 of the Insolvency Act 2011 expressly provides that a person is not qualified to be appointed or to act as an insolvency practitioner, including an administrator, unless her or she is a lawyer, an accountant or a chartered secretary, who is a registered member of the relevant professional body for such profession.[288] The Insolvency Act 2011 proceeds to prescribe that at the time of appointment, the practitioner must be able to provide security or enjoy professional indemnity to guarantee proper performance of his or her duties as an insolvency practitioner.[289] These requirements are intended to secure professionalism and to protect the creditors and the company against general professional negligence, including losses

283 Section 153 of the Insolvency Act 2011.
284 The Uganda Law Reform Commission Report (2004) 26 para 2.2.16.
285 *ibid.*
286 The Uganda Law Reform Commission (2004) Recommendations 21 and 22, 27–28.
287 Section 203 of the Insolvency Act 2011.
288 Section 204(1)*(a)* of the Insolvency Act 2011.
289 Section 204(1)*(b)* of the Insolvency Act 2011.

caused in the management of the insolvency process by the appointed insolvency practitioner.[290]

Whereas the company and its creditors are afforded discretion to appoint a person to act as the provisional administrator[291] and administrator,[292] the law limits their choice to only the licensed insolvency practitioners. This ensures that only qualified persons are appointed to discharge the functions of a provisional administrator or administrator.

6.5.5 Remuneration of provisional administrator or administrator

The absence of clear legislative guidance on the criteria for determination of the remuneration payable to persons appointed to serve as insolvency practitioners was one of the gaps which the ULRC recommended the legislature to address.[293] It was noted that the lack of clear guidelines for determination of fees payable to office holders exposed insolvent companies to the risk of extortion through paying exorbitant fees and expenses to insolvency practitioners.[294]

This risk was addressed when Parliament incorporated section 171 of the Insolvency Act 2011. It provides that a provisional administrator or administrator is entitled to the remuneration agreed upon by the parties,[295] or remuneration fixed by the court on application for taxation and assessment of costs and fees of the administrator or provisional administrator where the parties do not agree.[296] Although the Insolvency Act 2011 does not prescribe the exact criteria on how the fees are to be agreed upon; arguably, this position of law presents a good starting point for determining the remuneration payable to administrators. First, it recognises the right of the parties to freely negotiate and agree on an appropriate remuneration package. Since the persons eligible for appointment into these roles are professionals already regulated by professional rules such as the Advocates (Remunerations and Taxations of Costs) Regulations,[297] it is expected that the negotiations are to be guided by the criteria

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290 Regulation 196 of the Regulations.
291 Section 139(1) of the Insolvency Act 2011.
292 Section 162(2) of the Insolvency Act 2011.
293 The Uganda Law Reform Commission 'Study report on Insolvency law' ULRC Publication No.13 (2004) Recommendation 23, 28–29.
294 *ibid.*
295 Section 171(1)(a) of the Insolvency Act 2011.
296 Section 171(1)(b) of the Insolvency Act 2011.
297 The Advocates (Remuneration and Taxation of Costs) Regulations SI 267–4 as amended.

detailed in the profession's rules applicable to the insolvency practitioner's mother profession.

Secondly, the Insolvency Act 2011 recognises that there could be circumstances where the parties may not mutually agree on the remuneration payable, in which case the law clearly guides the parties to file a bill of costs before the court.[298] This, again, is a good provision insofar as it gives the parties the right to access a neutral party, the court, to moderate the bill of costs and claims that the administrator may come up with.

6.5.6 Rights of stakeholders during administration

As already noted,[299] administration is meant to be a temporary procedure[300] through which the administrator is expected to work closely with other stakeholders to facilitate the attainment of the objectives and spirit of the administration deed.[301] It is argued that when firms are reorganised through a business rescue procedure such as administration, there is a fair prospect that not all assets of the company will be liquidated, workers will remain employed, shareholders will preserve their wealth, creditors will get repaid, suppliers will retain a customer and the company will continue to trade on a solvent basis.[302] Whereas the law makes the administrator the primary driver for the rescue agenda, he or she cannot single-handedly achieve the objectives of administration without recognising and respecting the rights of other key stakeholders. These stakeholders are discussed below.

6.5.6.1 Creditors

In the broad scheme of things, creditors are the primary stakeholders during administration. The law bestows several rights to creditors. Unless the administrator respects their rights and interests, and work towards the attainment of their collective interests, administration cannot succeed.

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298 Section 171(1)*(b)* of the Insolvency Act 2011.
299 See the discussion in 6.4.6.
300 *Atlantic Computer Systems Plc* [1990] EWCA Civ 20 para 30.
301 Section 165 of the Insolvency Act 2011.
302 Levenstein 'An Appraisal of the New South African Business Rescue Procedure' 118.

First, the creditors must approve the provisional administrator's proposal before a company can be authorised to execute an administration deed.[303] If the provisional administrator fails to demonstrate and convince the creditors that the continued existence of the company presents any reasonable hope for the creditors to recover their debts, it is within their absolute powers to outrightly reject the proposal and resolve to end provisional administration and immediately cause the company to be liquidated.[304]

The Insolvency Act 2011 does not create room for the company, its shareholders, or directors to veto the creditors' decision not to approve the provisional administrator's proposal. This means that it is very important for the provisional administrator to manage the creditors well and ensure that their rights are well respected, otherwise they can easily frustrate the rescue efforts and cause the company to exit provisional administration and abruptly slide into liquidation.

This position is expressly captured in section 152 of the Insolvency Act 2011, which provides that where the company omits or fails to execute an administration deed within 21 days or such extended period as the court may allow, shareholders are deemed to have passed a resolution for the liquidation of the company where the creditors resolve that the company should be liquidated at a meeting called to consider the provisional administrator's proposal.[305] Therefore, companies should be serious about their desire to settle the creditors' claims before they pass a resolution to place the company under provisional administration, lest the company gets easily into liquidation.

Where the creditors agree to place the company into administration, the administrator must also ensure that the creditors' rights as specified in the administration deed are well taken care of. This partly explains why the law empowers the administrator to call a creditors' meeting at any time to report on the progress made in the implementation of the deed or consult with them on any material developments.[306]

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303 Section 148(3)*(a)* of the Insolvency Act 2011.
304 Section 148(3)*(b)–(c)* of the Insolvency Act 2011.
305 Section 152 of the Insolvency Act 2011.
306 Section 166(1) of the Insolvency Act 2011.

The law further empowers the creditors to require the administrator to call a creditors' meeting at any time.[307] The creditors may demand to be provided with reports on the progress of the administration from the administrator.[308]

Even where the administrator realises that the administration deed needs to be varied for purposes of facilitating the attainment of the objective of administration, he or she must obtain a resolution passed at a creditors' meeting.[309]

Similarly, where the administrator fails to satisfy the interests of the creditors, the law empowers any single creditor of the company, without necessarily obtaining concurrence from other creditors, to apply to the court for the termination of administration.[310] In considering such an application, the Insolvency Act 2011 allows the court to make any appropriate order, including an order for the termination of administration, where the court is satisfied that administration is oppressive or unfairly prejudicial or unfairly discriminatory against a creditor or contrary to the interests of the general body of creditors of the company.[311] Therefore, creditors are the bosses during administration. It is imperative that the administrator works diligently to satisfy the creditors' individual and collective interests.

6.5.6.2 Employees

Unlike the South African regime, which expressly prioritises the rights and interests of employees of companies in business rescue[312] and recognises them as 'affected persons'[313] with almost equal rights to creditors, shareholders, and directors of the company,[314] Uganda's Insolvency Act 2011 is silent on the rights of the company employees during administration.

Unless employees of the company are owed salaries in arrears and subsequently qualify to exercise rights vested in creditors as has been discussed above,[315] the Insolvency Act 2011 does not create any special rights and/or privileges for employees

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307 Section 166(2) of the Insolvency Act 2011.
308 Section 166(3) of the Insolvency Act 2011.
309 Section 167(1) of the Insolvency Act 2011.
310 Section 169(1)*(b)* of the Insolvency Act 2011.
311 Section 169(3)*(f)* of the Insolvency Act 2011.
312 Section 136(1) of the Companies Act 2008.
313 Section 128(1)*(a)* of the Companies Act 2008.
314 Section 131 of the Companies Act 2008.
315 See the discussion in 6.7.2.

of companies in administration. It also does not provide for a scheme for the protection of the rights of employees when the company enters into administration.

In fact, section 158 of the Act clearly provides that a provisional administrator shall not be deemed to have adopted an employee's contract of employment merely by reason that nothing was done about the employee's contract within ten days from the date of appointment of a provisional administrator. This implies that the Insolvency Act 2011 gives the administrator legal latitude, within ten days from the date of appointment, to decide whether to adopt any employee's contract of employment.

This creates a legal window for the administrator, within the statutory ten-day period, to pick out employees that he or she may consider necessary to the rescue efforts and either adopt their contracts as they were or give them new contracts on such terms and conditions as the administrator may deem necessary in the circumstances. The terms may comprise salary reductions, demotions, or any other term. Employees who the administrator may not consider critical during administration may be dismissed.[316]

Well intentioned as this provision may appear insofar as it allows the administrator to terminate contracts of excess employees to rationalise the business operations and possibly save on less critical expenditure, this provision is at cross purposes with the notion that insolvency proceedings are a collective procedure that seeks to address interests of diverse stakeholders, including employees.[317] For collectivity to be attained, employees as the providers of labour, ought to be viewed from the same lens as capital providers. After all, a combination of capital and labour are the two main factors of production or service delivery in any given market economy.[318]

The way the Insolvency Act 2011 is currently structured leaves a lot to be desired. It completely ignores the fact that employees significantly contribute to the success or failure of an enterprise. Recognising the rights of employees per se and enhancing security of their tenure during administration might be a worthwhile motivation for them to work even harder during administration to see their employer out of danger. Being the key internal stakeholder with inside information about the operations of the

316 *Carluccio's Limited (in administration)* [2020] EWHC 886.

317 Milman, 'Priority rights on corporate Insolvency' in Clark (ed.) *Current Issues in Insolvency Law* 57.

318 Nsubuga, 2016 *NIBLeJ* 19. Available at https://www.researchgate.net/publication/311946743_Corporate_Insolvency_and_Employment_Protection_A_Theoretical_Perspective (Date of use: 22 March 2021).

company, the administrator ought to give employees a reasonable opportunity to give their views on proposed rescue plan and strategies on the implementation of the administration deed, the same way it is done in South Africa.[319]

Therefore, it is argued in Chapter 8 that the Ugandan regime should use the South African provisions in sections 136 and 144 of the Companies Act 71 of 2008 as benchmark for improving its corporate rescue provisions.

6.5.6.3 Directors, secretary and shareholders of the company

As noted,[320] a lack of cooperation between directors, shareholders and the rescue expert may have devastating effects on the success of rescue efforts. If the directors and the shareholders do not feel confident that the administrator will adequately protect and respect their interests, they might withhold valuable information from the administrator. Having accurate and complete information about the company and its prospects is certainly a very critical ammunition in the administrator's arsenal against corporate failure.[321]

The Insolvency Act 2011 does not, unfortunately, sufficiently recognise the role of directors, the company secretary and shareholders of the company during administration. Besides a general statement in section 155 that during provisional administration, a company, its directors and secretary shall not exercise any of its functions, powers or duties, except with the administrator's general or specific approval, the Act does not go any further to establish a clear reporting line between the company officials and the administrator.

The Act provides that every director and secretary of the company in administration shall make available to the administrator the company seal, documents and information relating to the company and give all necessary assistance to the administrator as may be necessary.[322] It also provides that where the director or secretary fails to cooperate with the administrator, a court may make an appropriate compliance order as it may be deemed necessary.[323] .

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319 Section 152(1)*(c)* of the Companies Act 2008.
320 See the discussion in 4.8.4.
321 Cassim and others, *Contemporary Company Law* 887.
322 Section 155(2) of the Insolvency Act 2011.
323 Section 156 of the Insolvency Act 2011.

In addition to placing onerous obligations on the directors and the company secretary to cooperate, the Insolvency Act 2011 fails to recognise the role of these key stakeholders in the rescue process. The law ought to have gone further to establish clear obligations resting on the administrator to consult with the directors, secretary and even shareholders about the proposed rescue plan and measures.

The law is also very lukewarm on the role of shareholders during administration. The only role that shareholders play throughout the entire process of provisional administration and administration is passing a special resolution that the company needs to reach a settlement with its creditors prior to the appointment of a provisional administrator[324] and to participate in the general meeting where the administration deed is executed by the company.[325] Shareholders are not given any other powers during administration.

The decision to lock out shareholders, directors and other company officials from rescue process might have been premised on the general perception that they might be responsible for leading the company into the deep waters from which the administrator might be trying to save the company. However, as the group with immediate knowledge about the affairs of the company and as the residual owners of the company (in case of shareholders), the value of their input during business rescue cannot be underestimated. Failure to give such critical stakeholders a voice during administration is a big strategic mistake which requires urgent redress. This approach potentially causes shareholders, directors and the company secretary to feel excluded from the struggle to rescue the company and denies them a reasonable opportunity to share their perspectives on the proposals made by the administrator. This might ultimately negatively affect the quality of proposals made by the provisional administrator and/or the attainment of the goals as set out in the administration deed.

Just like the case with employees, Chapter 8 argues that this position needs to be rethought, so that consideration is made to properly recognise the roles of these key internal stakeholders in the rescue process. Furthermore, this may be done in the same way as under the South African business rescue framework.

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[324] Section 139(3) of the Insolvency Act 2011.
[325] Section 162(1) of the Insolvency Act 2011.

6.6 Termination of administration

Once a company is placed under administration, it is expected to remain in administration until any of the circumstances or triggers for its termination as specified in the deed arise, or when the court orders for its termination.[326]

In terms of section 169(1) of the Insolvency Act 2011, an application for the termination of administration may be made to the court by the administrator, a creditor of the company or any liquidator of the company. The law specifically provides that the court may make an order terminating administration if it is proved that any of the following grounds exists:

(a) That the provisional administrator or creditors were given inaccurate information about the company's business, property affairs or financial circumstances at the time when they voted in favour of placing the company in administration.[327]

(b) That the report or the statement made in the provisional administrator's proposal contained false or misleading information or omission about the company affairs.[328]

(c) That a person bound by the administration deed has failed to comply with the deed or with his or her obligations under the deed.[329]

(d) That the company has failed to act as may have been reasonably required by the administrator for the purpose of facilitating the administration.[330]

(e) That the administration cannot be completed without undue injustice or undue delay.[331]

(f) That the administration is oppressive or unfairly prejudicial or unfairly discriminatory against a creditor or contrary to the interest of the creditors of the company as a whole.[332]

(g) That the administration should be terminated for any other sufficient reasons.[333]

Where the application for termination of administration is filed by the administrator, the application must be accompanied by a progress report covering the period from the

326 Section 168 of the Insolvency Act 2011.
327 Section 168(3)*(a)* of the Insolvency Act 2011.
328 Section 168(3)*(b)* of the Insolvency Act 2011.
329 Section 168(3)*(c)* of the Insolvency Act 2011.
330 Section 168(3)*(d)* of the Insolvency Act 2011.
331 Section 168(3)*(e)* of the Insolvency Act 2011.
332 Section 168(3)*(f)* of the Insolvency Act 2011.
333 Section 168(3)*(g)* of the Insolvency Act 2011.

last progress report, or the date on which the company entered into administration and a statement indicating the opinion of the administrator on how the company should proceed.[334] Applications by other eligible parties must only state the grounds upon which the applicant wishes the court to base its decision to terminate the administration[335]

6.7 Weaknesses in administration as a rescue procedure

From the analysis of the features of administration as a rescue procedure in Uganda it is apparent that it is riddled with several glaring inherent limitations. This is partly because the process through which the Insolvent Act 2011 was enacted was slow, spanning over a period of thirteen years, from 1998 to 2011,[336] and did not involve adequate consultation with the key local stakeholders in Uganda.[337] The Uganda Law Reform Commission, which took the lead in the insolvency law reform process heavily relied on foreign consultants, notably Reid and Priest LLP and Clare Manuel.[338] Reid and Priest LLP, a firm of Attorneys from Washington DC, was contracted by the Government of Uganda to provide consultancy services on the reform of commercial and related laws in Uganda and issued its report on 26 June 1998.[339] The report was reviewed by Ms. Clare Manuel, who was also a UK government lawyer[340] with no documented prior practical knowledge of the local circumstances in Uganda. This was made worse by the fact that from 2004 when the Insolvency Bill was prepared,[341] there is no documented evidence that the Uganda Law Reform Commission undertook any further independent study to update and incorporate into the Insolvency Bill the developments which had occurred in England after the promulgation of the Enterprise Act 2002.[342] Although the legislative process took thirteen years, the insolvency Bill

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334 Regulation 57(1) of the Regulations.
335 Regulation 57(2) of the Regulations.
Uganda Law Reform Commission 'Study report on Insolvency law' ULRC Publication No.13 (2004) 5.
337 ULRC Publication No. 13 of 2004, 5.
338 ULRC Publication No. 13 of 2004, 5–6.
339 ULRC Publication No. 13 of 2004, 5.
340 Uganda Law Reform Commission 'Study report on Company law' ULRC Publication No.35 (2004) 9; ULRC Publication No. 13 of 2004, 5.
341 See the discussion under 6.4.1.
342 See the discussion under 7.3.1.

2004 remained largely unchanged from 2004 until it was eventually passed by Parliament in 2011 and subsequently came into force in 2013.[343]

This partly resulted into the enactment of the Insolvency Act in its current form, with many apparent loopholes, which invariably lessen the efficacy of administration as a rescue procedure and accounts for its dismal use in Uganda as argued hereunder.

6.7.1 Frailty of the moratorium

As noted,[344] whereas section 164(2) provides that commencement of administration in Uganda triggers a semblance of a moratorium in favour of the company in administration, the scope and protection afforded to companies in administration by the moratorium under the Act is inadequate. The legal provisions in the Insolvency Act 2011 regulating the moratorium in their current form, leave several legal loopholes that can be exploited by third parties.[345] For example, they may commence disruptive proceedings against the company during administration and divert the attention of the administrator from concentrating on his or her primary role of resuscitating the company through the implementation of the administration deed. This is particularly so because, whereas in other countries such as the UK,[346] South Africa[347] and the US,[348] the legal provisions on the nature and scope of the moratorium provided to companies in comparable rescue procedure were deliberately drafted in wide terms to literally apply to cover all legal and enforcement proceedings by all persons, and not just creditors, the company and its officials; in Uganda, the moratorium only binds and restricts persons bound by the administration deed.[349] A plain and literal interpretation of section 164(2) of the Insolvency Act 2011 clearly shows that the restriction on commencement of enforcement and other legal proceedings against the company during administration only applies and bars the company, its directors, shareholders,

343 The Insolvency Act 2011 (Commencement) Instrument 25 of 2013; Also See the discussion under 6.1.

344 See the discussion in 6.5.2(b).

345 Section 164(1) of the Insolvency Act 2011 specifies the parties bound by the Administration Deed, which means that any other person, is a third party to the deed and hence not bound by it. This includes, regulatory bodies, employees and customers.

346 Section 11 of the UK Insolvency Act 45 of 1986.

347 Section 133 of the Companies Act 2008.

348 Section 362*(a)* of Chapter 11 of the US Bankruptcy Code; McCormack, 2018 *J CLS* 14. *In re Nortel Networks Inc* (2011) 669 F 3d 128.

349 Section 161(2) of the Insolvency Act 2011.

the administrator and creditors from commencing enforcement and other legal proceedings against the company during administration.[350]

This is a very big crack in administration as a corporate rescue procedure in Uganda. Disruptive proceedings that may disorient the administrator from concentrating on the daunting task of salvaging the company out of its financial doldrums do not only come from the parties bound by the deed but could also be commenced by third parties. For instance, legal proceedings can be commenced by a dissatisfied consumer who may not be pleased by the quality of the product or service provided by the company in administration. Proceedings can also be commenced by employees of the company.

The risk of employees commencing proceedings against the company during administration in Uganda is even more imminent. Unlike in South Africa, where the business rescue practitioner cannot unilaterally terminate employees' contracts upon commencement of business rescue proceedings,[351] in Uganda, the Act is conspicuously silent on the preservation of employees' contracts during administration. In addition, wrecking proceedings could be commenced by a regulator, who may not necessarily be a creditor to the company in administration but may deem it necessary, for purposes of achieving its regulatory functions to commence adverse proceedings such as license revocation, spectrum withdrawal or other compliance investigations against the company during administration.[352]

The effect of such actions and proceedings by third parties who are not bound by the administration deed and, resultantly, not limited by the moratorium provided in section 164 of the Insolvency Act 2011, might be more destructive to the value of the company and the rescue efforts than the actions by the parties bound by the deed combined. This is certainly worrying, and probably, partly explains the low uptake of administration as a rescue procedure in Uganda.

The decision to restrict the scope of the moratorium enjoyed by companies in administration may not have been deliberate. Because with respect to provisional administration, which is more of a temporary and transitory procedure that naturally culminates into administration, the framers of the Insolvency Act 2011 crafted a fairly

350 See the discussion under 6.5.2(b).
351 Section 136(1) of the Companies Act 2008.
352 See the discussion under 6.5.2(b); s 164 of the Insolvency Act 2011.

satisfactory provision on the scope of the moratorium[353] enjoyed by a company during provisional administration. In addition to restricting the company and its creditors from commencing disruptive proceedings such as the application for the liquidation of the company and the appointment of a receiver in respect of any property of the company during provisional administration, section 143(1)*(f)*(ii) of the Insolvency Act 2011 clearly provides that, except with the provisional administrator's written consent or with the leave of the court and in accordance with such terms as the court may impose, proceedings, execution or other legal processes shall not be commenced or continued and distress shall not be levied against the company or its property during provisional administration.

The import of section 143(1)*(f)*(ii) is sufficiently broad to restrict all other legal processes by any persons, including third parties, such as regulatory bodies, consumers, and employees against the company during provisional administration.

It is conceivable that Parliament might have thought that the moratorium enjoyed during provisional administration also extends to administration, which is unfortunately, technically, not the case.

Similarly, consideration should be made to restrict the way secured creditors exercise their rights against company property during administration. This is particularly necessary because in terms of section 164(3) of the Insolvency Act 2011, it is apparent that the commencement of administration does not prevent a secured creditor from exercising a power of enforcement of a charge over company property, except where such secured creditor voted in favour of the resolution for the execution of a deed. With this provision, it is inconceivable in practice that any secured creditor can willingly, without a statutory or a court command, allow to relegate his or her contractual right by supporting a resolution for the execution of an administration deed.

This provision is very abrasive to the attainment of the objectives of administration as a rescue procedure, especially in a country like Uganda where majority of the companies are small and medium enterprises with limited asset portfolio.[354] In most cases, by the time the company becomes unable to pay its debts and accordingly

353 Section 143(1) of the Insolvency Act 2011.
354 The National Small Business Survey of Uganda 2015, 1 and 4. Available at https://www.nathaninc.com/wp-content/uploads/2017/10/National-Small-Business-Survey-report.pdf (Date of use: 19 April 2021).

eligible to commence provisional administration and eventually administration, it will have charged virtually all its valuable assets, including trading stock and all company property. Although section 164(3) of the Act is broad, it is improbable that any company can successfully undergo administration in Uganda without secured creditors enforcing payment against their security and leave the administrator with nothing to use to turn around the company.

Consideration should therefore be made to suspend the rights of secured creditors during administration so that the administrator can have the opportunity to appropriately deploy the company assets, subject of course to the underlying rights of the secured creditor to whom such property might have been mortgaged or charged by the company. This would enable the administrator to utilise the encumbered assets for purposes of reviving the company and to work towards the attainment of the collective benefit by both the secured creditor, the company and other unsecured claimants.

The provision should be improved to create a waterproof moratorium that protects companies in administration from all legal and enforcement actions by all persons, including secured creditors, regulators, creditors and other third parties and not just the parties bound by the administration deed as it is the position now.

6.7.2 Cumbersome commencement procedure

Since administration is intended to provide specialised care of troubled companies under close scrutiny of a rescue expert, the administrator; it is necessary that the entry procedure to such critical procedure is seamless and flexible. It should be conducted by a wide range of parties with legitimate interest in the recovery and wellbeing of the troubled company, in the same way any concerned person is allowed to rush a sick person to hospital for treatment. However, in Uganda, this is not the case with administration. For example, neither the company nor any single creditor, shareholder or regulator of the sector can cause a company to directly enter into administration.[355]Administration is commenced only after the company and the creditors have agreed to execute an administration deed.[356]

355 See the discussion in 6.4.3.
356 Section 162(1) of the Insolvency Act 2011.

Before a company and its creditors can consider executing an administration deed to commence administration, the company must first be placed under provisional administration. Provisional administration has its own separate commencement procedure and can only be commenced when the company agrees to make a settlement with its creditors and then petition the court for an interim protective order in a general meeting.[357]

This procedure presents many practical challenges. First, when a company is in financial distress, it may not be easy for it to mobilise its members and convene a general meeting to quickly pass a special resolution that the company needs to make a settlement with its creditors as required under section 139(3) of the Insolvency Act 2011. This is a big challenge because under the Companies Act 2012, there are strict rules on convening of general meetings and passing of special resolutions. For instance, section 148 of the Companies Act 2012 provides that a company resolution shall be deemed to be a special resolution when it has been passed by a majority of not less than three fourths (75 percent) of such members as are entitled to vote either directly or by proxy after giving due notice of intention to pass such special resolution. The law further determines that any provision in the company's articles shall be void to the extent that it allows for calling of a meeting of the company by a shorter notice of less than 21 days.[358] This implies that the ailing company must wait for at least 21 days before its members can pass a special resolution authorising its directors to appoint a provisional administrator and to petition the court for an interim protective order.

Secondly, the petition is supposed to be made to the High Court,[359] and not a special insolvency court. With the case backlog in Ugandan courts,[360] one cannot possibly predict with precision how long it would take before the court can entertain the petition. The period could be two to three months, or even years. Even when the court sits to hear the petition, the law clothes many parties with *locus standi* to appear and either support or oppose the grant of the interim protective order,[361] including a receiver,

357 Section 139 of the Insolvency Act 2011.
358 Section 140(1) of the Companies Act 2012.
359 Section 254(1) of the Insolvency Act 2011.
360 The Judiciary 'A report of the case backlog reduction Committee' 29th March 2017. Available at http://judiciary.go.ug/files/downloads/case%20backlog%20Report%20final.pdf (Date of use:25 March 2021).
361 Regulation 138 of the Regulations.

where one was already appointed in respect of any of the company property,[362] a petitioner or provisional liquidator, where one was appointed in respect of the company,[363] and any enforcement officer with the execution of any legal process against the company or its property.[364]

In addition, the court is not obliged to grant the interim protective order. The company must present cogent evidence to the court that provisional administration will help the company to achieve a better result for the general body creditors than if it went straight into liquidation.[365] The law does not prescribe any grounds upon which the court may exercise its judicial discretion to either grant or deny the petition. Apparently, entry to provisional administration and administration is not a straightforward journey and can take a long time, despite the well acknowledged fact that time is of extreme importance in matters of corporate rescue. For a sick company, everyday matters.

In Chapter 8, we argue that the commencement procedure for administration and its precursor, provisional administration, is riddled with many practical hurdles which might be contributing to the low uptake of this procedure in Uganda. Therefore, the law should relax the commencement procedure to facilitate easy entry. It will also be argued that the law should allow more parties to petition the court for an order to place a company in administration, the same way it is in South Africa[366] and in the UK.[367]

6.7.3 Absence of rescue finance

It has already been argued[368] that rescue finance is the lifeblood of corporate rescue.[369] Just like a moratorium, it is central to any business rescue process.[370] Consequently, for any corporate rescue procedure to be effective, it must have a mechanism through which the rescue expert can access money to fund the rescue strategies. Rescue finance helps the company to meet its ongoing obligations, such

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362 Regulation 137(1)*(a)* of the Regulations.
363 Regulation 137(1)*(b)* of the Regulations.
364 Regulation 137(1)*(d)* of the Regulations.
365 *Sunshine Agro Products Limited (in administration)* High Court Misc. Application 344 of 2019 5.
366 Section 131 of the Companies Act 2008.
367 Section 9(1) of the Insolvency Act 45 of 1986.
368 See the discussion in 4.8.2.
369 Cassim and others*, Contemporary Company Law* 882.
370 *ibid.*

as paying for the crucial supplies that the administrator may deem necessary to facilitate the continued steady operation of the company during rescue.[371]

It is, however, baffling that the framers of the Insolvency Act 2011 did not provide for post-commencement finance. The law is conspicuously silent on principles such as super priority financing for companies in administration as is the case in jurisdictions such as the US[372] and South Africa.[373] This means that upon entry into provisional administration and/or administration, the administrator's only hope for funding is in the income generated from the company. Yet, in majority of cases, by the time a company decides to opt for administration, it will have nearly exhausted all the conventional capital generation alternatives.[374] The Insolvency Act 2011 does not even provide any incentive to lenders who provide turnaround capital to companies in administration. This is another big weakness in Uganda's corporate rescue procedure.

It is recommended in Chapter 8 that if administration or any other form of rescue procedure is to have any hope of success in Uganda, deliberate statutory reforms must be made to incentivise the provision of post-commencement funding to companies in administration.

6.7.4 Absence of restriction on application of *ipso facto* clauses

It was argued that the operation of *ipso facto* clauses,[375]if not restricted, can have devastating effects on rescue efforts. In Uganda, unfortunately, the law does not impose any statutory restriction on the exercise of power by third parties to enforce contractual obligations, including the *ipso facto* clauses, against companies in administration, even if doing so would thwart the rescue initiatives. This is exacerbated by the fact that the moratorium on enforcement or taking of legal processes against companies in administration only binds creditors who signed the administration

371 UNICTRAL Legislative Guide on Insolvency Law (2004) 114 paras 94–99.
372 Section 364 of the US Bankruptcy Code 1 of 1978.
373 Section 135 of the Companies Act 2008.
374 Akprareva 'Business funding in corporate rescue; the UK perspective' 1; McCormack 2007 *JBL* 701–732.
375 See the discussion in 4.8.3.

deed[376] with secured creditors expressly excluded from the effects of the moratorium.[377]

The parties that could have entered into contracts with the company prior to the commencement of administration can freely exercise their contractual right to terminate executory contracts with the company in administration on account of commencement of administration, even if it is obvious that the survival of the company depends on such contract.[378] Moreover, the absence of a provision that allows providers of critical services to the company during administration to jump the queue and become preferential creditors, creates further motivation and urgency to persons in contractual relationship with the company in administration to terminate the contract and immediately stop supplying the company with goods and services to avoid the risks of not being paid, in case administration eventually fails.

Whilst it is important to respect pre-insolvency commitments made by companies for purposes of achieving the wider objective of administration; it is desirable for the insolvency legal regime to include clear provisions that statutorily, by operation of law, render exercise of powers to terminate or withhold supply of critical goods and service pursuant to an *ipso facto* clause impermissible during administration.

It is argued in Chapter 8 that consideration should be made by the Uganda legislature to incorporate in the Insolvency Act 2011, a provision similar to section 365 of the US Bankruptcy Code of 1978, which curtails the application of *ipso facto* clauses to companies in rescue procedure.[379] This will go a long way in preserving the company and its business during administration.

6.7.5 Stigma caused by entry into administration

Whereas the conceptual objective of administration is quite different from liquidation and winding up, to many average people, who are the overwhelming majority in most of our societies, the perception is that these are one and same proceedings. Entry into

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376 Section 164(4) of the Insolvency Act 2011.

377 Section 164(3) of the Insolvency Act 2011.

378 Blazic, 'Rehabilitation regime or corporate graveyard: Practitioner's perspective of the Australian Part 5–3 A Voluntary Administration Legislation' 42.

379 Rosenthal, Bouslog and Cassidy 2018 *American Bankruptcy Institute Journal* 2. Available at https://www.gibsondunn.com/wp-content/uploads/2018/02/Rosenthal-Bouslog-Cassidy-Bankruptcy-Court-Upholds-the-Enforcemnt-of-the-Ipso-Facto-Clause-Against-a-Foreign-Debtor-ABI-Feb-2018.pdf (Date of use: 16 April 2020).

administration is seen as an early warning sign of an impending corporate failure and not as a positive step towards a company and its creditors finding a lasting solution to its challenges.

This is partly because in Uganda, both administration and liquidation are formal insolvency proceedings and are conducted in accordance with the same law, the Insolvency Act 2011. Both proceedings are triggered by the company's apparent inability to pay debts.[380] This is worsened by the fact that commencement of provisional administration and eventually administration is supposed to be widely published in the newspaper[381] and the administrator is required to give notice of provisional administration and administration on every invoice, order for goods or business letter issued by or on behalf of the company on which the company name appears.[382]

Commencement of administration brings with it the negative perception that the company is no longer credit worthy. For parties with contracts with *ipso facto* clauses, entry into administration is usually a trigger event that entitles them to immediately terminate executory contracts with the company, withdrawal of service and general mistrust about the prospects of the company. This, unfortunately, has the potential to catapult an otherwise stable company into deeper trouble.

In jurisdictions with underdeveloped insolvency systems, the absence of robust rescue culture and the stigma associated with it often thwarts the continuation of the business activity and ends up frustrating chances of business recovery and value preservation.[383] This is indeed one of the obvious structural weaknesses of administration in Uganda. Unless deliberate measures are taken to limit the publication of the procedures, this problem is likely to continue jeopardizing the potential for recovery from administration.

380 Sections 3, 139(2), 92(2) of the Insolvency Act 2011.

381 Section 163 of the Insolvency Act 2011; reg 149 of the Regulations.

382 Section 144(1) of the Insolvency Act 2011.

383 World Bank Group Insolvency and Creditor/Debtor Regimes Task Force (2017) 'Report on the Treatment of MSME Insolvency' 24: Available at http://documents1.worldbank.org/curated/en/973331494264489956/pdf/114823REVISEDPUBLIC-MSME-Insolvency-report-low-res-final.pdf (Date of use: 15-03-2021).

Therefore, Chapter 8 posits that consideration should be made to revisit the legal provisions on publication of information about companies in administration to the public, such that notification is only limited to key stakeholders like creditors.

6.8 Conclusion

Uganda's corporate rescue framework is comprised of both the informal, [384] usually undocumented rescue procedures and the formal rescue procedures. It has been argued that informal as they might appear, the general perception is that many companies that are faced with financial distress often resolve their problems with their creditors through informal negotiations and compromises, usually negotiated informally outside of the mainstream court and legal procedures. The informality accounts for the absence of formal reports about the efficacy or otherwise of the informal rescue interventions.[385]

Following the outbreak of the global COVID-19 pandemic, sector regulators, especially the Bank of Uganda, officially came out to encourage regulated lending institutions to allow their borrowers to restructure their nonperforming assets at no extra cost.[386] This has enabled many companies to overcome their short-term credit pressures and it has kept many companies afloat amidst the COVID-19 economic strains. The casualness of the informal rescue procedures in Uganda has, however, sometimes worked against its efficacy, with some borrowers failing to fulfil their restructuring plans, thereby entitling the lenders to exercise their contractual rights against the borrowers and their assets, which has unfortunately culminated into many undocumented corporate failures.[387]

Companies that are facing real financial distress are required to pursue the formal corporate rescue procedure under the Insolvency Act 2011, specifically provisional administration, with the hope that if the provisional administrator can convince the creditors about the prospects of the company, an administration deed is executed to give way for entry into administration. The commencement of provisional administration triggers a few protection mechanisms, including a moratorium against

384 See the discussion under 6.2.
385 This is discussed under 6.3.
386 See the discussion under 6.3.1
387 See the discussion under 6.3.1.

creditor's actions, which to some extent, gives troubled companies some breathing space.[388]

It is evident that the protection provided to companies in provisional administration and administration generally in Uganda is still not fireproof because even when a company is under administration, it can still be wrecked by actions of secured creditors and other non–creditor related third party actions.[389]

The chapter also highlighted that the entry procedure into provisional administration and administration in Uganda is riddled with many challenges.[390] This partly accounts for the low uptake of formal rescue procedure in Uganda.[391] There is need for urgent legislative intervention to improve the corporate rescue procedure in Uganda, using the strong points identified in the South African regime.[392]

The discussion in the next chapter on corporate rescue from an international perspective will further inform the conclusions and recommendations in Chapter 8.

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388 See the discussion under 6.4.4.
389 This is discussed under 6.5.2(b).
390 See the discussion under 6.7.2.
391 Discussed under 6.7.
392 *ibid*.

CHAPTER SEVEN
CORPORATE RESCUE FROM AN INTERNATIONAL PERSPECTIVE

7.1 Introduction

There is a debate among academics[1] and judges[2] regarding whether the phenomenon of and character of insolvency is universal.[3] Therefore, any process that seeks to improve any country's insolvency regime ought to take into account the practices and systems applicable in other jurisdictions, to consider the good and bad points from other comparable jurisdictions, before any reform processes are undertaken.

In this chapter, a global context to corporate rescue is provided by analysing the principles espoused by key international organisations regarding corporate rescue. The discussion starts with a general overview of corporate rescue at a global level[4]. This sets the stage for understanding the international debate on corporate rescue generally.[5] The discussion will then advance into analysing the guidelines and principles that have been developed over the years by leading institutions such as the UNCITRAL,[6] the World Bank[7] and the International Monetary Fund (IMF) on corporate rescue.[8]

Thereafter, an examination of the legal framework on corporate rescue in the sampled jurisdictions of UK and the US is undertaken.[9] The UK regime is deemed relevant to this study because as already noted,[10] both Uganda and South Africa adopted the common law system[11] and it is believed that the UK system is widely recognised as mature enough to be a benchmark for any regime seeking to improve its corporate rescue profile.[12] A terse discussion of the US legal regime on corporate rescue will provide further context to our discussion, especially in terms of how debtor friendly the

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1 Crystal 2011 Jersey and Guernsey LR 2. Available at: https://www.jerseylaw.je/publications/jglr/Pages/JLR1102_Crystal.aspx (Date of use: 27 April 2021).

2 *Solomons v Ross* (1764) 1 H B1 131. Also see *Cambridge Gas Transp Corp v Official Cttee of Unsecured Creditors of Navigator Holdings Plc* [2007] 1 AC 508.

3 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 121. Also see McCormack 2012 JLS 325–347and *Re HIH Casualty and General Insurance Ltd* (2008) UKHL 21.

4 See the discussion under 7.2

5 Discussed under 7.2.

6 See the discussion under 7.2.1.

7 Discussed under 7.2.2.

8 See the discussion under 7.2.3.

9 See the discussions under 7.3.2.

10 This was discussed in 2.1; 3.2.1; 4.1 and 6.2.

11 See the discussion in 3.2.1.

12 Loubser 'Some Comparative Aspects of Corporate Rescue in South African Company Law' 8.

US system is as compared to the UK system, and by extension, the Ugandan and South African regimes.

This is expected to provide a complete global perspective to the preceding discussion on corporate rescue in Uganda and South Africa and will further enrich the research findings and recommendations in Chapter 8.

7.2 International perspectives on corporate rescue

As already noted, rescuing companies from the risk of corporate failure was for a long time not one of the primary objectives of the law and policy on insolvency.[13] However, as business dynamics kept changing across the world, a global paradigm shift emerged, which triggered debates over questions whether insolvency law should seek only to maximise the return to pay creditors of an insolvent company and whether other goals such as preserving jobs, rehabilitating troubled companies and protecting the interest of local communities matter.[14]

The concept of a formal business rescue regime in modern times goes back to 1926, when the South African legislature introduced judicial management under the South African Companies Act of 1926.[15] Although judicial management itself later turned out to have been an abject failure, the South African regime is commended for having sowed the original seeds for the corporate rescue philosophy.[16]

This later spread across the world, with the US becoming the champion of modern ideology of corporate rehabilitation.[17] Eventually, it culminated into a change in perception about insolvency policy: from being focused on 'debtor repression' to 'debtor protection' and a redefinition of insolvency from 'sin to risk'; and from 'moral failure to economic failure'.[18] The influence from the American approach to business

13 Goode, *Principles of Corporate Insolvency Law* 57–63.
14 Bo, *Comparative Insolvency Law: The Pre-pack Approach in Corporate Rescue* 8; Goode, *Principles of Corporate Insolvency Law* 382.
15 This was discussed in 5.1. Also see Loubser 2004 *SA Merc LJ* 137, 139, Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 53; Westbrook and others, *A Global View of Business Insolvency Systems* 122.
16 Loubser 2004 SA Merc LJ 137, 139. Also see Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 53 and Westbrook and others, *A Global View of Business Insolvency Systems* 122.
17 Bridge 2013 *Law in Transition* 28, 32.
18 Verdoes and Verweij 2018 *International Insolvency Review* 400.

rescue through the introduction of chapter 11 greatly influenced the subsequent development of business rescue procedures in the rest of the world.[19]

Following the 2008 economic crisis, which triggered a sharp rise in the number of financially distressed businesses that needed rescue,[20] the preservation of insolvent companies from the risk of closure became widely recognised as a fundamental goal of modern insolvency law across the world.[21] Many countries have embraced the 'fresh start' approach to insolvency in varying degrees.[22] The fresh start approach sees insolvency not as a crime, but as a natural consequence of entrepreneurial risk.[23]

The history of bankruptcy has been described as a development or enlightenment from debtor repression to debtor protection,[24] so much that there is now increased global recognition that:

> "Modern corporate rescue and reorganisation should seek to take advantage of the reality that in many cases, an enterprise not only has substantial value as a going concern, but its going concern value exceeds its liquidation value. Through judicial bankruptcy procedures, reorganisation seeks to maximise, preserve and possibly even enhance the value of a debtor's business enterprise, in order to maximise payment to the creditors of the distressed debtor."[25]

It is now widely recognised that corporate rescue seeks to engender legal regimes that facilitate and encourage the rehabilitation of financially distressed companies from collapsing while at the same time respect the broader policy objective for protection of the principle that contracts must be respected and enforced.[26] Corporate rescue seeks to achieve a fine equilibrium between those championing the preservation of the company at the expense of the creditor's rights and those who project the rights of creditors during insolvency as paramount.[27]

An effective and efficient insolvency law that guarantees certainty, transparency and efficiency is considered to be a key factor in stimulating efficient market exchange and

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19 Verdoes and Verweij 2018 *International Insolvency Review* 400.
20 Boon and Madaus 'Toward a European Business Rescue Culture' in Adriaanse and Van der Rest (eds)*Turnaround Management and Bankruptcy* 4.
21 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 100.
22 *ibid*.
23 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 100.
24 Verdoes and Verweij 2018 *International Insolvency Review* 400.
25 Burdette 2004 *SA Merc LJ* 244.
26 Blazic 2010 *Business HDR Student Conference 13*, 6.
27 *ibid*.

building national and global economies.[28] The growth of international commerce has deepened the level of interdependency amongst states so much that the insolvency of virtually every company usually presents transnational challenges regarding treatment of foreign creditors, funders, subsidiaries or branches in other jurisdictions or assets that are located abroad.[29]

This has necessitated a global push for countries to review their legislations to improve their overall reflection of the standards, principles and rescue approaches evident in other countries.[30] The ultimate objective is to move towards having globalized insolvency law reform and convergence towards putting in place common insolvency legislation drawn from jurisdictions that demonstrate a history of maturity in matters of corporate rescue.[31] It is evident across most jurisdictions, especially in the Western world, that there is a historical shift in policy from viewing insolvency as terminal proceedings for businesses ending in liquidation to recognising insolvency proceedings as a gateway to potential business rescue.[32] Insolvency law has been recognised as an essential part of an economy that encourages businesses and persons to be entrepreneurial and to take economic risks.[33]

Initiatives for making corporate rescue the primary focus of insolvency law reform is happening not only at national levels, but also at regional levels,[34] with some regional blocks such as the European Union[35] adopting deliberate recommendations geared

28 Hagan 2001–2002 17 Conn J Int'l L 63. Also see Too 'A Comparative Analysis of Corporate Insolvency Laws: Which is the Best Option for Kenya?'216.

29 Eidenmuller H 'Comparative Corporate Insolvency Law' in *The Oxford Handbook of Corporate Law and Governance.* Available at https://www.oxfordhandbooks.com/view/10.1093/oxfordhb/9780198743682.001.0001/oxfordhb–9780198743682–e–42?print=pdf (Date of use: 26 May 2021) 2.

30 Blazic 'Rehabilitation Regime or Corporate Graveyard: Practitioner's Perspective of the Australian Part 5.3A Voluntary–Administration Legislation 51; Brown D 'Corporate Rescue: Report for the Ministry of Economic Development' November 2000. Available at: https://www.iiiglobal.org/sites/default/files/6–_corp_rescue.pdf (Date of use: 10 May 2021) 5.

31 Blazic, 'Rehabilitation Regime or Corporate Graveyard: Practitioner's Perspective of the Australian
Part 5.3A Voluntary–Administration Legislation' 51; Brown 'Corporate Rescue: Report for the Ministry of Economic Development' November 2000.
Available at: https://www.iiiglobal.org/sites/default/files/6–_corp_rescue.pdf (Date of use: 10 May 2021) 5.

32 Boon and Madaus 'Toward a European Business Rescue Culture' in Adriaanse and Van der Rest (eds)*Turnaround Management and Bankruptcy* (Routledge, 2017) 4.

33 Bridge 2013 *Law in Transition* 28, 30.

34 Godwin 2012 *Sydney LR* 163.

35 European Parliament resolution 2011/2006/IND of 15 November 2011 recommended to the

towards achieving a fresh start for companies in financial distress.[36] For example, modernising insolvency rules to facilitate the survival of businesses and present a second chance for entrepreneurs was identified as a key action to improve the function of internal markets and is part of the efforts to strengthen and revitalize economies in Europe.[37] It is noted that:

> Modern insolvency law in the member states should help sound companies to survive and encourage entrepreneurs to get a second chance. It should ensure that procedures are speedy and efficient, in the interest of both debtors and creditors, and should help safeguard jobs, help suppliers to keep their customers and owners to retain value in viable companies… the reforms of national insolvency law are an important tool to promote economic recovery.[38]

The European Union has taken a leading role in promoting rescue options to be introduced and strengthened in national insolvency regimes. They also promote formal restructuring proceedings for viable businesses, including out of court solutions, with the overarching strategic objective of maximising value for creditors, ensure continuation of the businesses and promote preservation of jobs.[39]

The motivation behind the adoption of the rescue culture has been invariably justified by its potential to preserve viable enterprises, value entrepreneurship and competition, reduce the impact of the financial crisis, preserve jobs, encourage productivity, protect industries of specific strategic importance in society, facilitate risk taking, promote financial stability and maintain the going concern value of business.[40]

The establishment of an efficient and effective corporate rescue mechanism presents several practical challenges for all jurisdictions, not just the developing jurisdictions.[41] First, there are many different corporate rescue models from which countries can choose and these require a range of underlying issues to be considered and resolved.

Commission on Insolvency proceedings in the context of EU Company law. See Boon and Madaus 'Toward a European Business Rescue Culture' in Adriaanse and Van der Rest (eds)*Turnaround Management and Bankruptcy* 6.

36 European Commission Communication, *A New European Approach to Business Failure and Insolvency* (2012) 742. Available at https://eur–lex.europa.eu/legal–content/EN/TXT/PDF/?uri=CELEX:52012DC0742andfrom=EN (Date of use: 5 May 2021) 2.

37 Bridge 2013 Law in Transition 28, 33.

38 European Commission Communication, *A New European Approach to Business Failure and Insolvency* COM (2012) 742. Available at https://eur–lex.europa.eu/legal–content/EN/TXT/PDF/?uri=CELEX:52012DC0742andfrom=EN (Date of use: 5 May 2021) 3.

39 Boon and Madaus 'Toward a European Business Rescue Culture' in Adriaanse and Van der Rest (eds)*Turnaround Management and Bankruptcy* 5.

40 Verdoes and Verweij 2018 *International Insolvency Review* 401.

41 Godwin 2012 *Sydney LR* 164.

For instance, a country needs to make a deliberate decision before deciding whether in its chosen model, creditors should be able to initiate the process, or whether the debtor should be left to remain in possession of the ailing company during corporate rescue.[42]

Secondly, the choice of a model to be adopted by a country is often perceived as reflective of where the country stands in relation to other political, social and economic issues. These include where to strike a balance between the rights of debtors and creditors, the extent to which the rights of stakeholders other than the debtors and the creditors should be considered and protected, and the role of the existing management in corporate rescue, the role of the courts and the nature and extent of their supervisory powers. Others are the extent to which government should intervene and play an active role in facilitating the process, and the way in which tensions between the various players should be resolved.[43]

Implementation of a successful and effective corporate rescue reform process needs to be undertaken as part of a comprehensive reform process for other related laws such as company law, lending laws and the law of contract. This helps to address other incidental questions such as the duties and liabilities of directors of insolvent companies, the appointment, qualification and removal of corporate rescue professionals, the role, and powers of courts in the rescue process and the availability and priority of assets or securities.[44]

The puzzle is further complicated by the fact that virtually every rescue model has its inherent advantages and disadvantages. To produce a good corporate rescue framework, each country needs to exercise caution, and avoid the temptation to copy and paste models from other countries, without first assessing and considering its own foundational political, social and economic fundamentals.[45]

It would be ideal that before a country embarks on a reform process, it should identify the basic macro indicators that distinguish the different corporate rescue models in the different countries, decipher their strengths and weaknesses and then either deliberately choose its preferred model or develop its own hybrid model that speaks

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42 Godwin 2012 *Sydney LR* 164.
43 *ibid*.
44 Godwin 2012 *Sydney LR* 164.
45 Godwin 2012 *Sydney LR* 166.

to its unique political, social and economic circumstances.[46] This helps to create a conceptual framework that highlights the extent to which different models reflect the key legal indicators of a good rescue framework.

The differences in models notwithstanding, there is common understanding[47] that any jurisdiction that seeks to improve its restructuring regime must ensure that at least, the model it embraces or develops contains the generally recognised minimum standards or features of a good restructuring or corporate rescue framework.[48]

First, the legal framework should generally encourage early recourse to corporate rescue.[49] This is borne out of the presumption that if a debtor embraces corporate rescue at the earliest possible moment, the rescue measures adopted can potentially help the company or the business as the case may be, from the risk of becoming insolvent, which ensures business continuity and ultimately benefits all key stakeholders, including the creditors, employees, the debtor and the economy as a whole.[50] The recommendation for timeous pre-insolvency recourse is further premised on the fact that early restructuring often presents an opportunity for the debtor to go through the rescue cycle at minimal costs, thereby leaving sufficient resources to pay off the creditors' claims.[51] Thus, in reforming any rescue framework, provision should be made to facilitate and encourage debtors to initiate rescue proceedings earlier than later; after all, the hospital is of no use if the patient is already in a terminal condition.[52]

Secondly, the rescue framework should provide a mechanism for automatic stay of claims or imposition of a moratorium on claims by creditors immediately upon entry into rescue proceedings.[53] This is recognised as one of the key elements in protecting the debtor company from disorientation caused by pressure from creditors, litigations and execution proceedings.[54] The stay provided to companies in rescue should extend to preventing counterparties from exercising *ipso facto* rights to terminate contracts

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46 McCormack and others 2016 European Commission Report No. JUST/2014/JCOO/PR/CIVI/0075, 221.
47 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 101.
48 Zwieten 2014 Law in Transition. Available at: https://www.ebrd.com/downloads/research/law/lit114e.pdf (Date of Use: 19 May 2021) 4.
49 Zwieten 2014 *Law in Transition* 4.
50 Boon and Madaus 'Toward a European Business Rescue Culture' in Adriaanse and Van der Rest (eds), *Turnaround Management and Bankruptcy* 11.
51 Horst and Zwieten 2015 Law Working Paper No.301/2015, 12.
52 Westbrook and others, *A global view of Business Insolvency Systems* 133.
53 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 101.
54 *ibid*.

entered into with the company upon its entry into corporate rescue, since this is reported to be the single biggest issue to successful rescue efforts.[55] This helps to preserve the debtor's assets and property from being dissipated.[56] The stay should be designed to enable the assets of the debtor to be kept together, by preventing their piecemeal dismemberment by both the secured and unsecured creditors.[57] Failure to provide a waterproof moratorium directly impedes the efficacy of any rescue framework.[58] Deliberate provisions ought to be made to broaden the scope and strength of the statutory stay on all claims by both secured and unsecured creditors during corporate rescue. The law should have a clear mechanism for either automatic stay of all enforcement and legal proceedings against the company and its property upon commencement of the formal rescue proceedings or create a clear window through which a debtor may apply to court for an order of stay against individual enforcement action by creditors, whether secured or not.[59]

Thirdly, it is generally understood that an effective rescue framework should, as much as possible be swift, inexpensive, with less formality and limited involvement of court.[60] The law should encourage out of court negotiations between the debtor and the creditors to evaluate possible restructuring options, and only refer the processes to court for confirmation.[61] This mitigates the risks associated with delays in the enjoyment of the benefits of the rescue plan as well as the negative publicity that often ensues from adjudication of rescue application in courts of law.

An effective rescue framework must support a debtor to restructure his or her debt during financial distress without necessarily getting approval from all creditors.[62] Sometimes, this is referred to as the right to cram-down dissenting creditors.[63] Cramdown prevents obstruction of a feasible plan by uncooperative creditors[64] and

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55 Blazic, 'Rehabilitation Regime or Corporate Graveyard: Practitioners' Perspective of the Australian Part 5.3A Voluntary Administration Legislation' 132.

56 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 101. Also see UNCITRAL, 'Legislative Guide on Insolvency Part 1' (2005) 12.

57 Zwieten 2014 Law in Transition 5.

58 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 101.

59 European Commission 'A new approach to business failure and insolvency, 2014/134/EU of 12th March 2014, Recommendation 10.

60 Zwieten 2014 Law in Transition 5.

61 Boon and Madaus, 'Toward a European Business Rescue Culture' in Adriaanse and Van der Rest (eds)*Turnaround Management and Bankruptcy* 12.

62 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 102.

63 Westbrook and others, *A Global View of Business Insolvency Systems* 156.

64 Westbrook and others, *A Global View of Business Insolvency Systems* 156.

facilitates the restructuring to proceed and for a rescue plan to be approved and implemented for the benefit of the debtor, its shareholders, employees and the majority creditors, without necessarily being hobbled down by the minority dissenting creditors.[65] The right to cramdown dissenting creditors must, however, only be permissible where there is evidence that the proposed plan is beneficial to the company, and it is not unfair to the dissenting minorities.[66] The framework must provide inherent mechanisms through which a competent court can only cramdown the plan on the non–accepting creditors if there is evidence that the proposed plan will leave the dissenters in a better position than if the company were left to retrogress into liquidation.[67] Just as is the practice in the US,[68] fairness can also be achieved if dissenters are guaranteed to receive equal treatment as the approving creditors.[69]

Availability of rescue financing is also widely recognised as one of the critical features of an efficient corporate rescue regime.[70] It has been argued that for companies and businesses in rescue, not dying often depends on the ease with which they can access post-commencement finance.[71]Where the insolvency regimes promotes the continuation of trading by the company during rescue, it is essential for the relevant rescue framework to provide mechanisms for rescue financing and clear guidelines on salient issues such as approval and priority of providers of post-commencement finance.[72] Therefore, in designing a rescue framework, it is critical that the policy makers should properly define what constitutes rescue finance and clear legal incentives created for providers of post-commencement credit to companies and businesses in corporate rescue.[73]

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65 Westbrook and others, *A Global View of Business Insolvency Systems* 156.
66 Booth 1986 *American Law Journal* 70.
67 Horst and Zwieten 2015 Law Working Paper No.301/2015, 22.
68 Booth 1986 *American Law Journal* 71.
69 Westbrook and others, *A Global View of Business Insolvency Systems* 156.
70 Westbrook and others, *A Global View of Business Insolvency Systems* 156.
71 Pretorius and Du Preez 2013 *SAJESBM* 169.
72 UNCITRAL, 'Legislative Guide on Insolvency 2005'; Available at: https://uncitral.un.org/sites/uncitral.un.org/files/media–documents/uncitral/en/05–80722_ebook.pdf (Date of use: 1 June 2021) 114 para 97.
73 Pretorius and Du Preez 2013 *SAJESBM* 185. Also see UNCITRAL, 'Legislative Guide on Insolvency 2005' 118 Recommendations 63–68.

Below, we provide a detailed discussion on how the sampled leading international bodies have generally guided states and policy makers on the necessary measures for improving insolvency law and policy.

7.2.1 UNCITRAL Legislative Guide on Insolvency law

On 17 December 1966, the United Nations General Assembly established the United Nations Commission on International Trade Law (UNCITRAL),[74] as a specialised body with the mandate to harmonise and modernise international trade law to reduce obstacles to transnational trade.[75] UNCITRAL was established to operate as a specialised vehicle through which the UN would play an active role in influencing and shaping global policies in international trade.[76] In line with this objective, in 1999, UNCITRAL undertook a study on insolvency law, specifically on corporate insolvency law, with the aim of fostering and encouraging the adoption of effective national corporate insolvency regimes.[77] The specific focus of the Working Group V was tasked to prepare a comprehensive statement of key objectives and core features for a strong insolvency, debtor-creditor regime, including out-of-court restructuring and a legislative guide with approaches to the implementation of the set objectives and features.[78] The preparatory work entailed the collection of input from leading international insolvency stakeholders, including INSOL international and the International Bar Association.[79]

After a series of engagements, the Legislative Guide on insolvency was approved on 25 June 2004 and got adopted by the UN General Assembly on 2 December 2004 vide resolution 59/40.[80]

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74 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 80. See too UN Resolution 2205 (XXI) of 17th December 1966. Also see https://uncitral.un.org/en/about (Date of use: 01 June 2021).

75 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 80. See too UN Resolution 2205 (XXI) of 17th December 1966. Also see https://uncitral.un.org/en/about (Date of use: 01 June 2021).

76 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 80.

77 UNCITRAL, 'Legislative Guide on Insolvency 2005' (iii).

78 UNCITRAL, 'Legislative Guide on Insolvency 2005' (iii).

79 *ibid*. See also Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 80.

80 UNCITRAL, 'Legislative Guide on Insolvency 200'5 (iii). Also see Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 80.

The primary purpose of the UNCITRAL Legislative Guide on Insolvency Law was to assist the establishment of an efficient and effective legal framework to address financial difficulty of debtors, with the expectation that it would be used as a reference by national authorities and legislative bodies when preparing new laws and regulations or reviewing the adequacy of existing laws and regulations in their respective jurisdictions.[81] UNCITRAL sought to ensure that the Guide is used to achieve a balance between the need to address the debtor's financial difficulty quickly and efficiently, while at the same time uphold the rights and interests of creditors and other parties with a stake in the debtor's business as well as the public policy concerns.[82]

Aware of the diversity in opinion on some critical matters in insolvency law, the Guide presents, in a balanced and well researched manner, the key issues to be considered in the design and formulation of an effective and efficient insolvency law. Despite the differences in policy and legislative opinions, they are widely recognised in many jurisdictions as necessary in any efficient insolvency regime.[83] It also presents the international core themes on corporate rescue and the tools for efficient insolvency practice, with very clear recommendations for incorporation in any country's insolvency framework.[84]

For avoidance of any doubt about the rationale of the legislative guide, UNCITRAL made it clear that the Guide does not seek to provide a single set of model solutions to address all insolvency policy issues but is only a compilation of ideas collected from a range of actors and experts with the hope that it would assist policy makers in evaluating the different approaches and enable them to choose the most suitable options for their respective national interests.[85]

Similarly, UNCITRAL argues that although country approaches to insolvency law may vary, there is broad consensus that any country seeking to improve its insolvency law

81 UNCITRAL, 'Legislative Guide on Insolvency 2005' 1.
82 *ibid*.
83 UNCITRAL, 'Legislative Guide on Insolvency 2005' 1.
84 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 83.
85 UNCITRAL, 'Legislative Guide on Insolvency 2005' 1. Also see Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 83.

regime should ensure that its chosen approach or framework reflects the following nine key objectives:[86]

(1) The framework must provide certainty in the market in order to promote economic stability and growth.[87] Insolvency laws and institutions should as much as possible promote restructuring of viable businesses as well as efficient closure, transfer of the assets of the failed businesses, and facilitate the provision of finance for start-ups and the reorganisation of businesses.[88]

(2) An efficient insolvency law framework must facilitate maximisation of value of assets.[89] This is achieved by facilitating a fair balance of the risks allocated between the parties directly involved in insolvency proceedings, such as creditors, employees, directors and shareholders of the troubled company while at the same time respect the rights of other parties that the insolvent entity could have contracted with before it slid into insolvency.[90]

(3) Insolvency law should strike a balance between liquidation and reorganisation.[91] It is argued that an efficient insolvency law framework should balance the advantages of debt collection through liquidation proceedings, which is often preferred by secured creditors, against the overarching policy objective to preserve value of the debtor's business through reorganisation, which is often preferred by the unsecured creditors and the debtors.[92] Achieving the desired level of balance may have implications for other social policy considerations such as encouraging the development of an entrepreneurial class and protecting employees.[93] Modern insolvency law should include clear avenues for viable businesses to undergo reorganisation as an alternative to liquidation because this rhymes with the basic economic theory which portends that greater value

86 UNCITRAL, 'Legislative Guide on Insolvency 2005' 10–14. Also see Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 83–84.
87 UNCITRAL, 'Legislative Guide on Insolvency 2005' 10.
88 *ibid*.
89 UNCITRAL, 'Legislative Guide on Insolvency 2005' 10.
90 *ibid*.
91 UNCITRAL, 'Legislative Guide on Insolvency 2005' 11.
92 UNCITRAL, 'Legislative Guide on Insolvency 2005' 11.
93 *ibid*.

may be obtained from keeping the essential components of a business together much more than when it is broken down and disposed of in fragments.[94]

(4) Ensure equitable treatment of similarly situated creditors.[95] This objective is based on the notion that insolvency proceedings are recognised as collective proceedings and as such, creditors with similar legal rights should be treated equally and fairly by ensuring that they receive distribution on their claims in accordance with their relative ranking and interests.[96] Although countries may modify the principle of equitable treatment based on their unique socio-economic policies, it is recommended that the decision to deviate from this common norm should be informed by clear and defendable policy objectives, not on the basis of fraud or utter favouritism.[97]

(5) Provide for timely, efficient and impartial resolution of insolvency and rescue disputes.[98] In this regard, countries should ensure that insolvency of any company or business is addressed and resolved in an orderly, quick and efficient manner and avoid undue disruption to the business activities of the debtor.[99] Insolvency processes should be tailored to promote timeous liquidation of the non–viable and inefficient companies, while at the same time facilitate the survival of the efficient and potentially viable businesses.[100] The desired level of efficiency can be achieved if the insolvency law provides easy procedures for commencement of insolvency or rescue proceedings, by stating clear and objective criteria for dealing with insolvency related matters. [101]

(6) Insolvency law should promote the preservation of the insolvent estate to allow equitable distribution to creditors. This can be achieved through preventing premature attachment and sell of the debtor's assets by individual creditors. It is recommended that insolvency law should provide mechanisms for stay of

94 UNCITRAL, 'Legislative Guide on Insolvency 2005' 11.
95 *ibid*.
96 UNCITRAL, 'Legislative Guide on Insolvency 2005' 11.
97 UNCITRAL, 'Legislative Guide on Insolvency 2005' 12.
98 *ibid*.
99 UNCITRAL, 'Legislative Guide on Insolvency 2005', 12.
100 *ibid*.
101 UNCITRAL, 'Legislative Guide on Insolvency 2005', 12.

proceedings against the insolvent estate to provide the debtor with an opportunity to properly assess its situation and undertake processes aimed at maximisation of value, collection and distribution of the proceeds obtained from the sale of the assets of the debtor.[102]

(7) Insolvency law should be transparent and predictable, with clear incentives for gathering and dispensing of pertinent information. Arguably, this enables potential lenders and creditors to understand how the insolvency proceedings operate and to assess the risks associated with their position as creditors in the event of insolvency of any player,[103] which ultimately promotes stability in commercial relations and attracts lending and investment at lower risk premiums.[104]

(8) An efficient insolvency framework should also recognise pre-insolvency creditor's rights and establish clear rules for the ranking of priority claims. This creates certainty in the marketplace and facilitates the provision of credit.[105] It is argued that to the greatest extent possible, priorities and ranking of creditors should be based upon commercial bargains and not necessarily reflect social and political concerns that have the potential to distort the outcome of insolvency.[106]

(9) The insolvency law must establish a clear framework for cross-border insolvency. This is intended to promote coordination between jurisdictions and facilitate the provision of assistance in the administration of insolvency proceedings originating in foreign countries.[107]

In addition, UNCITRAL instructively notes that States vary significantly in their social, political, economic and ultimately legislative needs, and consequently there can never be a universal solution to the design of an insolvency law for every country.[108] States

102 UNCITRAL, 'Legislative Guide on Insolvency 2005', 12.
103 UNCITRAL, 'Legislative Guide on Insolvency 2005', 13.
104 *ibid.*
105 UNCITRAL, 'Legislative Guide on Insolvency 2005', 13.
106 *ibid.*
107 UNCITRAL Legislative Guide on Insolvency 2005, 14.
108 UNCITRAL Legislative Guide on Insolvency 2005, 15.

are urged to evaluate their unique needs and either adopt insolvency laws that favour stronger recognition and enforcement of creditor rights and commercial bargains and give creditors more control over the proceedings, thereby be considered as creditor-friendly regime, or design their laws to lean towards giving the debtor more control over the proceedings and be considered as a debtor-friendly regime.[109]

States may also choose to strike a balance to have some laws that give prominence to liquidation of the debtors to remove inefficient and incompetent market players while at the same time favour reorganisation and corporate rescue of the struggling but potentially viable enterprises.[110] The guide warns that adopting a reorganisation-friendly approach should not result in establishing a safe haven for moribund enterprises, arguing that enterprises that are beyond rescue should be quickly and effectively liquidated.[111]

Although it is now over fifteen years since the Guide was published, it remains a solid masterpiece that any jurisdiction that is seeking to establish or improve its insolvency or rescue regime ought to study and pick guidance from.[112] The Guide contains principles and best practices, which if considered, can greatly enrich any policy reform process on insolvency law.

7.2.2 World Bank Principles on Insolvency

As a key player in the world financial sector, the World Bank has over the years been working with partner organisations and international experts to develop and update principles for insolvency and creditor/debtor rights system.[113] The principles were originally developed in 2001 as a response to requests by the international community for technical guidance on ways through which countries could deal with the effects of the financial crisis that had hit the emerging markets in the late 1990s.[114] At that time,

109 UNCITRAL, 'Legislative Guide on Insolvency 2005', 12.
110 UNCITRAL Legislative Guide on Insolvency 2005, 15.
111 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 85.
112 *ibid*.
113 The World Bank *Principles for Effective Insolvency and Creditor/Debtor Regimes* 2015. Available at https://observatoriofinancieroybursatil.uexternado.edu.co/wpcontent/uploads/sites/7/2020/12/ICRPrinciplesInsolvencyCreditorDebtorRegimes2016–.pdf (Date of use: 08 June 2021) iii.
114 *ibid*.

there were no internationally recognised benchmarks or standards to evaluate the effectiveness of domestic creditor/debtor rights and insolvency systems.[115]

The preparation of the principles started in 1999 with the constitution of an ad hoc committee of partner organisations and the technical support of leading international experts who participated in the World Bank's Task Force and working Group, which comprised of representatives from the African Development Bank, Asian Development Bank, International Finance Corporation, International Monetary Fund, Organisation for Economic Cooperation and Development, United Nations Commission on International Trade Law, INSOL International and the International Bar Association.[116] Following extensive consultations and peer review by over 70 leading experts from countries around the world that participated in the Task Force and Working Groups, the World Bank's Board of directors approved the final text of the World Bank principles for effective insolvency and creditor/debtor regimes in 2001.[117]

Based on the experience gained from the use of the principles, and following extensive consultations with the stakeholders, the principles were subsequently revised and updated in 2005, 2011 and in 2015.[118] The principles have been described as a distillation of international best practice on design aspects of insolvency and creditor/debtor related issues,[119] and were designed as a broad-spectrum assessment tool to assist countries in their efforts to evaluate and improve core aspects of their commercial law systems.[120]

Just like the UNCITRAL guidelines,[121] the principles also state that as a bare minimum, an effective insolvency system should seek to engender the following eleven key objectives:[122]

(i) Integrate with a country's broader legal and commercial systems;
(ii) Maximise the value of a firm's assets and recoveries by creditors;
(iii) Provide for the efficient liquidation of both nonviable businesses and businesses whose liquidation is likely to produce a greater return to creditors and reorganisation of viable businesses:

115 The World Bank *Principles for Effective Insolvency and Creditor/Debtor Regimes* 2015 iii.
116 The World Bank *Principles for Effective Insolvency and Creditor/Debtor Regimes* 2015, 1.
117 *ibid.*
118 The World Bank *Principles for Effective Insolvency and Creditor/Debtor Regimes* 2015, 1.
119 *ibid*.
120 The World Bank *Principles for Effective Insolvency and Creditor/Debtor Regimes* 2015, 3.
121 UNCITRAL *Legislative Guide on Insolvency* 2005, 10–14. Also see Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 83–84.
122 The World Bank *Principles for Effective Insolvency and Creditor/Debtor Regimes* 7.

(iv) Strike a careful balance between liquidation and reorganisation, allowing for easy conversion of proceedings from one proceeding to another;
(v) Provide for equitable treatment of similarly situated creditors, including similarly situated foreign and domestic creditors;
(vi) Provide for timely, efficient and impartial resolution of insolvencies;
(vii) Prevent improper use of the insolvency system;
(viii) Prevent premature dismemberment of a debtor's assets by individual creditors seeking quick judgments;
(ix) Provide a transparent procedure that contains and consistently applies clear risk allocation rules and incentives for gathering and dispensing information;
(x) Recognise existing creditor rights and respect the priority of claims with a predictable and established process; and
(xi) Establish a framework for cross-border insolvencies, with recognition of foreign proceedings.

The principles further provide that the rescue of a business should be promoted through both formal and informal procedures, noting that:

> Where an enterprise is not viable, the main thrust of the law should be swift and efficient liquidation to maximise recoveries for the benefit of creditors. Liquidation can include the preservation and sale of the business, as distinct from the legal entity. On the other hand, where an enterprise is viable, meaning that it can be rehabilitated, its assets are often more valuable if retained in a rehabilitated business than if sold in a liquidation. The rescue of a business preserves jobs, provides creditors with a greater return based on higher going concern values of the enterprise, potentially produces a return for owners and obtains for the country the fruits of the rehabilitated enterprise. The rescue of a business should be promoted through formal and informal procedure.[123]

The principles further guide that countries that are determined to improve their insolvency legal regimes should focus on building integrity of the insolvency system by ensuring that strong institutions and regulations are put in place.[124] Institutional framework has three main elements: the institutions responsible for insolvency proceedings, the operational system through which cases and decisions are processed and the requirements needed to preserve the integrity of those institutions, with emphasis that the integrity of the insolvency systems is the linchpin of its success.[125]

Developing insolvency systems alone may not produce the desired effects, if there are poor practices and policies in other legal systems.[126] Therefore, countries should adopt a predictable and reliable legal framework and judicial processes that nurture fair treatment of all parties and deter unacceptable practices by players in the

123 The World Bank *Principles for Effective Insolvency and Creditor/Debtor Regimes* 7.
124 *ibid.*
125 The World Bank *Principles for Effective Insolvency and Creditor/Debtor Regimes* 7.
126 The World Bank *Principles for Effective Insolvency and Creditor/Debtor Regimes* 8.

insolvency value chain, such as shareholders, borrowers and company directors.[127] The principles have proven to be an important development tool for promoting the World Bank's goals of assisting countries to achieve sustainable development.[128]

There is no doubt that any country that seeks to improve its overall insolvency framework should pay keen attention to the recommendations and guidance contained in the principles.

7.2.3 International Monetary Fund perspective on corporate rescue

The International Monetary Funds (IMF) has over the years been involved in the promotion of orderly and effective insolvency systems among its members.[129] In 1999, the IMF published a report titled 'orderly and effective insolvency procedures', in which it guided that an effective insolvency system is an important pillar in fostering growth and competitiveness and may also assist in the prevention and resolution of financial crises.[130] Effective insolvency systems also support the domestic banking systems by enabling banks to curtail the deterioration of the quality of their claims, including claims on the corporate sector, whether through a court-approved restructuring or, where necessary, through an efficient liquidation.[131]

The report further states that improving insolvency systems is particularly relevant for economies in transition because insolvency laws play a critical role in addressing problems associated with the insolvency of state-owned enterprises. It is argued that having an orderly and effective insolvency system provides an important mechanism for ensuring adequate private sector contribution to the resolution of financial crises.[132]

IMF further guides that although insolvency laws of different countries differ in many respects, it is possible for countries to identify two overall objectives that are generally recognised by most insolvency systems.[133] IMF argues that the first primary objective

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127 The World Bank *Principles for Effective Insolvency and Creditor/Debtor Regimes*, 8–11.
128 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 89.
129 The IMF *Orderly and Effective Insolvency Procedures: Key Issues* 1999. Available at https://www.elibrary.imf.org/view/books/071/05062–9781557758200–en/05062–9781557758200–en–book.xml (Date of use: 15 June 2021) vii.
130 The IMF *Orderly and Effective Insolvency Procedures: Key Issues* 1.
131 The IMF *Orderly and Effective Insolvency Procedures: Key Issues* 8.
132 *ibid*.
133 The IMF *Orderly and Effective Insolvency Procedures: Key Issues* 5.

of insolvency law is the allocation of risk among participants in a market economy in a predictable, equitable and transparent manner to build confidence in the credit system and foster economic growth for the benefit of all participants.[134]

The second of objective of an insolvency law should be to protect and maximise value for the benefit of all interested parties and the economy in general, through the fulfilment of equitable risk allocation, using measures such as nullification of fraudulent transactions that occur before insolvency.[135]

Countries are advised to ensure that the design of the insolvency system they choose reflects a fair balance of the above primary objectives to attain other ancillary policy objectives such as facilitating the rehabilitation procedure and protection of jobs.[136] It is observed that:

> When determining how to strike the balance between the various objectives described above, it is necessary to avoid easy stereotypes. Debtors are not always fraudulent or incompetent, and creditors are not always grasping and selfish. As borne out by recent experience, although companies may fail because of incompetence, they may also fail because of economic difficulties beyond their control.[137]

An insolvency law must make policy choices with respect to a number of substantive issues, such as the mechanism for identifying a debtor that may be subjected to insolvency proceedings, how insolvency proceedings may be commenced, and the extent to which the debtor should be displaced from the management and control of the enterprise after commencement of the insolvency proceedings. It should also consider the scope of the moratorium accorded to the company as well as the powers and functions of the insolvency practitioner charged with the task of managing the insolvency procedure.[138]

On the question of whether a country should adopt a pro-creditor or pro-debtor system, the IMF guides that:

> In any event, experience shows that the degree to which an insolvency law is perceived as pro-creditor or pro-debtor is, finally, less important than the extent to which these rules are effectively implemented by a strong institutional

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134 The IMF *Orderly and Effective Insolvency Procedures: Key Issues* 5.

135 The IMF *Orderly and Effective Insolvency Procedures: Key Issues* 6; Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 96.

136 The IMF *Orderly and Effective Insolvency Procedures: Key Issues* 7.

137 The IMF *Orderly and Effective Insolvency Procedures: Key Issues* 7–8.

138 The IMF *Orderly and Effective Insolvency Procedures: Key Issues* 7–8.

> infrastructure. In particular, given the complex and urgent nature of insolvency proceedings, effective implementation requires judges and administrators that are efficient, ethical, and adequately trained in commercial and financial matters and the specific legal issues raised in the insolvency proceedings. A pro-debtor law that is applied effectively and consistently will engender greater confidence in financial markets than an unpredictable pro-creditor law.[139]

IMF further argues that with respect to rehabilitation procedures, it is important for states to design the law in such a way that the company or business is given some breathing space to recover from the pressure caused by its liquidity challenges, and where necessary, provide the company with an opportunity to restructure its operations and its relations with creditors.[140] It is recommended that a good insolvency law should provide for both out-of-court and formal restructuring.[141]

The report further guides on other substantive issues in insolvency proceedings, such as treatment of encumbered assets and secured creditors,[142] avoidance of pre-commencement transaction and transfers,[143] treatment of contracts,[144] set-off,[145] priority in distribution[146] and rehabilitation procedures generally.[147]

The report is a well written piece of guidance on engendering orderly and effective insolvency system.[148] It encapsulates the global best practices on insolvency law and has influenced many of the subsequent publications and guidelines by other international bodies such the World Bank, UNCITRAL and European Bank for Reconstruction and Development (EBRD) on effective insolvency system.[149] Any country seeking to improve or develop its insolvency system should heed the recommendations and policy guidance provided by the IMF.

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139 The IMF *Orderly and Effective Insolvency Procedures: Key Issues* 2. Also see Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 96.

140 The IMF *Orderly and Effective Insolvency Procedures: Key Issue*s 13.

141 The IMF *Orderly and Effective Insolvency Procedures: Key Issues* 13–14.

142 The IMF *Orderly and Effective Insolvency Procedures: Key Issues* 30.

143 The IMF *Orderly and Effective Insolvency Procedures: Key Issues* 35.

144 The IMF *Orderly and Effective Insolvency Procedures: Key Issues* 38.

145 The IMF *Orderly and Effective Insolvency Procedures: Key Issues* 42.

146 The IMF *Orderly and Effective Insolvency Procedures: Key Issues* 46.

147 The IMF *Orderly and Effective Insolvency Procedures: Key Issues* 52.

148 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 96.

149 The EBRD *Core Principles of an Effective Insolvency System* 2021, Available at https://www.ebrd.com/legal–reform/ebrd–insolvency–core–principles.pdf (Date of use: 15 June 2021) 11.

7.2.4 EBRD Principles on effective insolvency system

The European Bank for Reconstruction and Development (EBRD) was established in 1991 as a multilateral development and investment bank to foster the transition towards open market-oriented economies and to promote private and entrepreneurial initiatives.[150] EBRD has over the years been a proponent of the notion that a country's likelihood to attract foreign direct investment and bank credit increases directly proportional to the increase in the effectiveness of its insolvency legislation.[151] EBRD was one of the first international financial institutions to develop a legal transaction framework, through which countries' laws are evaluated to determine their responsiveness and effectiveness in addressing issues such as insolvency.[152]

In 2006, EBRD developed a ground breaking set of principles for insolvency office holders wherein specific recommendations were made on how to improve professionalism and accountability amongst insolvency practitioners.[153] These principles were recently updated in 2021[154] and articulate the core elements that should be considered by policy makers as they work towards improving professionalism, integrity, fairness and efficiency in their insolvency law systems.[155] In the principles, EBRD lists 12 core principles which every country needs to entrench in its insolvency regime to promote efficiency in insolvency processes, to wit:

(1) Licensing and regulation: EBRD argues that owing to the special nature of their work and the scope of the fiduciary duties they owe to different stakeholders, insolvency office holders should be regulated by a system of either licensing, involving the issuance of a license, certificate or similar official document or registration, in which the names of the authorised insolvency office holders are entered on the official list.[156] Only the persons with the requisite license or certificate should be allowed to act as insolvency office holders, and eligibility for licensing should be restricted to persons with a clean professional record

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150 https://www.ebrd.com/who–we–are.html(Date of use: 17 June 2021)
151 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 98.
152 *ibid*.
153 https://www.ebrd.com/downloads/legal/standards.pdf(Date of use: 17 June 2021)
154 EBRD *Insolvency Office Holder Principles* 2021. Available at https://www.ebrd.com/documents/legal–reform/ebrd–insolvency–office–holder–principles.pdf (Date of use: 17 June 2021).
155 EBRD *Insolvency Office Holder Principles* 2021, 3.
156 EBRD *Insolvency Office Holder Principles* 2021, 6.

without any criminal history.[157] This improves individual accountability of insolvency professionals.

(2) Qualification and training: The principle guides that insolvency office holders should have relevant tertiary qualifications and professional expertise, and they should be required to maintain their professional skills and knowledge throughout the duration of their license to practice as insolvency office holders.[158]

(3) Appointment and review of appointment: EBRD argues that the persons appointed to act as insolvency office holders have a decisive impact on the outcome of the cases they handle for both the creditors and the debtors and as such, the law should establish a fair, transparent and effective system for appointment of office holders, that balances the interests of all stakeholders and minimises conflict of interest.[159]

(4) Removal and resignation: Effective insolvency system should include clear provisions, detailing the circumstances under which any stakeholder with justified interest in the insolvency case should have a right to apply for the removal of the insolvency office holder.[160]

(5) Replacement: EBRD argues that a good insolvency system should provide a clear procedure for appointing another qualified party to replace the office holder that was removed or otherwise resigned from the role. This should seamlessly happen to avert the risks associated with creating a vacuum in leadership.[161]

(6) Standards of professional conduct: The regulatory framework for insolvency office holders should set professional standards that guide office holders and support the effective and timely administration of insolvency proceedings.[162]

157 EBRD *Insolvency Office Holder Principles* 2021, 6.
158 *ibid*.
159 EBRD *Insolvency Office Holder Principles* 2021, 9.
160 EBRD *Insolvency Office Holder Principles* 2021, 11.
161 EBRD *Insolvency Office Holder Principles* 2021, 13.
162 *ibid*.

(7) Reporting: The principles guide that all stakeholders in an insolvency procedure, including the court, creditors, the debtor and the regulatory authority should be regularly informed by the office holder about the progress of the insolvency proceedings. This empowers the stakeholders to effectively monitor the actions and decisions made by the office holders for both accountability and transparency.[163]

(8) Regulation, supervision and discipline: EBRD argues that active supervision and regular monitoring supports compliance by insolvency office holders with legal and professional duties and standards of professional and ethical conduct and recommends countries to consider setting up dedicated regulatory authorities to oversee the conduct of insolvency office holders.[164]

(9) Remuneration and expenses: Since insolvency office holders are normally paid out of the debtor's estate, a clear statutory framework should be developed to regulate and protect the office holder's professional fees.[165] EBRD recommends that countries should set clear models for determining the fees payable to office holders, and the remuneration should be sufficient to allow the development of the profession and permit the practitioner to establish the necessary administrative infrastructure to manage the professional activities arising in the course of discharge of his or her duties.[166]

(10) Code of Ethics: The law should encourage and facilitate the development of a code of ethics for insolvency office holders and its monitoring, noting that the code should include specific provisions that promote impartiality, independence and objectivity of the office holder, as well as provide for confidentiality of information accessed by the practitioner among others.[167]

(11) Insurance and bonding: Office holders have a significant influence on the course of the insolvency proceedings and any breach of duty by the practitioner may result in substantial losses to the stakeholders. Therefore, the law should require

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163 EBRD *Insolvency Office Holder Principles* 2021, 14.
164 EBRD *Insolvency Office Holder Principles* 2021, 15.
165 EBRD *Insolvency Office Holder Principles* 2021, 17.
166 *ibid*.
167 EBRD *Insolvency Office Holder Principles* 2021, 19.

the office holder to maintain a bond or professional liability insurance to protect stakeholders against any potential risks associated with breach of duty by the office holder.[168]

(12) Release of office holders: This principle recommends that countries should consider including in their regulatory framework for insolvency office holders clear procedures on how the practitioner can be discharged or released from the office upon the occurrence of specific events.[169]

EBRD also recently released another set of fifteen core principles of an effective insolvency system.[170] The principles seek to further contribute to the improvement and harmonization of insolvency legislations by clearly articulating the general objectives of any commercial insolvency law reform, which may be adapted to the specific national context of any jurisdiction.[171] The EBRD principles, although not materially different from what we have already discussed with respect to other international bodies, present a more updated perspective on the core features of a modern insolvency system as discussed hereunder.

It is argued that a country's insolvency law should have procedural flexibility to meet the needs of the different participants, including the micro, small and medium sized enterprises.[172] EBRD notes that some elements of the current insolvency laws are only suitable for large business and may not be appropriate for the small and medium enterprises (SMEs), which are the majority in the developing markets. Law reform, especially in the developing economies should seek to create simplified insolvency processes with few formalities, shorter deadlines and lower costs to address the concerns of the small businesses.[173]

EBRD further guides that insolvency procedures should be designed and implemented to preserve and maximise the total value of the debtor's business, noting that an

168 EBRD *Insolvency Office Holder Principles* 2021, 19.
169 *ibid*.
170 EBRD *Core Principles of an Effective Insolvency System* 2021. Available at https://www.ebrd.com/legal–reform/ebrd–insolvency–core–principles.pdf (Date of use: 17 June 2021).
171 EBRD *Core Principles of an Effective Insolvency System* 2021, 2.
172 EBRD *Core Principles of an Effective Insolvency System* 2021, 4.
173 *ibid*.

effective insolvency system should be transparent, certain, and predictable to support debtors who are already insolvent while at the same time facilitate speedy and early treatment of financial distress before it is too late.[174]

EBRD recommends that an effective insolvency law should provide for both liquidation and reorganisation and make it possible for conversion from one type of procedure to another.[175] A liquidation procedure should be tailored to support non–viable companies to exit the market smoothly and timeously, while reorganisation should seek to facilitate the rehabilitation and financial or operational restructuring of the financially distressed but viable companies.[176]

With respect to restructuring, EBRD guides that a country's legal regimes should support the consensual financial restructuring of businesses outside of a formal insolvency law procedure, such that companies can explore the out-of-court alternatives early enough before sliding into insolvency.[177] Furthermore, the insolvency framework should be structured in such a way that both debtors and creditors have a right, in specific circumstances, to initiate reorganisation and/or liquidation proceedings.[178] This is particularly important because the debtor may, for fear of losing control over the company, take long to concede that the company is in need of rescue intervention, and only ends-up doing it when it is too late for the company to be saved.[179]

EBRD guides that the insolvency law should enable the suspension of individual enforcement actions by creditors to preserve the debtor's estate and ensure equal treatment of creditors in a liquidation or reorganisation procedure,[180] noting that in some cases, insolvency office holder should be empowered to dispose of the debtor's assets, including the secured ones, if doing so is deemed necessary and beneficial to the entire body of creditors.[181] In addition, the principles recommend that the insolvency system should ensure equal treatment of creditors with similar economic

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174 EBRD *Core Principles of an Effective Insolvency System* 2021, 4.
175 EBRD *Core Principles of an Effective Insolvency System* 2021, 5.
176 *ibid.*
177 EBRD *Core Principles of an Effective Insolvency System* 2021, 5.
178 EBRD *Core Principles of an Effective Insolvency System* 2021, 6.
179 *ibid*.
180 EBRD *Core Principles of an Effective Insolvency System* 2021, 6.
181 EBRD *Core Principles of an Effective Insolvency System* 2021, 6.

and legal interests in the debtor's estate[182] and should provide for a possibility of independent review of the actions undertaken by the debtor and its management in the period immediately before the entry into liquidation or reorganisation.[183]

To preserve value of the debtor's estate during reorganisation or any other rescue procedure, EBRD recommends that the procedure should be capable of encompassing all types of creditor's claims, including the secured and preferential creditors' claims.[184] The law should be able to restrict the rights of preferential and secured creditors to veto the rescue plans, otherwise these can potentially frustrate all rescue efforts.[185]

EBRD also notes that an effective insolvency system should ensure that the courts vested with legal mandate to settle insolvency cases should be managed by judicial officials with the requisite degree of technical expertise in insolvency matters[186] because owing to the complexity of insolvency disputes, where possible, only specialised members of judicial authorities should be appointed to oversee insolvency cases.[187]

EBRD recommended that a modern forward-thinking business insolvency system should adopt and embrace digital tools to increase transparency, efficiency and cost effectiveness of the insolvency procedures. The law should, for instance, provide electronic insolvency registers, promote use of online case management systems and permit filing of claims and submission of documents to the courts using electronic means.[188]

Lastly, EBRD argues that given the transnational nature of modern businesses, an effective insolvency system should facilitate the smooth conduct and resolution of cross-border insolvencies and set clear rules on recognition of foreign court orders.[189]

The EBRD principles are a truly rich piece of information that any country ought to seriously study and consider in its pursuit for reformation of its insolvency legal system.

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182 EBRD *Core Principles of an Effective Insolvency system* 2021, 7.
183 *ibid*.
184 EBRD *Core Principles of an Effective Insolvency system* 2021, 8.
185 *ibid.*
186 EBRD *Core Principles of an Effective Insolvency system* 2021, 9.
187 *ibid*.
188 EBRD *Core Principles of an Effective Insolvency System* 2021, 10.
189 EBRD *Core Principles of an Effective Insolvency System* 2021, 10.

7.3 Corporate rescue regimes in developed economies

Whereas nurturing a rescue culture has for several years been a strategic target for many countries, the developed economies have moved more steps ahead of the developing economies in putting in place measures to engender the fresh start attitude. For completeness of our exploratory study on rescue processes, we examine the state of corporate rescue in the selected countries of UK and the US.

7.3.1 Corporate rescue system in the UK

Before the 1980s, the English legal system was not very keen on promoting corporate rescue and the general focus of English insolvency law was to facilitate creditor wealth maximisation with liquidation being widely seen as the centrepiece of corporate insolvency law.[190] Corporate insolvency law was primarily concerned with the disposal of the insolvent business, where it could be sold as a going concern, or with the sale of the debtor's individual assets on a break-up basis.[191] Liquidation and receivership were the main corporate recovery procedures.[192]However, receiverships had come into existence for a specific objective of facilitating the recovery of debts by holders of floating charges/debentures.[193] Receivership was, by its very nature, more of an enforcement weapon for the unpaid debenture holder than a useful procedure for the benefit of unsecured creditors.[194] During the 1960s and 1970s, the insolvency of a company would normally lead to the appointment by the main secured creditor of a firm of accountants with the task of recovering debts through receivership.[195] The receiver's primary objective was to realise his client's security through sale of the company's assets.[196]

From the early 1980s, however, the English legal system witnessed a change in attitude towards nurturing the rescue culture.[197] The impetus for a new approach came to the fore in the findings and recommendations of the Insolvency Law Review

190 Goode, *Principles of Corporate Insolvency Law* 381.
191 *ibid*.
192 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 103.
193 *ibid.*
194 Goode, *Principles of Corporate Insolvency Law* 382.
195 Omar and Gant 2016 *Insolvency Law Journal* 43.
196 Omar and Gant 2016 *Insolvency Law Journal* 43.
197 Goode *Principles of Corporate Insolvency Law* 382.

Committee (the Cork Report).[198] It was the conclusion of the Cork Committee that the UK insolvency system lacked any real method for rescuing companies in financial distress, and that the existing procedures such as receiverships could not nurture the growth of corporate rescue.[199]

The Cork Committee dedicated a lot of effort to discuss the need for a paradigm shift towards promoting corporate rehabilitation[200]and laid the foundation for what is now commonly referred to as the 'rescue culture' in the UK.[201] The report clearly stated that a good modern system of insolvency law should provide a means for preserving viable commercial enterprises capable of making a useful contribution to the economic life of the country.[202] It emphasised that:

> We believe that a concern for the livelihood and well-being of those dependent upon an enterprise which may well be the lifeblood of a whole town or even a region is a legitimate factor to which a modern law of insolvency must have regard. The chain reaction consequences upon any given failure can potentially be do disastrous to creditors, employees and the community that it must not be overlooked.[203]

Following receipt of the findings and recommendations of the Cork Committee, the UK Parliament rapidly considered and agreed to overhaul the laws applicable to both Company law and Insolvency law in England.[204] The English legislature quickly enacted the UK Companies Act of 1985 and the Insolvency Act of 1985 in the same Parliamentary session.[205] The Insolvency Act of 1985 was shortly later re-enacted into the Insolvency Act 1986,[206] which substantially adopted the Cork Committee's recommendations to promote recovery of financially distressed companies through the introduction of two new rescue procedures. Company Voluntary Arrangement (CVA) targets companies that are not yet insolvent, while Administration seeks to facilitate

198 Cork Insolvency Law and Practice: Report of the Review Committee (the Cork Committee) (Cmnd.8558) (1982) para 496.
199 Omar and Gant 2016 *Insolvency Law Journal* 43, 47.
200 Goode *Principles of Corporate Insolvency Law* 382.
201 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 202.
202 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 202.
203 Cork Insolvency Law and Practice: Report of the Review Committee (the Cork Committee) (Cmnd.8558) (1982) para 204. Also see Finch and Milman *Corporate Insolvency Law* 202.
204 Omar and Gant 2016 *Insolvency Law Journal* 46.
205 *ibid*.
206 Goode *Principles of Corporate Insolvency Law* 383.

the rescue of companies that are nearly insolvent but with viable business prospects.[207] It has been argued that:

> The Insolvency Act 1986 embraced the objective of promoting recovery by the introduction of two new rescue procedures: the CVA, covering companies prior to formal insolvency, and administration for companies closer to insolvency. In its deliberations over how to approach corporate rescue from a UK perspective, although the Cork Committee considered a number of pre-existing procedures as examples of regimes that they might wish to emulate in some way, the inspiration for the two new recovery procedures were found in models that already existed within the law. Thus, the structural foundations for the CVA and administration were found respectively in a simplified and stripped-down version of the scheme of arrangement and receivership. Nonetheless, there was also a conceptual difference between the two procedures: the CVA attempted to provide a framework for the type of debtor-creditor negotiation that was similar to an informal workout, while administration was more formal a process directed by an administrator under the overall supervision of the court. Both procedures lay on a path of increasing formality, with the CVA upstream and administration further downstream. In addition, unlike receivership, administration was in nature a collective procedure, thus serving the interests of all creditors, both secured and unsecured, rather than just the principal secured creditor. Rejecting the debtor-in-possession model, what the two procedures had in common was the fact that, though the right of initiation could rest with the debtor, they were both managed exclusively by an insolvency practitioner.[208]

The incorporation of CVA and Administration procedures into English insolvency law solidified the rescue culture in the UK and further engendered the reorganisation of companies with the objective of restoring them to profitable trading and avoid the destructive effects of liquidation.[209]

In view of the primacy of both formal rescue procedures to this study, it is necessary to briefly expound on their nature and practical scope hereunder.

(a) Company Voluntary Arrangement (CVA)

A company Voluntary Arrangement (CVA) is an agreement through which creditors of a financially distressed company accept less than the amount due to them in the discharge of their claim. It is also known as a composition, or a scheme of arrangement of its affairs, the composition or scheme resulting from acceptance of a proposal by

207 Omar and Gant 2016 *Insolvency Law Journal* 48.
208 Omar and Gant 2016 *Insolvency Law Journal* 48.
209 Goode *Principles of Corporate Insolvency Law* 383.

the directors and creditors of the company.[210] The procedure for procuring a CVA is set out in sections 1 to 7 of the Insolvency Act 1986. It is commenced when the directors of the company or the liquidator or administrator, where the company is already under liquidation or administration, come up with a proposal (voluntary arrangement) on how they intend to settle the creditors' claims.[211]

CVA was intended to be a simple procedure through which companies, just like individuals, could organise their debts by freely negotiating and entering into a binding arrangement with their creditors for the settlement of their debts without going through a lot of formalities.[212] CVA was supposed to be an inexpensive, quick and efficient method of dealing with financial difficulties without engaging in formal insolvency procedures.[213] It is not necessary for the company to be insolvent or unable to pay its debts for it to utilise a CVA.[214]

Except where it is expressly agreed upon in the CVA agreement, or where the procedure is commenced when the company is already under liquidation or administration, the directors of the company remain in control of the company and continue to exercise all the necessary powers in the business and to realise its assets.[215]To safeguard the interests of the creditors, the law clearly provides that the proposal made must name an external person who must be an insolvency practitioner, to act as a trustee or supervisor for the effective implementation of the arrangement.[216]

The nominee is required to present a report to court within 28 days from the date of being notified of the CVA. He or she is required to state (a) whether, in his or her opinion, meetings of the company and of its creditors should be summoned to consider the proposal; and (b), if in his or her opinion, such meetings should be summoned, the date on which, and time and place at which, he or she proposes the meetings to be held.[217]

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210 Section 1 of The Insolvency Act 45 of 1986. Also see Goode, *Principles of Corporate Insolvency Law* 494.

211 Section 1 of The Insolvency Act 45 of 1986. Also see Goode, *Principles of Corporate Insolvency Law* 494 and Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 417–418.

212 Finch and Milman *Corporate Insolvency; Perspectives and Principles* 417.

213 Omar and Gant 2016 *Insolvency Law Journal* 48.

214 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 418. Also see Goode, *Principles of Corporate Insolvency Law* 494*.*

215 Goode, *Principles of Corporate Insolvency Law* 494.

216 Section 1(2) of the Insolvency Act 45 of 1986.

217 Section 2(2) of the Insolvency Act 45 of 1986.

Basing on the report submitted by the nominee, court proceeds to grant permission for the nominee or liquidator or administrator as the case may be, to summon meetings of shareholders and creditors to consider the terms of the arrangement.[218] The arrangement must be approved by at least 75 percent of the creditors present voting in person or by proxy in reference to value of the claims, and must also be supported by 50 percent in value of the members/shareholders of the company present in the meeting.[219]

Upon being approved by the requisite numbers of creditors and shareholders, the arrangement becomes binding on all creditors of the company except the secured creditors.[220] A CVA does not affect the rights of secured creditors to enforce their security except where they expressly consent to abandon their rights under the security instrument.[221] Similarly, the creditors and members cannot purport to approve a CVA that results into the modification of the priority or entitlement to payment by any preferential creditors, except with the concurrence of such preferential creditor.[222]

The underlying rationale behind the adoption of a CVA as far as creditors of an insolvent company are concerned is that it offers them a better return than they would realise if some other formal insolvency procedures were to be commenced in relation to the company, including a possibility that trade creditors might retain a customer for the future.[223] CVA was intended to be a simple procedure that would help companies in financial distress to resolve their debt problems without enduring the formal insolvency procedure. This had the potential to benefit all creditors, regardless of whether their debts had been reduced in the compromise as opposed to just a single secured creditor profiting from a receivership to the total detriment of other creditors.[224] As a debtor-friendly procedure, CVA was also intended to encourage companies to

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218 Section 3 of the Insolvency Act 45 of 1986. Also see Omar and Gant 2016 *Insolvency Law Journal* 9.

219 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 418.

220 Section 7 of the Insolvency Act 45 of 1986. Also see Finch and Milman *Corporate Insolvency Law* 418.

221 Section 4(3) of the Insolvency Act 45 of 1986; Finch and Milman *Corporate Insolvency Law* 419.

222 Section 4(4) of the Insolvency Act 45 of 1986.

223 Goode, *Principles of Corporate Insolvency Law* 495.

224 Omar and Gant 2016 *Insolvency Law Journal* 51.

seek help at an early stage, while at the same time provide a catalyst for management changes that would further assist in the turnaround of the company.[225]

In its original form under the insolvency Act of 1986, CVA did not give companies any moratorium against enforcement action or debt recovery proceedings from creditors during the period when negotiations were underway between the company and its creditors.[226] This meant that unless the company did an excellent job to engage and persuade all creditors to support the proposed CVA by not instituting any proceedings during the 28 days before the CVA could be considered and approved by the creditors, there was always a risk that any creditor could, upon receiving a proposal from the company for a CVA, just move ahead of other creditors and institute debt recovery proceedings against the company, before the CVA is approved. This rendered CVA unattractive as a rescue procedure.[227] According to Lord McIntosh of Haringey,

> The recession of the early 1990s showed that it (CVA) was not particularly useful to the smaller company when it encountered financial difficulty. This is because of a lack of a short breathing space in the procedure-that is, a temporary stay on creditors' rights so that management can put a rescue plan to creditors.[228]

This prompted the UK government to undertake studies on how to improve this procedure.[229] In 2000, an amendment of the Insolvency Act was made, which among others introduced a moratorium for small companies that opt for a CVA.[230] Unfortunately, the definition of small companies that are eligible to enjoy a moratorium immediately their directors make a proposal for a CVA is too narrow that it leaves out the majority of companies in the UK.[231] In fact, reports indicate that the general uptake of CVAs as a rescue procedure has been disappointingly low since 1986.[232]

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225 Omar and Gant 2016 *Insolvency Law Journal* 51.

226 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 419.

227 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 419.

228 Hansard, Insolvency Bill (H.L) 4th April 2000, Vol.611 Column 1249. Also see Tribe J 'The extension of Small Company Voluntary Arrangements: A response to the Conservative Party's corporate restructuring proposals' in Omar (ed), *Insolvency Law: Issues, Themes and Perspective* 5.

229 The Insolvency Service, Company Voluntary Arrangements and Administration Orders: A consultation Documents (DTI, London October 1993).

230 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 419–420.

231 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 423. Also see Insolvency Service, A review of the Corporate Insolvency framework para 7.4.

232 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 425. Also see Tribe 'The extension of Small Company Voluntary Arrangements: A response to the Conservative Party's

The dismal use of CVAs is attributed to a number of reasons, notably the general perception that the procedure for obtaining approval from the members and creditors is laborious and hence expensive for especially the small companies.[233] Absence of a moratorium for all companies under CVA, except the small companies, which renders the company vulnerable during the period leading to the approval of the proposal.[234] Similarly, the fact that under a CVA, the management of the debtor company remain in its possession during the negotiations and throughout the implementation of the arrangement, creates justified suspicion about the capacity of the same directors who could have driven the company into insolvency to remain in charge of its operations during the implementation of the CVA.[235] Lack of finance to fund the rescue strategies and operations of the company during the CVA has also rendered CVA an unattractive procedure.[236] CVA has also remained underutilised because of the uncertainty about what happens if the company defaults in meeting its obligations under the approved arrangement, with a fear that creditors might find themselves in a less favourable position. In addition, CVAs often result into creditors giving very big waivers or concessions to the debtor which ends up affecting their net return.[237]

Those factors have undermined the efficacy of CVAs as a vehicle for corporate rescue in the UK,[238] and it is important for other jurisdictions to avoid similar pitfalls in the design process of their corporate rescue laws.

(b) Administration

Administration is a collective insolvency procedure that was specifically designed to promote the rescue culture by facilitating the placement of the company's affairs in the hands of an administrator entrusted with the task of promoting the interests of the general body of creditors. The primary objective is to rescue the company as a going

corporate restructuring proposals' in Omar (ed), *Insolvency Law: Issues, Themes and Perspective* 10–11.

233 *ibid*.

234 Omar and Gant 2016 *Insolvency Law Journal* 51.

235 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 424.

236 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 424.

237 Omar and Gant 2016 *Insolvency Law Journal* 52.

238 *ibid*.

concern or, if that is not practicable, to achieve a better result for its creditors than would be achieved on an immediate liquidation.[239]

The roots of administration can be traced back to the Cork Committee's belief that corporate rescue could be furthered by allowing an independent expert to take over the management of a distressed company and work towards its resuscitation.[240] The Cork Committee proposed the institution of an administrator who would be an independent professional, specifically appointed to undertake a reorganisation of the distressed company with a view to restoring its profitability, maintain employment, ascertain the chances of restoring the company back to its owners, or where rescue is not feasible, develop a proposal for the orderly realisation and sale of the assets of the company for the benefit of all creditors.[241]

Following acceptance of the Cork Committee's recommendations, administration was introduced in England through the Insolvency Act of 1985 and was retained in the re-enacted Insolvency Act of 1986 (The Insolvency Act).[242] The Insolvency Act[243] provided the mechanism and procedures through which an eligible company could enter into administration.[244] At that time, administration could only be commenced after obtaining an administration order of court[245] directing the affairs, business and property of the company to be managed by an administrator.[246] This would follow a petition to court by the company, or the director, or by a creditor or creditors, including any contingent or prospective creditor or creditors, or by all or any of those parties, together or separately.[247]

The court could make the administration order if it was satisfied first, that the company was likely to become unable to pay its debts and secondly, that the making of the order would enable the company to achieve the survival of the company, and the whole or

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239 Insolvency Act 45 of 1986 Sch. B1 para.3(1). Also see Goode, *Principles of Corporate Insolvency Law* 33.
240 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 301.
241 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 302.
242 Goode, *Principles of Corporate Insolvency Law* 33.
243 Section 8 of the Insolvency Act 45 of 1986.
244 Sections 8–27 of the Insolvency Act 45 of 1986.
245 Section 8 of the Insolvency Act 45 of 1986.
246 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 302.
247 Section 9(1) of the Insolvency Act 45 of 1986.

any part of the undertaking as a going concern,[248] the approval of a voluntary arrangement,[249] the sanctioning of a compromise or arrangement between the company and any of the persons mentioned in section 425 of the companies Act,[250] and a more advantageous realisation of the company's assets than would be effected on winding up.[251]

Evidence, however, indicates that before the enactment of the Enterprise Act 2002, administration had been less efficacious as a rescue device than expected.[252] It is reported that by 1999, the ratio of administration appointments to liquidation was 440: 14280; the business preservation rate in administration for the period 1998-1999 was only 79 percent, with a job preservation rate at 40 percent.[253]

A number of factors weakened the effectiveness of administration as a rescue device and discouraged its use.[254] First, the procedure through which a company could enter into administration under the Insolvency Act of 1986 was prone to obstruction by a floating charge holder, by simply appointing an administrative receiver and refusing to consent to the making of the administration order.[255] The law clearly provided that court would dismiss a petition for an administration order where there was an administrative receiver appointed in respect of the company unless the person on whose behalf the administrative receiver was appointed had consented to the making of the administration order.[256] This meant that:

> Administration was a process that could only be used if the firm had no creditor with a floating charge (a rare occurrence given the proliferation of secured lending in standard British financing arrangements and banking practice) or if the floating charge holder was happy to see the company's troubles dealt with by administration rather than by administrative receivership.[257]

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248 Section 8(3)*(a)* of the Insolvency Act 45 of 1986.
249 Section 8(3)*(b)* of the Insolvency Act 45 of 1986.
250 Section 8(3)*(c)* of the Insolvency Act 45 of 1986.
251 Section 8(3)*(d)* of the Insolvency Act 45 of 1986.
252 Goode, *Principles of Corporate Insolvency Law* 383. Also see Finch and Milman *Corporate Insolvency Law* 304.
253 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 304–305.
254 Insolvency Service, Company Voluntary Arrangements and Administration Orders: A Consultation
Document (DTI, London, October 1999) 5.
255 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 305.
256 Section 9(3)*(a)* of the Insolvency Act 45 of 1986.
257 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 305.

Vesting the right of veto for administration in the hands of holders of floating charges directly undermined its use as a corporate rescue procedure in the UK, since in majority of cases, floating charge holders, mostly the banks, would find every reason to obstruct the placement of their debtor in administration.[258] To a floating charge holder, administrative receivership was a much better remedy than administration, since an administrative receiver, unlike an administrator, would primarily work towards facilitating the recovery of the charge holder's debt.[259]

Secondly, the procedural cost of administration also discouraged its use, largely because of its over dependency on judicial supervision. The court was heavily involved in the processes for the appointment, supervision and/or removal of the administrator.[260]

Thirdly, the Insolvency Act of 1986 vested a lot of powers in the administrator and alienated creditors and shareholders in making critical decisions about the way administration was to be conducted.[261] This discouraged creditors from instigating or agreeing to the commencement of administration, especially the floating charge holders because they knew that once an administrator is appointed, they will cease to exercise control over the way the administration is conducted.[262]

Fourthly, the legal requirement that court could only make an administration order where it was satisfied that the company was likely to become unable to pay its debts[263] also worked against administration and was at odds with the Cork Committee's vision of an administrator being appointed at an earlier stage in the corporate decline curve of the company.[264] Other reasons for the dismal use of administration before 2002 included mistrust of insolvency practitioners, fear of failure by company directors, fear of withdrawal of funding by banks upon entry into administration, and the fact that court

[258] Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 305.
[259] Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 305.
[260] Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 305.
[261] Insolvency Service, Company Voluntary Arrangements and Administration Orders: A consultation Document (DTI, London, October 1999) 30.
[262] Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 306.
[263] Section 8(1)*(a)* of the Insolvency Act 45 of 1986.
[264] Cork Insolvency Law and Practice: Report of the Review Committee (the Cork Committee) (Cmnd.8558) (1982) para 197; Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 306.

could not make an administration order when the company was already in liquidation.[265]

After realising that the UK was not realising the envisaged benefits of corporate rescue through administration, it became apparent that legal reform of this procedure was necessary.[266] In 1999, the Chancellor of the Exchequer and the Secretary of State for Trade and Industry constituted a team of experts to review aspects of corporate insolvency law in the UK and elsewhere relating to the opportunities for and the means by which businesses can resolve short to medium term financial difficulties so as to preserve maximum economic value and make recommendations for consideration.[267]

By May 2000, the review group issued a report with very clear recommendations that the provisions of the Insolvency Act of 1986 should be revised to remove all the identified legal hurdles to the use of administration by deliberately trimming the powers and rights enjoyed by holders of floating charges to veto the entry of debtors into administration.[268] The recommendations of the review group were endorsed by government through the White Paper on Productivity and Enterprises,[269]which ultimately culminated into the enactment of the Enterprise Act 2002.[270] The Enterprise Act 2002 came into force on 15th September 2003[271] and substituted the original part II of the Insolvency Act 1986 with a new part II, the provisions of which are set out in a new Schedule B1 to the Insolvency Act 1986.[272]

The Enterprise Act 2002 revolutionalised the law governing administrative receiverships and administration in UK by inserting a new Chapter IV into Part III of

265 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 306. Also see Insolvency Service, Company Voluntary Arrangements and Administration Orders: A Consultation Document (DTI, London, October 1999) 30 and Goode, *Principles of Corporate Insolvency Law* 384.

266 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 312.

267 The Insolvency Service, A review of Company Rescue and Business Reconstruction Mechanisms Report by the Review Group (DTI, London, 2000) 5.

268 The Insolvency Service DTI Report 2000, 21. Also see Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 312.

269 White Paper, Productivity and Enterprise: Insolvency-A Second Chance (Cm 5234, July 2001) para 2.15.

270 The Enterprise Act 40 of 2002.

271 The Enterprise Act 2002 (Commencement No 4 and Transitional Provisions and Savings) Order 2003 SI No. 2093 of 2003.

272 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 312.

the Insolvency Act 1986.[273] The corporate insolvency provisions of the Enterprise Act 2002 were intended to reconfigure the structure and procedure of insolvency law by limiting the control rights of secured creditors with a view to encouraging greater use of administration procedure as a simple and effective tool for engendering corporate rescue in the UK.[274]

The Enterprise Act made it clear that administration was the preferred procedure for attempting to rescue troubled companies in the UK and abolished the use of administrative receiverships by holders of floating charges, except in a few circumstances.[275]The Enterprise Act also streamlined the procedure for the appointment of an administrator, by clearly providing three routes through which an administrator can be appointed.[276] Unlike the pre-Enterprise Act position where an administration order could only be made by court, the Enterprise Act broadened the commencement window by providing that an administrator can be appointed either by the court, on the application made by the company, its directors, one or more of the company's creditors or a combination of these parties,[277] or out of court on the application of the holder of a qualifying floating charge,[278] and out of court on the application of a company or the company directors.[279]

With this change in commencement procedure, it became easier for companies and floating charge holders, mostly banks, to cause the appointment of administrators in respect of financially distressed companies at an early stage, without necessarily going through the often-lengthy court process.[280]

The Enterprise Act also removed the burdensome requirement for a floating charge holder to satisfy court that the company was or was likely to become unable to pay its

273 Goode, *Principles of Corporate Insolvency Law* 384–385.
274 Armour, Hsu and Walters, 'The Impact of the Enterprise Act 2002 on Realisations and costs in Corporate Rescue proceedings' Report to the Insolvency Service December 2006, 7.
275 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 312.
276 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 312.
277 Insolvency Act 45 of 1986 as Amended by the Enterprise Act 40 of 2002, Schedule B1 paras 11–13. Also see Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 313.
278 Insolvency Act 45 of 1986 Schedule B1 paras 14–21. Also see Finch and Milman *Corporate Insolvency Law* 313.
279 Insolvency Act 45 of 1986 Schedule B1 paras 22–34. Also see Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 313.
280 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 313.

debts within the meaning of section 123 of the Insolvency Act 1986, before an administration order could be made.[281] By making it possible for a holder of a qualifying floating charge to make an appointment without the need for the company to be actually insolvent or facing insolvency, the law encouraged floating charge holders to place companies in administration before their financial positions become critical, which is in line with the original policy objective of administration.[282]

The Enterprise Act 2002 also replaced the multi-purpose administration with a regime in which there is only a single purpose, to be selected according to a three-part hierarchy.[283] Unlike under the original regime under section 8(3) of the Insolvency Act of 1986, where administration sought to achieve a number of objectives, including the survival of the company, the approval of a CVA, or the attainment of a compromise, the Enterprise Act substituted this requirement with a new provision which states that an administrator of a company must perform his functions with the primary objective of attaining one of the three stated objectives of administration, namely rescuing the company as a going concern, achieving a better result for the company creditors as a whole or realising the company property to make a distribution to one or more secured or preferential creditors.[284]

It also introduced flexibility in the exit routes from administration, including the ability to move from winding up to administration and from administration straight to dissolution.[285] Under the revised regime, there is a greater range of exits from administration than was formerly the case.[286] Under the post-Enterprise Act regime, a company can exit from administration and enter into a CVA,[287] a compromise or arrangement,[288] a distribution within administration with the court's permission,[289] a

281 Goode, *Principles of Corporate Insolvency law* 390.
282 Goode, *Principles of Corporate Insolvency law* 390.
283 Goode, *Principles of Corporate Insolvency Law* 385.
284 Insolvency Act 45 of 1986 Schedule B1 para 3 as Amended by the Enterprise Act 40 of 2002.
285 Goode, *Principles of Corporate Insolvency Law* 385.
286 Goode, *Principles of Corporate Insolvency Law* 470.
287 Insolvency Act 45 of 1986 Sched B1 clause 49(3)*(a)* as Amended by the Enterprise Act 40 of 2002.
288 Insolvency Act 45 of 1986 Sched B1 clause 49(3)*(b)* as Amended by the Enterprise Act 40 of 2002.
289 Insolvency Act 45 of 1986 Sched B1 clause 65(3) as Amended by the Enterprise Act 40 of 2002.

creditor's voluntary winding up,[290] and a dissolution of the company without first going into winding up.[291]

It is reported that the above reforms improved the relevance and efficacy of administration as a rescue procedure and resulted into significant increase in the percentage of companies that are placed under administration in the UK.[292]

It is also worth noting that the English legal system has given birth to a formidable informal rescue procedure, commonly referred as pre-packs. For completeness of our discussion on the rescue system in England, it is paramount to briefly discuss what this informal procedure portends.

(c) Pre-pack administration

A pre-packaged administration, commonly referred to as 'pre-pack', is an informal rescue procedure under which a troubled company and its creditors conclude an agreement in advance of the formal statutory administration procedure.[293] This usually occurs where, prior to the appointment of an administrator, negotiations and arrangements are made by the company and a prospective buyer, for the sale of the company's business immediately after the formal appointment of the administrator, usually without convening a creditor's meeting or making any application to court for approval.[294] A pre-pack sale may also be concluded by an administrator appointed by court, in which case the court may be asked to make an order approving the proposed sale.[295]

Pre-pack administration entails an administrator selling the business at or soon after his or her appointment, often to the existing owners/directors, and usually the bulk of the preparatory work for the sale is carried out in advance of formal administration and before the creditors have been told about the failure of the business.[296] Pre-packs are

290 Insolvency Act 45 of 1986 Sched B1 clause 83 as Amended by the Enterprise Act 40 of 2002.
291 Insolvency Act 45 of 1986 Sched B1 clause 84 as Amended by the Enterprise Act 40 of 2002.
292 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 323.
293 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 371.
294 Goode, *Principles of Corporate Insolvency Law* 412.
295 Goode, *Principles of Corporate Insolvency Law* 412. Also see *Re Hellas Telecommunications (Luxemburg)II SCA* [2010] B.C.C 295.
296 Graham 'Review into Pre–pack Administration' (Insolvency Service, June 2014) 4.

a means through which administrators quickly realise the assets of an insolvent company and use the proceeds to pay creditors to prevent them from enforcing their fixed charges and to protect the company from the risk of liquidation.[297]

Pre-packs emerged as an informal measure to address the uncertainty that often engulfs stakeholders about the future of the company and/ or its business after entry into formal administration. With a pre-packaged administration, all the preparatory work for the sale of the company's assets and/or business is carried out in advance such that by the time the administrator is formally appointed, the company will have already discussed and agreed with the administrator and the prospective purchaser about the value and price at which the company assets and/ or business will be bought and how creditors' claims and other concerns like employees' rights will be dealt with immediately after entry into administration.[298]

The concept and procedure of pre-packs is however not entirely new; it was previously used in the UK by administrative receivers.[299] The UK's pre-pack procedure derives its roots from the US[300] pre-packaged bankruptcy filings, which are reported to have first emerged in the mid-1980s and rapidly grew in popularity in the early 1990s.[301] In the US, unlike in the UK, pre-packaged bankruptcy filings are more formal and subject to stricter disclosure obligations. Whereas it is acceptable for the debtor to reach out to its creditors before formal filings are made, the proposed pre-pack arrangement must be approved by a significant majority of creditors, often around 90 percent of the creditors,[302] before the company can make a formal Chapter 11 filing in court.[303] The debtor company is required to accompany its court petition with a pre-pack plan and a disclosure statement, which then allows court to conduct a quick hearing to determine the adequacy of the pre-petition disclosure and whether the proposed plan should be confirmed.[304] This obviates the risks associated with adverse and lengthy negotiations with creditors, which saves time and results into payment of lesser

297 Conway and Shalchi, 'Pre–pack Administrations' Briefing Paper No.5035 of 4 March 2021, 5.
298 Conway and Shalchi, 'Pre–pack Administrations' Briefing Paper No.5035 of 4 March 2021, 5.
299 Goode, *Principles of Corporate Insolvency Law* 412.
300 *ibid*.
301 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 371.
302 Section 1126 of the US Bankruptcy Code Chapter 11 of 1978. Also see Mkhondo and Pretorius 2017 *Southern African Business Review* 100.
303 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 372.
304 *ibid*.

professional fees, than would be the case in ordinary bankruptcy filings without pre-packs.[305]

In the UK, pre-packs are not expressly provided for in the insolvency legislation or at all.[306] It has, however, been argued that the Enterprise Act 2002 significantly encouraged the use of pre-packs when it introduced the streamlined system for out-of-court routes into administration and simpler means of exiting from administration.[307] In the UK, pre-packs typically involve a pre-agreed restructuring deal between the company its leading creditors followed by the appointment of an office holder, either an administrator or an administrative receiver to consummate the transaction.[308] The process is mostly market driven and the role of court is very limited.[309]

Proponents of pre-packaged administration in the UK argue that it presents a number of benefits, noting that it minimises disruptions to the business in contrast to the often-protracted formal insolvency processes, which helps in preserving business value and employment.[310] Pre-packs are also said to be cheaper than upstream informal insolvency procedures such as schemes of arrangements, mainly because a pre-pack administration can be undertaken outside of the court formality and can be concluded without the involvement of the unsecured creditors or with only their limited involvement, which results into significant savings on costs and professional fees paid out.[311]

Once the pre-pack is arranged with a purchase contract drawn and an insolvency practitioner appointed as an administrator, the courts will in most cases be sympathetic to the company against disruptive actions by creditors, which ultimately helps to further protect the going concern value of the company.[312] It has also been argued that the speed of the pre-pack process may be particularly valuable in sectors or businesses

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305 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 372. Also see Vilapana 1998 *The Practical Lawyer* 33.
306 Mkhondo and Pretorius 2017 Southern African Business Review 103. Also see Conway and Shalchi 'Pre–pack administrations' Briefing Paper No.5035 of 4 March 2021, 7.
307 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 375.
308 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 373.
309 Mkhondo and Pretorius 2017 *Southern African Business Review* 104.
310 Graham, *Graham Review into Pre–pack Administration* (Insolvency Service, June 2014) 6.
311 Graham, *Graham Review into Pre–pack Administration* (Insolvency Service, June 2014) 7.
312 Conway and Shalchi 'Pre–pack Administrations' Briefing Paper No.5035 of 4 March 2021, 9.

where protracted formal insolvency procedures or restructuring processes would considerably affect corporate value. Use of pre-packs is advisable in transactions involving companies in regulated sectors such as telecommunications, banking, insurance, or aviation. In such regulated sectors, retaining of licenses, franchises and other valuable business opportunities may be significantly affected by the adverse publicity or public uncertainty created by formal insolvency procedures.[313]

Due to the apparent benefits of pre-packs, anchoring this procedure in UK's restructuring and insolvency framework will attract overseas companies to transfer their centre of main interest to the UK to avail themselves of this flexible restructuring, insolvency, and company law framework, which may potentially become a source of inward investment to the UK economy.[314]

Its apparent benefits notwithstanding, the use of pre-packs has generated a lot of negative publicity such as that unsecured creditors have no voice in the process, which lacks transparency with a consequential lack of accountability.[315] Pre-packs may also be unacceptably biased towards the interests of secured creditors, particularly the holders of floating charges and the business may be rushed into a sale at an undervalue, particularly in cases where there is a proposed management buy-out and the management has a close relationship with the intended administrator.[316]

Others have argued that pre-packs result into businesses being sold at undervalue price, especially where the company is sold to the previous owners or a connected party with no open marketing of the business or effective valuation of the business before conclusion of the sale.[317] Fairness of pre-packs has also been questioned because of the secretive nature of the negotiations.[318] It is argued that pre-pack sales usually occur before the market has been adequately tested since some interested parties may not have been made aware of the sale, with the risk that the company or

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313 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 375.

314 Graham, *Graham Review into pre–pack administration* (Insolvency Service, June 2014) 7.

315 Goode *Principles of Corporate Insolvency Law* 413.

316 Goode, *Principles of Corporate Insolvency Law* 413. Also see Frisby, 'A preliminary Analysis of Pre-Packaged Administration' Report to the Association of Business Recovery Professional August 2007, Available at: https://www.iiiglobal.org/sites/default/files/sandrafrisbyprelim.pdf (Date of use: 10 July 2021) 71.

317 Conway and Shalchi 'Pre–pack administrations' Briefing Paper No.5035 of 4 March 2021, 9.

318 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 378.

business may end up being unsold.[319] Lack of transparency and consultation also creates a sense of alienation and disenfranchisement amongst, especially the unsecured creditors, which has greatly watered down the efficacy of pre-packs as a useful rescue procedure.[320]

In spite of all the above concerns, insolvency practitioners still justify the use of pre-packs as opposed to traditional administration procedure because they believe that it presents better benefits to creditors.[321] Proponents of pre-packs argue that they consider their use necessary due to lack of funds to meet the cost of trading during administration and hence the need to make a quick sale and exit out of administration before the company runs out funds to sustain its continued operations.[322] They also argue that for businesses with a large customer base and where the customers can easily find an alternative source of supply, the uncertainty associated with the commencement of formal insolvency proceedings often causes sudden loss of business value, hence the need to quickly pre-package the transaction and sell the business sooner than later.[323] Similarly, pre-packs are considered useful in businesses where it is thought that employees and business goodwill are key components of the business. In such cases, it is argued that selling the business fast is necessary, otherwise any delay in ordinary administration processes could cause employees to find alternative jobs and for the business to lose its good will, which could ultimately result into reduced value of the business.[324]

To minimise the key concerns about pre-packs, in 2009, the UK's Insolvency Practitioner's Association, issued a Statement of Insolvency Practice 16 (SIP 16), which contained a detailed guide on how practitioners should conduct themselves with respect to pre-packaged administrations.[325] This reflected a commitment by

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319 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 378.

320 *ibid*, Also see Graham, *Graham Review into Pre-Packaged Administration* (Insolvency Service, June 2014) 10.

321 Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 108.

322 Finch and Milman *Corporate Insolvency Law* 413. Also see Frisby, 'A Preliminary Analysis of Pre-packaged Administration' Report to the Association of Business Recovery Professional, August 2007. Available at: https://www.iiiglobal.org/sites/default/files/sandrafrisbyprelim.pdf (Date of use: 10 July 2021) 32.

323 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 413.

324 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 413.

325 https://insolvency-practitioners.org.uk/uploads/documents/f30389ce35ed923c06b2879fecdb616a.pdf

insolvency practitioners to eliminate abuse and restore trust in pre-packs.[326] Following further review and recommendations by the Graham Review,[327] SIP 16 was revised in November 2015 with emphasis on improved and transparent marketing of the business before completion of the sale by the administrator.[328]

To further improve the conduct of pre-packs and minimise room for abuse, on the 30 April 2021,[329] the UK government, introduced the Administration (Restrictions on Disposal etc. to connected Persons) Regulations 427 of 2021,[330] to guide practitioners in the management of administrations generally, and pre-packs in particular. The regulations, among others, clearly provide that an administrator must not make a substantial disposal unless either the sale has been approved by creditors or a qualifying report from an independent professional (evaluator) has been obtained.[331]

It is believed that with these new set of regulations, pre-packaged administration will be subject to greater scrutiny and transparency, and the creditors will feel more involved in the processes leading to the disposal of the debtor's assets, which will inevitably go a long way in preserving value for distressed companies while at the same time engender the rescue culture in the UK.

7.3.1.1 Key positives about UK's corporate rescue system

Although the UK's corporate rescue framework is far from being perfect, there is demonstrated evidence that the UK government has consistently shown firm commitment to build an efficient and effective insolvency system[332] that seeks to nurture enterprises and create a business environment that supports the survival of distressed but viable businesses.[333] This commitment has partly been shown through

(Date of use: 10 July 2021).

326 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 399.

327 Graham, *Graham Review into Pre–Pack Administration* 6.

328 *ibid*.

329 Regulation 1(1) of the Administration (Restrictions on Disposal etc. to connected persons) Regulations 427 of 2021.

330 https://www.legislation.gov.uk/ukdsi/2021/9780348220421 (Date of use: 10 July 2021).

331 Regulation 3 of the Administration (Restrictions on Disposal etc. to connected persons) Regulations 427 of 2021.

332 White Paper, Productivity and Enterprise: Insolvency–A second Chance (CM 5234), July 2001). Available at: https://www.iiiglobal.org/sites/default/files/26–_2nd_chance.pdf (Date of use: 12 Jul 2021) 9.

333 The Insolvency Service 'A review of the corporate insolvency framework; A consultation on

the many initiatives, consultative processes and amendments to the laws that have been undertaken by the UK government since 1985 to improve and remove the identified hurdles to the attainment of effective corporate rescue.[334] This has resulted into the following notable enablers of corporate rescue:

(i) Easy entry into rescue procedure

As noted above,[335] the initial provision of the Insolvency Act 1986 had created a procedural barrier to entry into administration, whereby a company could only commence administration after obtaining an administration order from a court of law. This would also necessitate the applicant satisfying a number of requirements including adducing evidence that the company was or was likely to become unable to pay its debts.[336] Before the enactment of the Enterprise Act 2002, floating charge holders enjoyed the right to veto the making of an administration order and this practically made it impossible for most trading companies to enter into administration.[337]

In recognition of the potential of administration as a rescue procedure[338] and in order not to lose focus of the original reasoning behind the introduction of administration under the insolvency Act 1986, the UK Government quickly resolved this problem by enacting the Enterprise Act 2002, which as has already been discussed,[339] opened the routes to administration, by allowing the appointment of an administrator by court, or out of court at the instance of a qualifying floating charge holder or by the company or its directors.[340]

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options for Reform May 2016. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/525523/A_Review_of_the_Corporate_Insolvency_Framework.pdf (Date of use: 12 Jul 2021) 4.

334 The Insolvency Service ‘A review of the corporate insolvency framework; A consultation on options for Reform May 2016. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/525523/A_Review_of_the_Corporate_Insolvency_Framework.pdf (Date of use: 12 Jul 2021) 4.

335 See 7.3.1(b).

336 Section 8 of the Insolvency Act 45 of 1986.

337 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 312.

338 White Paper, Productivity and Enterprise: Insolvency-A second Chance (CM 5234), July 2001). Available at: https://www.iiiglobal.org/sites/default/files/26–_2nd_chance.pdf (Date of use: 12 Jul 2021) 10, para 2.7.

339 See 7.3.1(b).

340 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 313.

To further deregulate access to administration by distressed companies, in 2015 the UK Government enacted the Deregulation Act 2015,[341] wherein schedule 6, part 2 paragraph 5 removed another procedural impediment against directors initiating the appointment of administrators after a petition for the winding up of the company had been filed in court.[342]

Some creditors would use this provision to pre-empt the company's attempt to appointment administrator. However, under the new provision, directors of a distressed company can now appoint an administrator, and administration can proceed for as long as it can be proved that by the time the company or directors appointed an administrator, they were not aware of the petition to wind up the company.[343]

Owing to the improvements in the law, it is now easier for companies, directors, and creditors in the UK to cause distressed debtors to enter into administration, since the entry routes have been widened and made easier and less onerous.

(ii) Protects essential supplies to insolvent business

One of the challenges that many businesses face immediately they enter into any insolvency procedure is termination and/or withdrawal of supply of services by their contracting parties.[344] In most cases, suppliers will demand upfront payment for any services consumed and others will dictate new terms under which continued provision of service can be done. According to a survey that was conducted in the UK in 2013, it was reported that of the companies that entered into formal insolvency proceedings in UK,[345] 41 percent of their key trade suppliers withdrew supply and 49 percent

341 The Deregulation Act 20 of 2015.
342 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 314.
343 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 314.
344 The Insolvency Service 'A review of the corporate insolvency framework; A consultation on options for Reform' (May 2016) 19. Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/525523/A_Review_of_the_Corporate_Insolvency_Framework.pdf (Date of use: 12 July 2021).
345 R3 and ComRes: Association of Business Recovery Professionals Membership Survey, August

demanded for ransom payments or attempted to renegotiate their supply contracts as a condition before they could continue supplying the company during formal insolvency proceedings.[346] Such actions seriously frustrate rescue efforts and as we have already noted,[347] unless the law provides a mechanism for moderating the conduct of counterparties to contracts for essential goods and services with the insolvent businesses, success in rescue attempts is bound to remain elusive.

To mitigate the risks associated with this challenge and to further engender the rescue culture, in 2015, the UK Government passed the Insolvency (Protection of Essential supplies) Order 2015, which amended the Insolvency Act 1986. It comprised explicit provision to restrain providers of essential goods and services to companies undergoing corporate rescue proceedings such as providers of utilities, IT goods or services from withdrawing supply to customers on account of their insolvent state, without first obtaining a court order.[348]

Section 2 of the Insolvency (Protection of Essential Supplies) Order 2015 amended section 233 of the Insolvency Act 1986 by providing that the supply of gas, electricity, water, communication services and related goods and services such as sale of terminals, computer hardware, technical advice and assistance in connection to the use of information technology, data storage and process and website hosting services to a company undergoing administration or a voluntary arrangement shall be deemed essential goods and supplies. The law goes on to expressly provide that an insolvency-related term of a contract for the supply of essential goods or supplies to a company ceases to have effect when the company enters administration, or a voluntary arrangement approved under part of the Insolvency Act of 1986.[349]

2013, Termination Clauses. https://www.r3.org.uk/media/documents/policy/research_reports/R3_Membership_Survey_Termination_Clauses_09_August_2013.pdf (Date of use: 12 July 2021).

346 The Insolvency Service ‘A review of the corporate insolvency framework; A consultation on options for Reform’ May 2016, 19.

347 See the discussions in 4.8.3 and 6.7.4.

348 The Insolvency Service ‘A review of the corporate insolvency framework; A consultation on options for Reform’ May 2016, 19.

349 Sections 2–4 of the Insolvency (Protection of Essential Supplies) Order 2015.

The government's objective underlying these changes was to ensure that viable businesses stand a greater chance of rescue without being subjected to unhealthy pressure and ransom demands by providers of such critical goods and services.[350]

Countries seeking to create favourable conditions for the rescue of financially distressed companies ought to benchmark on this pragmatic intervention by the UK government to include similar provisions in their laws so as to protect value of businesses undergoing rescue proceedings.

(iii) Wide scope of moratorium

It has been argued[351] that the nature and strength of a moratorium provided to companies in rescue contributes a lot to the success of any rescue regime, since stay of proceedings is often vital in ensuring the preservation of value and the prevention of disruptive actions by individual creditors and the dissipation of the debtor's assets.[352]

The UK legal regime firmly reflects this position.[353] Sections 10 and 11 of Insolvency Act 1986 as amended by the Enterprise Act 2002 clearly provides that once a company enters administration, no step may be taken to enforce security over the company's property except with the consent of the administrator or the permission of court.[354] It goes on to provide that no step may be taken to repossess goods in the company's possession under a hire-purchase agreement except with the consent of the administrator or the permission of court.[355] The same provision goes on to protect the company against actions by landlords. It provides that a landlord may not exercise a right of forfeiture by peaceful re-entry in relation to premises let to the company, except with the consent of the administrator or the permission of court.[356] The same law

350 The Insolvency Service 'A review of the corporate insolvency framework; A consultation on options for Reform' May 2016, 19.

351 See the discussions in 6.5.2(b) and 6.7.1.

352 Instrument of the European Law Institute, 'Rescue of business in insolvency law' (2017 222). Available at: https://www.europeanlawinstitute.eu/fileadmin/user_upload/p_eli/Publications/Instrument_INSOLVENCY.pdf (Date of use: 13 Jul 2021).

353 Goode, *Principles of Corporate Insolvency Law* 424.

354 Paragraph 43(2) of the Enterprise Act 40 of 2002.

355 Paragraph 43(3) of the Enterprise Act 40 of 2002.

356 Paragraph 43(4) of the Enterprise Act 40 of 2002.

protects companies in administration and their property against all legal processes, including legal proceedings, execution, distress and diligence, except with the consent of the administrator or with the permission of court.[357]

It is imperative to note that the wording of the law clearly shows that companies in administration in the UK are not just protected against actions by creditors or persons bound by the administration deed, but everybody.[358] This means that for the period when the company is in administration, the company is in a safe harbour.

Furthermore, the law makes provision for what is called 'interim moratorium', which is another window through which a company can obtain a moratorium from the time it makes an application for an administration order or gives notice of intention to appoint an administrator.[359] This provision is particularly helpful in countries such as Uganda where administration is commenced only upon the grant of an administration order, and yet there are no special insolvency courts. This would imply that a company can petition court for an administration order and take up to six months before the administration order is made by court. In such a case, one would consider applying for an interim moratorium pending determination of the petition for administration. The UK law also provides a moratorium in favour of a small eligible company for as long as it proves to be undergoing any insolvency process or pending a meeting to consider a Company Voluntary Arrangement.[360]

In addition to the above measures, in 2020, the UK government enacted the Corporate Insolvency and Governance Act 12 of 2020 (the CIGA), which is yet another extraordinary law which provides a very liberal procedure through which companies can obtain a moratorium against a wide range of legal proceedings, including commencement of insolvency proceedings.[361] The CIGA has been described as a law that has made the most significant changes to UK's insolvency legislation in a generation.[362] It introduced three permanent rescue measures, namely a new free

357 Paragraph 43(5) of the Enterprise Act 40 of 2002.
358 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 317.
359 Section 44 of the Enterprise Act 40 of 2002.
360 Section 1A of the Insolvency Act 45 of 1985 Schedule A1. Also see Goode *Principles of Corporate Insolvency Law* 424.
361 Sections A20 and A21 of the Corporate Insolvency and Governance Act 12 of 2020.
362 Russel and Letson 'UK Insolvency and Corporate Governance Act 2020' DLA Paper publication

standing moratorium, a new restructuring plan process modelled on schemes of arrangement but with the addition of a cross-class cramdown, and restrictions on termination of contracts for the supply of goods and services to insolvent companies. It also introduced temporary measures intended to protect businesses dealing with financial distress caused by the raging effects of the COVID-19 pandemic, including restriction on using winding-up process against companies until 30 September 2021.[363]

According to section A20 of this law, during a moratorium enjoyed under the CIGA, no petition may be presented for the winding up of the company, except if it is commenced by the directors of the company. In addition, no resolution may be passed for the winding up of the company, no administrator can be appointed in respect of the company except if made by the directors and no administrative receiver can be appointed in respect of the company.[364] The Act also provides a number of restrictions on the enforcement and the commencement of legal proceedings against companies that have obtained the moratorium, including protection against the right of forfeiture or re-entry of landlords and repossession of goods in the company's possession.[365]

The Act also extended the prohibition on termination of contracts by reason of the company's entry into insolvency procedure, beyond just utilities and IT services, to cover all contracts, except a few special contracts.[366] The Act amended the Insolvency Act 1986, by introducing a new section 233B, which by operation of law, suspends the right of any person to terminate or do any other thing, including withdrawal of service to a company on account of its being subject to any insolvency procedure.[367] These changes maximise the opportunities for the rescue of business since they guarantee continuation of supply of goods and services to companies during corporate rescue.[368]

(1 July 2021). Available at: https://www.dlapiper.com/en/uk/insights/publications/2020/09/uk-corporate–insolvency–governance–bill/ (Date of use: 16 July 2021).

363 Norton Rose Fulbright publications 'The UK corporate Insolvency and Governance Act 2020: A move to a more debtor–friendly restructuring regime' July 2021. Available at: https://www.nortonrosefulbright.com/en/knowledge/publications/5ac21a15/the–uk–corporate–insolvency–and–governance–act–2020 (Date of use: 16 July 2021).

364 Section A20 of the Corporate Insolvency and Governance Act 12 of 2020.

365 Section A21 of the Corporate Insolvency and Governance Act 12 of 2020.

366 Section 14 of the Corporate Insolvency and Governance Act 12 of 2020.

367 Sections 14(3) and (4) of the Corporate Insolvency and Governance Act 12 of 2020.

368 Norton Rose Fulbright publications 'The UK corporate Insolvency and Governance Act 2020: A

(iv) Removal of crown preferences

One of the changes that was introduced by the UK government through the Enterprise Act 2002 was the removal of crown preferences.[369] This was after it became apparent that the position of the law under the pre-2002 Insolvency Act, which ranked debts payable to the Crown for PAYE, VAT and other taxes payable to Her Majesty Revenue and Customs (HMRC) and social security contributions, among the preferential debts, was inequitable especially, to the unsecured creditors.[370] This was recommended as a major step which would bring immediate benefits to trade and other unsecured creditors,[371] and encourage unsecured creditors to support corporate rescue procedures, noting that:

> Finally, as an important and integral part of this package of measures, we will proceed with the abolition of Crown preference in all insolvencies. Preferential claims in insolvency originated in the late 19th century, but in recent years, the trend in other jurisdictions has been towards restricting or abolishing Crown or State preference as, for instance, in Germany and Australia. We believe that this is more equitable. Where there is no floating charge, the benefit of abolition will be available for the unsecured creditors. Where there is a floating charge holder (in relation to a floating charge created after the coming into force of the legislation), we would ensure that the benefit of the abolition of preferential status goes to unsecured creditors. We will achieve this through a mechanism that ringfences a proportion of the funds generated by the floating charge.[372]

Although government is normally an involuntary creditor and crown debts are due to the public purse, government has other remedies it can use to recover money from delinquent companies, unlike a private trade creditor who may not have any other options.[373] It was also argued that the government is in a much better position to absorb bad debts than the average trade creditor.[374] This resulted in the inclusion of section 251 in the Enterprise Act 2002, which effectively abolished the preference that

move to a more debtor-friendly restructuring regime' July 2021. Available at: https://www.nortonrosefulbright.com/en/knowledge/publications/5ac21a15/the–uk–corporate–insolvency–and–governance–act–2020 (Date of use: 16 July 2021).

369 Goode *Principles of Corporate Insolvency Law* 248.

370 White Paper, Productivity and Enterprise: Insolvency-A second Chance (CM 5234, July 2001). Available at: https://www.iiiglobal.org/sites/default/files/26–_2nd_chance.pdf (Date of use: 16 July 2021) 12, para 2.19.

371 Foreword by Hon. Patricia Hewitt, Secretary of State for Trade and Industry, to the White Paper on Productivity and Enterprises: Insolvency-A second chance (CM 5234, July 2001) 3.

372 White Paper, Productivity and Enterprise: Insolvency-A second Chance (CM 5234, July 2001). Available at: https://www.iiiglobal.org/sites/default/files/26–_2nd_chance.pdf (Date of use: 16 July 2021) 12, para 2.19.

373 Tolmie, *Corporate and Personal Insolvency Law* 401.

374 *ibid.*

was previously enjoyed by debts due to HRMC as well as social security contribution.[375]

With this change in law, the money that was hitherto paid to government in the form of unpaid taxes and social security contributions was made available for distribution to the general body of creditors. Whereas the abolition of crown preferences resulted into a reduction in the amount of tax recovered by government from insolvent companies, it significantly increased recoveries by trade creditors and encouraged HMRC to take a longer-term view of forcing companies into insolvency.[376] The removal of crown preferences was also in line with the thinking of the Cork Committee which had observed as follows in its report:

> We unhesitatingly reject the argument that debts owed to the community ought to be paid in priority to debts owed to private creditors. A bad debt owed to the State is likely to be insignificant in terms of total Government receipts, yet loss of a similar sum by a private creditor may cause substantial hardship and bring further insolvencies in its train.[377]

To ensure that unsecured trade creditors derive the intended benefit from the abolition of crown preferences, the UK government went ahead to require that a fixed percentage of returns from the assets subject to floating charges should be surrendered for the benefit of unsecured creditors, the percentage being a fixed figure comparable to the benefit conferred on the holders of floating charges by no longer being subordinate to crown claims.[378] These legislative interventions greatly improved the position of unsecured creditors in the resolution of corporate insolvency matters and encouraged unsecured creditors to support corporate rescue measures.[379] Although the UK recently backtracked on this policy when Crown preferences in respect of claims for VAT, PAYE and other taxes withheld from employees and customers were reinstated in 2020,[380] it is still worth noting that countries seeking to engender corporate rescue should consider removing tax claims from the list of preferential debts. This would improve the chance for unsecured trade creditors to

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375 Tolmie, *Corporate and Personal Insolvency Law* 401.
376 Refer to: https://www.cadwalader.com/brass–tax/index.php?nid=4andeid=24.
377 Cork Insolvency Law and Practice: Report of the Review Committee (the Cork Committee) (Cmnd.8558) (1982) para 1410.
378 Goode, *Principles of Corporate Insolvency Law* 249.
379 Yang and Xiaobing 2012 *Asian Social Science* 22.
380 Section 98 of the Finance Act 14 of 2020. Also see https://www.natlawreview.com/article/hmrc–crown–preference–restored–1–december–2020–what–impact–lenders–and–uk–corporates.

recover their claims from businesses undergoing rescue proceedings and ultimately motivate them to support proposals for corporate rescue.

7.3.2 Corporate Rescue system in the US

Corporate rescue proceedings in the US are referred to as reorganisation proceedings and are provided for under Chapter 11 of the US Bankruptcy Code of 1978 (Bankruptcy Code).[381] The provisions of the Bankruptcy Code are widely regarded as pro-debtor, pro-restructuring; they are highly flexible and have been considered as a success and a model for reform of restructuring law worldwide.[382] The proponents of Chapter 11 argue that its provisions merit a prominent place in the pantheon of extraordinary laws that have shaped America's economy and society.[383] In *Canadian Pacific Forest Products Ltd v JD Irving Ltd*,[384] the court stated thus:

> Chapter 11 has as its objective,' to provide a debtor with the legal protection necessary to give it the opportunity to reorganise, and thereby to provide creditors with going-concern value rather than the possibility of a more meagre satisfaction of outstanding debts through liquidation.[385]

From a practical perspective, however, the US and English insolvency legal system share a lot of commonalities with both jurisdictions providing for liquidation of companies that are considered unviable and beyond rescue[386] as well as corporate rescue frameworks for the distressed but still potentially viable companies.[387]

With respect to corporate rescue, the US legal system differs from the UK system in its approach to reorganisation of businesses. The US Bankruptcy Code is largely based on the debtor in possession model, where the existing management of the ailing company remain in control of the company operations during the period of its

381 Broude *Reorganisations under Chapter 11 of the Bankruptcy Code* 2–2.
382 Wan and McCormack 2019 *Journal of Corporate Law Studies* 69–104. Available at: https://ink.library.smu.edu.sg/sol_research/2777/ (Date of use: 21 Jul 2021) 71; McCormack 2007 *The International and Comparative Law Quarterly* 515.
383 Wan WY and McCormack 2019 *Journal of Corporate Law Studies* 71.
384 (1995) 66 F 3d 1436.
385 *Canadian Pacific Forest Products Ltd v JD Irving Ltd* (1995) 66 F 3d 1436, 1442.
386 Chapter 7 of the US Bankruptcy Code of 1978. Available at: https://uscode.house.gov/view.xhtml?path=/prelim@title11/chapter7andedition=prelim (Date of use: 28 July 2021).
387 *Canadian Pacific Forest Products Ltd v JD Irving Ltd* (1995) 66 F 3d 1436, 1442.

reorganisation.[388] Chapter 11 contains a number of fundamental characteristics of a good corporate rescue framework, such as a strong automatic stay of creditor's actions against the debtor company, a debtor in possession regime where the management remains in control of the debtor company and continues to lead its restructuring efforts, the availability of super-priority financing and a cross-creditor cram-down process.[389] The US approach to corporate reorganisation has been described as endorsing an optimistic view, characterised by apparent recognition that failure does not need to rule out future successes of incumbent management.[390] These have made the US Bankruptcy code to be widely known as benign to debtors.[391]

7.3.2.1 Notable features of US reorganisation procedure

(a) Easy commencement procedure

Under the Bankruptcy Code, reorganisation proceedings can be commenced in basically two ways: voluntarily by the debtor[392] or involuntarily by company creditors.[393] A voluntary petition for reorganisation may be filed under Chapter 11 only by an entity that is a debtor within the meaning of the Bankruptcy Code. In terms of section 109(a) of the Bankruptcy Code, a debtor may be any person who resides or has a domicile, a place of business or property in the US or a municipality.[394] In *re Ionica PLC*,[395] a debtor who was the subject of a foreign proceeding decided to file a Chapter 11 case solely to take advantage of the doctrine of equitable subordination and substantive consolidation, which are not available under English law. The case was dismissed when the bankruptcy court found that the criteria of section 304(c) of the Code had been satisfied that the company was not domiciled in the US. This occurred despite a secured creditor of that petitioning debtor being located in the US and in possession of collateral worth more than 56 million US dollars.[396]

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388 McCormack 2007 *The International and Comparative Law Quarterly* 515.
389 Wan and McCormack 2019 *Journal of Corporate Law Studies* 72.
390 Brouwer 2006 *European Journal of Law and Economics* 9.
391 *ibid*.
392 Section 301 of the US Bankruptcy Code 11 of 1978.
393 Section 303 of the US Bankruptcy Code 11 of 1978. Also see Broude, *Reorganisations under Chapter 11 of the Bankruptcy Code* 2–2.
394 Broude, *Reorganisations under Chapter 11 of the Bankruptcy Code* 2–3.
395 241 B.R. 829 (Bankr. S.D.N.Y 1999).
396 Broude, *Reorganisations under Chapter 11 of the Bankruptcy Code* 2–4.

To prevent abusive multiple filings, section 109*(g)* of the Bankruptcy Code prevents one from becoming an eligible debtor to maintain a Chapter 11 petition for reorganisation where such debtor had another Chapter 11 case within 180 days before filing of the new petition.[397]If it is proved that the preceding petition was dismissed by court because of the debtor's wilful failure to abide by a court order, or to appear before the court, or was dismissed on the request of the debtor, the subsequent petition will also be dismissed.[398]

Courts have also added an implicit requirement that the petition must be filed in good faith before a case can be entertained by the bankruptcy system.[399] This is particularly important because in the US, unlike most other jurisdictions, the Bankruptcy Code does not prescribe any financial standard, such as insolvency or inability to pay debts, as a pre-requisite for one to file a petition for voluntary reorganisation.[400]

With respect to involuntary petitions, section 303*(a)* of the Bankruptcy Code provides that an involuntary case may be commenced against any person who is a debtor under the Bankruptcy Code, except a farmer, family farmer or a corporation that is not monied, business or commercial corporation.[401] Under the Bankruptcy Code, a farmer is defined as a person who received more than 80 percent of his or her gross income during the preceding taxable year of income from a farming operation owned or operated by such a person.[402] It is argued that famers were excluded from being liable to reorganisation proceedings because of the general recognition that the nature of their business is cyclical and vulnerable to involuntary variances in revenue, which would otherwise expose farmers to endless involuntary petitions.[403]

The Bankruptcy Code provides that a petition for involuntary reorganisation can be filed by a creditor, or where the debtor has twelve or more creditors, at least three

397 Broude, *Reorganisations under Chapter 11 of the Bankruptcy Code* 2–7
398 *Ibid*.
399 Broude, *Reorganisations under Chapter 11 of the Bankruptcy Code* 2–7. Also see *re South East Financial Associates, Inc.*212 B.R 1003 (Bankr.M.D. Fla. 1997).
400 Broude, *Reorganisations under Chapter 11 of the Bankruptcy Code* 2–7.
401 Broude, *Reorganisations under Chapter 11 of the Bankruptcy Code* 2–7.
402 Section 101(20) of the US Bankruptcy Code 11 of 1978.
403 Broude, *Reorganisations under Chapter 11 of the Bankruptcy Code* 2–11; H.R. Rep. No. 595, 95th Cong., 1st Sess.322(1977).

creditors, holding aggregate claims of not less than US 12,300 against the debtor.[404] The claims must be neither contingent nor subject of a *bona fide* dispute.[405] Although implicit, the general corpus of the Bankruptcy Code discourages a single creditor from filing an involuntary petition alone, and where one creditor insists on filing an involuntary petition for Chapter 7 liquidation or a chapter 11 reorganisation against a debtor without being joined by other creditors, the petition can be challenged on the ground that such a creditor should seek relief in some other non-bankruptcy forum.[406] In *Basin Elec. Power Coop. v. Midwest Processing Co,*[407] it was *inter alia* held that the three-creditor requirement is designed to prevent the use of involuntary bankruptcy proceedings by creditors as a means of harassing an honest debtor.[408]

The petitioning creditor(s) must also prove that the debtor is generally not paying its debts as they fall due. Although the Bankruptcy Code does not specifically define or set a standard for determining what 'general failure to pay' means, US Courts generally apply a flexible standard that looks to the totality of the circumstances of the debtor, by considering both the number and amount of unpaid claims at the time of filing the petition as well as other factors such as the manner in which the debtor has conducted its financial affairs.[409] In fact, unless there are special circumstances, the majority of US courts do not find the debtor's failure to pay a single debt as constituting a failure generally to pay its debts as they fall due.[410]

It is apparent that in drafting the Bankruptcy Code, the US Congress sought to balance competing interests of the debtor and the creditors, with a deliberate bias against

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404 Section 303 of the US Bankruptcy Code 11 of 1978 as amended by s 104*(b)* of the Bankruptcy Code 2004. Also see Broude, *Reorganisations under Chapter 11 of the Bankruptcy Code* 2–12.

405 Section 303*(b)*(1) of the US Bankruptcy Code 11 of 1978. Also see Lieb 1991 *Brook. Law Review* 803, 819.

406 Broude *Reorganisations under Chapter 11 of the Bankruptcy Code* 2–14. Also see *In re Gold Bond Corp.*98 BR.128 (Bankr. D.R.I 1989) and *Bankers Trust Co v Nordbrock (in re Nordbrock)* 772 F.2d 397 (8th Cir. 1985).

407 769 F.2d 483 (8th Cir.1985).

408 769 F.2d 483 (8th Cir.1985). Also see *In re Caucus Distrib Inc.* 106 B.R 890 (Bankr. E.D. Va.1989).

409 Lieb 1991 *Brook. Law Review* 823.

410 Lieb 1991 *Brook. Law Review* 823. Also see *Bankers Trust Co. BT Serv. Co. v Nordbrock (in re Nordbrock)*, 772 F.2d 397 (8th Cir.1985) and *Paradise Hotel Corp. Bank of Nova Scotia* 842 F.2d 47, 51 n.7(3d Cir.1988).

conduct by abusive creditors unnecessarily pushing debtors into bankruptcy.[411] Congress also sought to encourage negotiations between debtors and creditors and even went as far as including provisions such as section 305,[412] which expressly empower a bankruptcy court to abstain from a liquidation or reorganisation case in the interest of creditors and if, in the opinion of court, the debtor would be better served by dismissal of the petition.[413]

(b) Filing triggers automatic stay of all proceedings and actions

Section 362 of the Bankruptcy Code clearly provides that when a voluntary or involuntary petition for reorganisation is filed in court, it automatically operates as a stay against the commencement or continuation of all processes, proceedings and actions against the debtor.[414] The moratorium extends to barring all judicial proceedings,[415] enforcement actions against the debtor or any property of the debtor,[416] any act to obtain possession of property in custody of the debtor,[417] any act to collect, assess or recover a claim against the debtor that arose before the commencement of the case,[418] the set off of any debt owing to the debtor,[419] and the commencement of or continuation of a proceeding before the US Tax Court for a tax liability that arose before the commencement or the proceedings.[420]

The drafters of the Bankruptcy Code considered the automatic stay to be one of the fundamental debtor protection tools provided by the bankruptcy law, since it gives the debtor a breathing spell from his or her creditors, stops all collection efforts, all harassment and permits the debtor to attempt a reorganisation plan or simply to be relieved of the financial pressures that drove him or her to bankruptcy.[421] The scope of the moratorium that is automatically enjoyed by a debtor immediately upon filing a

411 Lieb 1991 *Brook. Law Review* 827.
412 Section.305 of the US Bankruptcy Code 11 of 1978.
413 Lieb 1991 *Brook. Law Review* 833.
414 Section. 362*(a)* of the US Bankruptcy Code 11 of 1978. Also see Broude, *Reorganisations under Chapter 11 of the Bankruptcy Code* 4–1.
415 Section 362*(a)*(1) of the US Bankruptcy Code 11 of 1978.
416 Section 362*(a)*(2) of the US Bankruptcy Code 11 of 1978.
417 Section 362*(a)*(3) of the US Bankruptcy Code 11 of 1978.
418 Section 362*(a)*(6) of the US Bankruptcy Code 11 of 1978.
419 Section 362*(a)*(7) of the US Bankruptcy Code 11 of 1978.
420 Section 362*(a)*(8) of the US Bankruptcy Code 11 of 1978.
421 Broude, *Reorganisations under Chapter 11 of the Bankruptcy Code* 4–1; H.R. Rep No.595. 95th Cong.1st Sess.340 (1977).

petition under Chapter 11 is so expansive that it even extends to stopping a supplier from taking any adverse measures against a debtor, on account of the commencement of bankruptcy proceedings. For instance, *in Sportfame of Ohio, Inc. v Wilson Sporting Goods Co. (in re Sportfame of Ohio, Inc.)*,[422] the court held that it was a violation of the stay for a supplier to refuse to sell to the debtor in possession merely because of the refusal of the debtor in possession to pay the pre-petition debt owed to the supplier. The court entered an injunction directing the supplier to henceforth sell to the debtor in possession.[423]

The nature of moratorium automatically enjoyed by companies in the US upon entry into Chapter 11 reorganisation proceedings explains why more debtors in the US find petitioning for reorganisation a default option, whenever they get hard pressed by creditors. Embedding similar provisions in the Ugandan legislation could be one of the strategic interventions through which debtors can be attracted to embrace corporate rescue.

(c) Obtaining credit

The Bankruptcy Code recognises the value of credit to companies undergoing reorganisation proceedings. Section 364(a) of the Bankruptcy Code clearly provides that if the trustee is authorised to operate the business of the debtor, which is almost always the case, unless the court orders otherwise, the trustee may obtain unsecured credit and incur unsecured debt in the ordinary course of business allowable as an administrative expense.[424] The Bankruptcy Code goes on to provide that if the trustee is unable to obtain unsecured credit allowable as an administrative expense, the court may authorise the obtaining of credit or the incurring of debt, with priority over any or all administrative expenses of the kind specified in sections 503 or 507,[425] secured by a lien on property of the estate that is not otherwise subject to a lien[426] or secured by a junior lien on property of the estate that is already subject of a lien.[427]

422 40 B.R. 47 (Bankr. N.D. Ohio 1984).
423 Broude *Reorganisations under Chapter 11 of the Bankruptcy Code* 4–19.
424 Section 364*(a)* of the US Bankruptcy Code 11 of 1978.
425 Section 364*(c)*(1) of the US Bankruptcy Code 11 of 1978.
426 Section 364*(c)*(2) of the US Bankruptcy Code 11 of 1978.
427 Section 364*(c)*(3) of the US Bankruptcy Code 11 of 1978.

This provision finely calibrated the mechanism for providing bankrupt debtors with new financing.[428] Debtor in possession financing is an important tool that creditors use to preserve the value of insolvent businesses and to influence the course of bankruptcy cases in the US.[429]

(d) Protects estate against termination or modification of contract

To further protect the company during reorganisation proceedings, section 365(e)(1) of the Bankruptcy Code clearly provides that notwithstanding any provision in an executory contract or unexpired lease or in applicable law, an executory contract or unexpired lease of the debtor may not be terminated or modified. Any right or obligation arising under such contract or lease may not be terminated or modified, at any time after the commencement of the case solely because of a provision in such a contact or lease that is conditioned on the insolvency or financial condition of the debtor at any time before the closing of the case or the commencement of a reorganisation case or the appointment of or taking possession by a trustee in a case under this title or a custodian before such commencement. This provision is a very stronghold for the success of corporate reorganisation in the US and provides a powerful arrow in the debtor's quiver, which gives the debtor the option to reshape the bankruptcy estate with an option to assume valuable contractual rights either for performance by the debtor or for assignment to a third party for a price, notwithstanding the existence of a breach.[430]

(e)Preserves supply of utility services to the debtor's estate

Section 366*(a)* of the Bankruptcy Code provides yet another safety valve for debtors during corporate reorganisation. It states that except as provided for in subsection *(b)* and *(c)* of this section, a utility may not alter, refuse or disconnect service to or discriminate against the trustee or the debtor solely on the basis of the commencement

428 American Bankruptcy Institute 'Debtor-In–possession Funding: Funding a Chapter 11 case, ABI 2012 5. Available at: https://www.cadwalader.com/uploads/books/decb0584e807daf9c24c2bee67fa19ba.pdf (Date of use: 22 July 2021).

429 American Bankruptcy Institute 'Debtor-In–possession Funding: Funding a Chapter 11 case, ABI' 2012.

430 Pottow 2018 Texas Law Review 1445–1446. Available at: https://repository.law.umich.edu/cgi/viewcontent.cgi?article=3006andcontext=articles (Date of use: 24 July 2021).

of a reorganisation case or that a debt owed by the debtor to such utility for service rendered before the order for relief was not paid when due. The utility service provider may however alter, refuse or discontinue service if neither the trustee nor the debtor, within twenty days after the date of the order for relief, furnishes adequate assurance of payment, in the form of a deposit or other security for service after such date.

In *re Hanratty*,[431] it was argued that the purpose of section 366*(a)* of the Bankruptcy Code is to limit the leverage a utility could wield in collecting prepetition debts, noting that this was intended to permit a debtor to continue to receive post-petition utility services that may be monopolistic and essential to a minimum standard of living of the debtor.[432] This section gives debtors protection from cut-off of service by a utility because of the filing of a bankruptcy case. The section is intended to cover utilities that have some special position with respect to the debtor such as an electric company, gas supplier or telephone company that is a monopoly in the area so that the debtor cannot easily obtain comparable service from another provider.[433]

From the above brief analysis of the key features of the US reorganisation procedure, it is apparent that many positive points can be copied from the US approach to corporate rescue. These can be customised to suit the local jurisdictional circumstances. Therefore, any reform effort should undertake a deeper study of Chapter 11 of the US Bankruptcy Code and pick out the strong points to inform any future legislative improvements to the existing rescue frameworks.

431 907 F.2d 1418, 1424 (3d Cir. 1990).
432 *Hanratty v Philadelphia Elec. Co*. 107 B.R.
433 S. Rep. No.95–989, 95th Cong., 2d Sess. 60 1978.

7.4 Conclusion

This chapter has presented a synopsis of corporate rescue from an international perspective. It has shown that the phenomenon of insolvency has a universal character.[434]In the current era of globalisation where the world is getting increasingly interconnected with many businesses trading across state boundaries, any insolvency law reform process should seek to nurture convergence in law and practice.

Several international organisations have undertaken research and published papers and guidelines wherein some principles and recommendations have been espoused as necessary in the pursuit of improved legal and regulatory frameworks on corporate rescue.[435] Whilst it is acknowledged that the recommendations made by researchers and international actors are not binding on sovereign States, these provide firm foundations and benchmarks for reform.

The chapter has also presented a concise analysis of the legal and regulatory framework on corporate rescue in the referenced developed economies of the UK and the US,[436] highlighting the key features of the respective system's corporate rescue frameworks. The UK government has undertaken a number of deliberate reforms in its insolvency law to engender the rescue culture and give financially distressed companies a chance to survive and continue contributing to the socio-economic wellbeing of the country. A similar trend has also been noted in the US reorganisation approach, where Chapter 11 has remained a strong benchmark for building strong corporate rescue systems.

This chapter has further triggered our thought process and widened our perspective on corporate rescue. It has further broadened our eyes to the salient features and modern practices on corporate rescue, which will further inform the findings and recommendations to be canvassed in the next chapter.

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[434] See the discussion in 7.1 and 7.2.
[435] See the discussion in 7.2.
[436] See the discussion in 7.3.

CHAPTER EIGHT
SUMMARY OF FINDINGS, CONCLUSIONS AND RECOMMENDATIONS

8.1 Introduction

This research has examined several issues on corporate insolvency law. The discussion centered on a thematic analysis of the legal framework on corporate rescue in South Africa,[1] Uganda,[2] UK[3] and the US[4]. From the preceding discussion, it is apparent that improving the legal framework on corporate rescue is now high on many jurisdictions' legislative agendas.[5] There is increasing common understanding that improving the corporate rescue framework is no longer just a private law matter. It is a necessary economic policy measure which every country ought to prioritise, especially at this time when virtually all economies are on their knees struggling to deal with the socio-economic ramifications of the COVID-19 global pandemic.[6]

This study sought to comparatively analyse the law on corporate rescue and to evaluate the extent to which the South African regime could serve as a benchmark for Uganda in its pursuit for reform of its legal and regulatory framework on corporate rescue. To achieve this primary objective, the role of insolvency law in promoting the rescue of financially distressed companies was considered,[7] and the strengths and weaknesses of South Africa's corporate rescue framework were identified.[8] This was compared to the legal framework applicable in Uganda.[9] Appropriate recommendations for improving Uganda's corporate rescue system are also put forward.[10]

The discussion in the preceding chapters has provided a focused review of the extent to which both the South African and Ugandan laws on corporate rescue generally reflect the ideals of a modern rescue framework. In the same vein, the study has provided a comparative analysis of the extent to which both the South African and

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1 Refer to the discussion under 5.5.
2 Discussed under 6.4.
3 See the discussion under 7.3.1.
4 Discussed under 7.3.2.
5 See the discussion under 7.2.
6 See the discussion under 4.6.
7 This is discussed under clause 4.4.
8 See the discussion under 5.9.
9 See the discussion under 8.2.
10 See the discussion under 5.5 and 5.9.2.

Ugandan laws address the common barriers to successful restructuring of financially distressed companies.[11]

This chapter presents the conclusions and the recommendations for possible improvement of Uganda's legal framework governing corporate rescue.[12]

8.2 Summary of findings about South Africa's corporate rescue system in comparison to Uganda's

This section contains the findings and conclusions made by the researcher on rescue systems in South Africa and Uganda. The study has confirmed that although not perfect,[13]South Africa's legal framework on corporate rescue contains key features of a modern and effective corporate rescue system.[14] The provisions of Chapter 6 of the Companies Act reflect a deliberate attempt by the Government of South Africa to engender the rescue culture and reduce the rate at which financially distressed but viable companies in South Africa dissolve.[15] The research has confirmed that the provisions of the Companies Act were not included by mistake. They accrue from concerted thoughtful efforts by the South African policy makers to ensure that the theme and corpus of South African company law provides an enabling environment for enterprises to thrive.[16] As argued in Chapter Five,[17] Chapter 6 of the Companies Act truly reflects the devotion by the Government of South Africa to nurture the survival of companies and businesses. This is, however, not the case with Uganda's corporate rescue framework.[18]

The study has revealed that save for introducing provisional administration as a novel entry procedure into administration, the framers of the Insolvency Act of 2011 mostly

11 McGowan and Andrews, 'Design of Insolvency Regimes Across Countries' OECD Working Paper No. 1504 (2018) 22.
12 The proposals are put forward under 8.3.
13 See the discussions under 5.9.
14 See the discussion in 5.5. Also see Levenstein, 'An Appraisal of the New South African Business Rescue Procedure' 281.
15 See the discussion in 5,5. Also see Bradstreet 2010 *SA Merc LJ* 195.
6. See the discussion in 5.5. The Department of Trade and Industry, 'The Companies Act no. 71 of 2008: An explanatory Guide' 2010, 6. Available at https://cdn.ymaws.com/www.iodsa.co.za/resource/collection/CB7E5DC1-E790-4BED-9693-9F8AA33E0032/Companies_Act_Guide.pdf (Date of use: 29 Jul 2020).9.
17 See the discussion under 5.5.
18 This is discussed under 6.4.

transplanted to Uganda the English position of law that was enacted in the Insolvency Act 1986.[19] There is a dearth of literature about the origin and rationale for the introduction of provisional administration in Uganda.[20] Moreover, no deliberate effort has been made to take into account the improvements that were introduced in the English rescue procedure through the Enterprise Act 2002 and the other subsequent legislative measures which I have already examined.[21] As a result, the Insolvency Act 2011 is deficient regarding the critical features of a modern corporate rescue system.[22] This partly accounts for the apparent low uptake of rescue procedures in Uganda and the consequential high rate of business mortality in the country.[23]

The study has confirmed that Uganda's legal system on corporate rescue must be 'rescued' by instituting deliberate structural reforms that seek to align and beef up the Insolvency Act with the widely recognised international principles of an effective corporate rescue framework.[24] In the same vein, it is argued that considering the many positives we have already seen in the South African business rescue framework,[25] coupled with the fact that the macro-economic fundamentals in South Africa, unlike the UK, the US and other developed economies, are more reflective of Uganda's socio-economic circumstances, there are compelling grounds to consider the South African regime as a suitable benchmark for improving Uganda's system.

The strengths of the South African legal framework on corporate insolvency are summarised below.

8.2.1 Commencement procedure

South Africa's rescue system provides a dual commencement procedure, which allows a financially distressed company to voluntarily[26] enter into business rescue procedure.

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19 This is discussed under 6.2 and 6.7.
20 See the discussion under 6.4.1
21 See the discussion under 7.3.1.
22 See the detailed discussion in 6.7.
23 The Guardian, 'Uganda is a land of entrepreneurs, but how many start-ups survive?' (16/02 2021). Available at https://www.theguardian.com/global-development-professionalsnetwork/2016/feb/16/uganda-is-a-landofentrepreneursbuthowmanystartupssurvive (Date of use: 8 Aug 2021).
24 See the discussion under 7.2.
25 See the discussions under 5.5 and 7.2.
26 Section 129 of the Companies Act 2008.

At the same time, it creates a window for the affected parties to petition court to compulsorily place the company into business rescue.[27] This is in line with the international best practice and recommendations by leading international bodies such as UNCITRAL[28] and IMF,[29] which emphasise that a good rescue system should allow the rescue procedure to be kick started by many stakeholders, not just the debtor(s).[30] This is one of the improvements that was introduced into English law through the Enterprise Act 2002.[31] The US Bankruptcy Code 1978 also provides for both voluntary and involuntary petitions for reorganisation by the company and the creditors respectively.[32]-This is unfortunately not the case in Uganda.

As was noted,[33] administration, which is the formal rescue procedure in Uganda, can only be commenced by the debtor through a petition to court for provisional administration.[34] This means that in Uganda, unlike in South Africa, the UK and the US, placement of a distressed company into rescue procedure is an exclusive preserve of the company and its directors.[35] If the directors take long to come to terms with the reality that their company is unable to pay its debts and needs to be rescued, they can keep the company limping for as long as possible until it becomes too late for it to be realistically rescued. This is made worse by the fact that the Insolvency Act[36] provides that commencement of administration effectively displaces the management of the company. The management functions are placed in the hands of an external party, the administrator, who assumes the right and legal mandate to run the company, including the power to remove the company directors from office.[37] Thus, there is less incentive for the company directors to convince the shareholders to pass a resolution to place a financially distressed company under provisional

27 Section 131 of the Companies Act 2008.
28 UNCITRAL, *Legislative Guide on Insolvency 2005*; Available at: https://uncitral.un.org/sites/uncitral.un.org/files/media-.–documents/uncitral/en/05-80722_ebook.pdf (Date of use: 6 August 2021) 64 recommendation 14.
29 The IMF 'Orderly and Effective Insolvency Procedures: Key Issues 1999' 56. Available at: HYPERLINK 'https://www.elibrary.imf.org/view/books/071/05062-9781557758200-en/05062-9781557758200-en-book.xml' https://www.elibrary.imf.org/view/books/071/05062-9781557758200-en/05062-9781557758200-en-book.xml (Date of use: 6 August 2021).
30 The IMF, 'Orderly and Effective Insolvency Procedures: Key Issues 1999' 56.
31 Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 312–314.
32 Sections 301 and 303 of the US Bankruptcy Code 11 of 1978. Also see Broude *Reorganisations under Chapter 11 of the Bankruptcy Code* 2-2.
33 Refer to the discussion in 6.4.
34 Section.139 of the Insolvency Act 14 of 2011.
35 See the discussion under 6.4.
36 Section 153(1)*(b)* of the Insolvency Act 14 of 2011.
37 Section 153(1)*(d)* of the Insolvency Act 14 of 2011.

administration. The directors would rather keep nursing the company until it either naturally collapses, or a creditor forcefully pushes it into liquidation. Corporate rescue is not the primary objective of liquidation. In most cases, when creditors petitions for the liquidation of a debtor, their main motivation is either to explore a possibility for cutting their losses by recovering whatever they can from the debtor through disposal of its assets, or to have the debtor formally liquidated such that they can properly take benefit of such occurrence to, for instance, be eligible for VAT refunds from invoices attributable to such debtor or otherwise classify the debt owed as a bad debt.[38] These objectives are at variance with the corporate rescue agenda, which seeks to help financially distressed companies to seek help early and possibly regain their solvency before it is too late.[39]

As I have already argued,[40] the cumbersome commencement procedure is derailing efforts to develop the rescue culture in Uganda. If the country is to achieve realistic milestones in nurturing a rescue culture, the insolvency Act 2011 should be revised to broaden the entry routes into the rescue procedure. It is strongly recommended that the review should consider embracing the flexibility in sections 129 and 131 of the South African Companies Act.

8.2.2 Scope of moratorium

Some studies have argued that a strong moratorium on actions against companies undergoing rescue procedure is one of the critical ingredients of a good rescue system.[41] Similarly, this study has shown that the framers of Chapter 6 of the South African Companies Act 2008 were alive to this position.[42] Section 133 of the Companies Act 2008 was broadly drafted to ensure adequate protection of companies undergoing business rescue proceedings against all legal and other forms of enforcement actions by both the company creditors and other persons who may otherwise undertake disruptive proceedings against the company.[43] This allows the business rescue practitioner to concentrate on measures to resuscitate the ailing

38 Section 43(1) of the Value Added Tax Act Cap 349.
39 See the discussion under 4.2.
40 See the discussions under 4.8.1 and 6.7.2.
41 Westbrook and others, *A Global View of Business Insolvency Systems* 69. Also see Cassim and others, *Contemporary Company* 878.
42 This is discussed in 5.5.4.1.
43 See the discussion under 5.5.4.1.

company with less pressure from uncooperative parties.[44] This partly accounts for the success of South Africa's rescue procedure.[45]

This study has shown that the moratorium provided to companies in provisional administration and administration in Uganda is inadequate in many ways.[46] First, the moratorium accorded to companies in administration only binds the parties to the administration deed, namely the company, the company directors, shareholders and creditors.[47] However, disruptive proceedings may come from parties who may not have signed the administration deed, such as customers, employees, regulators or other government agencies who may not necessarily be creditors but capable of triggering wrecking proceedings against the company during administration and end up disorienting the administrator.[48] Limiting the scope of the moratorium to the parties who signed the administration deed is definitely a big weakness in Uganda's rescue framework.[49] It is recommended that Uganda should benchmark on South Africa's law and practice and undertake the necessary review of the Insolvency Act 2011. This would ensure that the moratorium enjoyed by companies during administration is strong enough to restrict commencement of all legal, regulatory and/or enforcement actions, whether commenced by the parties who signed the administration deed or not.[50]

Secondly, section 143(2) of the Insolvency Act 2011 states that nothing in the Act shall prevent the continued exercise of a power of enforcement of a charge over property where the power was exercised before the commencement of provisional administration.[51] This creates an apparent weakness in the shield provided to companies during provisional administration. Since the same law provides that provisional administration commences, and that the appointment of the provisional administrator takes effect only when an interim protective order is made by court, the effects of provisional administration, including the moratorium on legal and enforcement proceedings, are activated only after the court order is made.[52] This

44 This is discussed under 5.5.4.1.
45 See the discussion under 5.5.4.1.
46 See the discussion in 6.7.1.
47 Section 164(1) of the Insolvency Act 14 of 2011.
48 See the discussion under 6.5.2.
49 This is discussed in 6.7.1.
50 See the recommended amendments under 8.3.
51 See the discussion under 4.8.1.
52 This aspect is discussed under 6.71.

means that creditors in Uganda can safely pre-empt the moratorium by exercising their enforcement power before the interim protective order is made.[53] The net effect of this provision is that once a company files an application for the interim protective order, aggressive creditors can exploit the window before the interim protective order is made, to invoke their enforcement rights under whatever security instruments they may have obtained from the company.[54] Even if the court eventually issues the interim protective order, these creditors will be able to hide behind section 143(2) of the Insolvency Act to continue exercising their power of enforcement against the company assets. This risk is further heightened by the fact that the application for the interim protective order is granted after a full hearing of all parties, including the creditors who the law clothes with *locus standi* to raise all manner of objections and other delaying tactics to frustrate the grant of the interim protective order.[55]

On the contrary, section 132 of the South African Companies Act 2008 provides in no uncertain terms that business rescue proceedings begin when the company files a petition to place itself under supervision, or when it applies to court for consent to file a resolution to commence business rescue or when an affected party applies to court for an order to place the company under supervision.[56] This ensures that right from the time when the company starts its journey into business rescue, it automatically begins to enjoy the full protection of the law against all legal and enforcement actions. The law does not create any gap or window for uncooperative parties to frustrate the rescue efforts by instituting pre-emptive proceedings against the company at any stage during the period when the company is undergoing business rescue.[57]

Removal of onerous procedural hurdles for companies to enter into business rescue, coupled with the fact that once a company decides to start rescue procedure, it immediately gets 'born-again' and begins to enjoy the benefits of business rescue is critical. The benefits include protection against all legal and other enforcement actions. This has made the business rescue procedure to naturally become the default option for financially distressed companies in South Africa.[58] This arguably accounts for the

53 See the discussion under 6.7.1
54 This is discussed in 6.7.1.
55 See the discussion in 6.4.3. Also see regs 138–142 of the Insolvency Regulations SI 36 of 2013.
56 This is discussed under 5.5.3.1.
57 See the recommendation regarding how this can be implemented in Uganda under 8.3.
58 This is discussed in 5.9.1.

impressive rate at which South African companies are entering business rescue compared to liquidation. The statistics from the CIPC show that between May 2011 and 31 October 2020, a total of 1521 companies had entered business rescue compared to only 446 companies that had entered into liquidation during the same period.[59]

On the other hand, the framers of the Insolvency Act 2011 in Uganda left this gap, when they provided that provisional administration is deemed to commence, and the appointment of the provisional administrator takes effect only after the interim protective order is made by court.[60] This means that until court has heard the merits of the petition, including any objections thereto by creditors and other interested persons,[61] the company and its property remain available to the creditors to enforce against. In a country where there are no special insolvency courts to expeditiously entertain such petitions for interim protective orders, this provision creates a big risk for companies considering entry into corporate rescue.[62] From the time when the petition for provisional administration is filed up until the interim protective order is granted by court, creditors can undertake any individual self-help measures such as recalling loans, attaching and selling company assets to pre-empt the moratorium to be triggered by the grant of the interim protective order.[63] By time the interim protective order is made, it is possible that the company could be in a worse off position, with all its hopes for recovery shuttered by the last-minute actions of creditors. The fear by company directors to lose their remaining assets to aggressive creditors during the period before the interim protective order is granted is certainly a big discouragement for any person who would otherwise consider subjecting their company to administration in Uganda.[64]

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59 The Companies and Intellectual Property Commission 'Business Rescue Proceedings Status Report 31st October 2020' 1. Available at http://www.cipc.co.za/files/3616/0490/5024/Status_of_Business_Rescue_Proceedings_in_South_Africa-as_at_31_October_2020_v1.0.pdf (Date of use: 17 Aug 2021).

60 Section 142 of the Insolvency Act 14 of 2011.

61 Regulations 138 and 141 of the Insolvency Regulations SI. 36 of 2013.

62 This is discussed under 6.7.2.

63 Refer to the discussion under 6.7.1.

64 See the discussion under 6.7.2.

Uganda should, therefore, urgently review this provision by taking the route that South Africa and other developed regimes like the UK[65] and US took.[66] All three jurisdictions have legislation in place that categorically provide that the moratorium commences immediately the company files or gives notice of intention to commence corporate rescue procedure.[67] The moratorium applicable in Uganda should be automatic upon filing for business rescue and not dependent on the making of any order by court, and its scope should cover all legal, regulatory and enforcement proceedings, including those that could have been commenced before entry into provisional administration.[68]

This should attract more distressed companies to begin looking at entry into administration the same way sick individuals look at entry into a hospital and not compare it to entry into mortuary or a funeral home.

8.2.3 Rescue finance

Rescue finance is the lifeblood of corporate rescue.[69] Where the insolvency system allows the insolvent business to continue trading during reorganisation or other rescue proceedings, the applicable law needs to address the issue of funding.[70] Any corporate rehabilitation procedure that does not provide alternatives for rescue finance is bound to fail.[71]

This study has confirmed that the framers of the Companies Act 2008 were resolute about the importance of rescue financing in building a modern rescue framework in South Africa.[72] This commitment was exemplified through the inclusion of section 135 in the Companies Act 2008, which is conspicuously subtitled 'post-commencement finance'. This legislative provision is worded in general terms to authorise the business rescue practitioner to obtain rescue funding, with the possibility to even pledge any

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65 See the discussion in 7.3.1. Also refer to s 44 of the Enterprise Act 40 of 2002 and s 362*(a)* of the US Bankruptcy Code 11 of 1978. Also see Broude, *Reorganisations under Chapter 11 of the Bankruptcy Code* 4–1.

67 Refer to s 132(1) of the Companies Act; s 44 of the Enterprise Act 40 of 2002 and s 362(a) of the Bankruptcy Act of 1978. Also see the discussions under 6.7.1 and 7.3.1.

68 See the wording of the recommended provision under 8.3.

69 See the discussions under 4.8.2 and 6.7.3. Also see Cassim and others *Contemporary Company Law* 882.

70 UNCITRAL Legislative Guide on Insolvency Law (2004) 114 para 97.

71 Westbrook and others, *A global View of Business Insolvency Systems* 144.

72 See the discussion under 5.7.

unencumbered assets of the company as security for such financing.[73] The same provision goes on to expressly characterise unpaid remuneration and other payments to employees during business rescue as part of the post-commencement financing to the company.[74] The policy makers went on to provide that all payments that fall within the broad category of post-commencement finance as specified in section 135 of the Companies Act 2008 rank equally and enjoy priority over all other unsecured creditors.[75]

It has been argued[76] that this provision fails to adequately promote the provision of rescue financing in South Africa insofar as it is silent on alternative mechanisms for raising financing, particularly in situations where the company does not have any unencumbered assets that can be pledged to secure the rescue finance.[77] This study has confirmed that even with this idealistic limitation, the South African policy makers ought to be commended for the firm step they took to provide a window for the business rescue practitioner to obtain rescue financing.[78] The US, which is often praised for facilitating post-commencement financing, does not make rescue financing an absolute right for every company in Chapter 11 proceedings.[79] A number of procedural requirements must be satisfied by the debtor in possession before the court can authorise the company to, for instance, obtain credit secured by a senior or equal lien on property that is already encumbered by pre-commencement lenders.[80]

This study argues that the scope of section 135 of the Companies Act 2008 adequately gives the rescue practitioner the necessary latitude to borrow and/or otherwise obtain post-commencement finance. This is not true for Uganda. The framers of the Insolvency Act of 2011 did not make any effort to provide for post-commencement finance in the law.[81] The Insolvency Act is conspicuously silent on how companies undergoing provisional administration and administration should fund their continued operations.[82] This implies that before any company considers subjecting itself to

73 Section 135(2) of the Companies Act 2008.
74 Section 135(1) of the Companies Act 2008.
75 Section 135(3) of the Companies Act 2008.
76 Stoop and Hutchison 2017 PER / PELJ 16.
77 See the discussion under 5.7.
78 *ibid*
79 See the discussion under 7.3.2.
80 Du Plessis 2016 International In-House Counsel Journal 1.
81 See the discussion under 6.7.3.
82 This is discussed in 6.7.3.

rescue procedure in Uganda, it must first carefully weigh its funding options and be clear on how it will finance its operations during provisional administration and eventually administration.

Unless a company has a solid post-commencement funding strategy, entry into provisional administration could be equated to taking a sick person to a hospital, with the hope that he or she will be miraculously healed with the help of some good Samaritans. Surviving in such a situation becomes a gamble and one can never be sure of the outcome. The situation is even worse for the Medium and Small Enterprises (MSMEs), which predominantly have difficulties accessing sufficient levels of financing.[83] The reality is that the rescue of any business, no matter how viable it might be, only happens if the business can receive financing to power its rescue strategies.[84]

In this regard, the Government of Uganda should be committed to using insolvency law as the strategic tool for giving financially distressed companies a second chance to survive as it is done in South Africa and US.[85] The law ought to be revised to expressly facilitate acquisition of post-commencement finance; the Insolvency Act should be reformed to ensure that deliberate provisions are made for rescue funding.[86] Being a developing economy, it is understandable that the Government of Uganda may not have sufficient financial muscles to fund the rescue of all private companies. However, strategic policy measures such as reforming the Insolvency Act should provide clear ways through which companies undergoing rescue procedure can fund their operations. For example, authorising the administrator to borrow and categorise rescue lenders as priority creditors, entitled to be paid ahead of all other unsecured creditors as it is in South Africa[87] could lead some financially distraught companies to survive.[88]

83 World Bank Report on the Treatment of MSME Insolvency 2017, 14.
84 World Bank Report on the Treatment of MSME Insolvency 2017, 14.
85 See the discussions under 5.7 and 7.3.2.1(b); Also see s 135 of the Companies Act 2008 and s 364(a) of the US Bankruptcy Code 1978.
86 See the proposed provision to be included in the legislation under 8.3.
87 See the discussion under 5.7.
88 See the proposed legislative provision to be incorporated in the Insolvency Act 14 of 2011 under 8.3.

8.2.4 Preservation of employees' rights

The desire to preserve employees' rights is one of the primary reasons why countries are excited about nurturing the rescue culture.[89] There is general recognition that when an employer becomes insolvent, employees and their families directly suffer more than other creditors, both in terms of losing employment and a source of livelihood.[90] To minimise the risks associated with employers' insolvency on employees, many insolvency systems across the world accord employees preferential rights over and above other creditors.[91]

This study has confirmed that an efficient and well-functioning business rescue procedure has clear advantages for every country and every type of economy,[92] but the advantages are even more relevant in developing countries where the preservation of jobs is of primary concern.[93] Therefore, the extent to which a country's legal framework reduces the rate of liquidation of businesses and thereby preserves the country's levels of employment is one of most natural indicators of how supportive such a regime is to corporate rescue.[94]

In Chapter Five,[95] I argued that the framers of the Companies Act 2008 were alive to the need to protect the rights of employees during business rescue procedure in South Africa.[96] For instance, employees are recognised as one of the affected persons[97] upon whom a wide range of rights and powers are bestowed, including the right to apply to court for compulsory commencement of business rescue,[98] the right not to be unilaterally terminated by the business rescue practitioner[99] as well as the right to notices during business rescue procedure.[100] This clearly places employees of financially distressed companies in South Africa in an enviable position. In the South African rescue regime, employees are recognised not just as creditors, but as key stakeholders with a statutory right to be consulted during the development of the

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89 Cassim and others, *Contemporary Company Law* 884.
90 Westbrook and others, *A global View of Business Insolvency Systems* 184.
91 Westbrook and others, *A global View of Business Insolvency Systems* 187.
92 See the discussion under 4.9.1.
93 Loubser 2007 *Comparative and International Law Journal of South Africa* 152.
94 Conradie and Lamprecht 2015 *South African Business Review* 22.
95 See the discussion in 5.5.4.2.
96 Conradie and Lamprecht 2015 *South African Business Review* 22.
97 Section 128(1)*(a)* of the Companies Act 2008.
98 Section 128(1)*(a)*(ii) and (iii) of the Companies Act 2008.
99 Section 136(1) of the Companies Act 2008.
100 Section 144(3) of the Companies Act 2008.

business rescue plan, the right to address creditors, and the right to even buy out uncooperative creditors or shareholders.[101]

The provisions of the Companies Act 2008 protect jobs in South Africa and promotes the development and maintenance of the standard of living of the community in which companies operate.[102] If one compares the rights of employees of companies that are immediately placed under liquidation to the ones which are placed under business rescue, the benefits derived by employees from companies undergoing business rescue become abundantly clear.[103] Undeniably, the South African business rescue framework adequately caters for the rights of employees,[104] a conclusion that cannot be made about Uganda's system. As noted,[105] the Insolvency Act 2011 does not give any manner of protection to employees. To many employees in Uganda, entry of their employers into provisional administration and administration is a clear signal of impending termination or redundancy.

For a small developing economy where the unemployment rate ranges above the global average, it is recommended that policy makers should urgently reform the provisions of the Insolvency Act to include specific provisions on the rights of employees during rescue procedure. Considering the many positive points highlighted in this thesis about the South African regime on employees' rights, the reform process should be guided by the provisions in the South African Companies Act 2008.[106]

8.2.5 Balancing the rights of secured creditors and other contracting parties

The way secured creditors and other contracting parties exercise their rights following the debtor's entry into business rescue has a big bearing on the success or failure of the rescue efforts. In a typical business environment, by the time a company resorts to business rescue procedure, it will have borrowed and mortgaged most of its valuable assets to lenders through debentures and other forms of security instruments. Unless the legal framework moderates the exercise of rights by secured creditors and

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[101] Conradie and Lamprecht 2015 *South African Business Review* 22.
[102] Mikovhe 2018 *Mich. Bus and Entrepreneurial L. Review* 101, 118.
[103] *ibid.*
[104] Conradie and Lamprecht *2015 South African Business Review* 22.
[105] See the discussion under 6.5.6.2.
[106] See the discussion under 8.3.

other contracting parties just like all other creditors, during business rescue procedure, the probability of success of the rescue efforts become less; the inverse is also true. Subjecting secured creditors and other parties to a stay during reorganisation proceedings gives the rescue efforts a better chance to deliver tangible benefits to all stakeholders, including the secured creditors themselves.[107]

It is ideal that while designing an efficient rescue procedure, deliberate efforts are made to balance the rights of the secured creditors against the wider policy objective to facilitate the rescue of financially distressed but viable businesses. The desired level of balance can be achieved through suspension of the rights of secured creditors to assert their right to sale or otherwise dispose of company property over which they hold security interests during the period of rescue.[108]

As argued,[109] countries are encouraged to ensure that distressed companies can benefit from stay of individual creditor's enforcements actions, by designing laws that prevent all creditors, including the secured and preferential creditors from undertaking any individual enforcement measures during the rescue period.[110] It is desirable for the stay to specifically apply to secured creditors for a sufficient period to allow the business rescue expert to undertake the rescue measures in an orderly manner without the fear of secured creditors exercising their security rights over the same company property that the rescue practitioner might be banking on to keep the business running.[111]

A reading of section 133 of the South African Companies Act shows that the framers of the South African regime tried to address this threat, when they provided that the moratorium extended to companies during business rescue suspends all legal proceedings, including enforcement actions against all property owned by or in lawful possession of the company.[112] This means that even if one obtained security against any of the company assets, upon commencement of business rescue proceedings,

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107 Westbrook and others, *A Global View of Business Insolvency Systems* 70.

108 Westbrook and others, *A Global View of Business Insolvency Systems* 70.

109 See the discussion under 7.2.

110 Article 6 of the EU Directive European Union Directive on corporate rescue 2019/1023. See also Nkoane 2021 *Business Law International* 187.

111 UNCITRAL Legislative Guide on Insolvency 2005 93 para 56. Available at: https://uncitral.un.org/sites/uncitral.un.org/files/media–documents/uncitral/en/05–80722_ebook.pdf (Date of use: 19 September 2021).

112 See the discussion under 5.5.4.1.

the automatic statutory moratorium suspends the rights of all creditors, including the secured creditors, against taking any enforcement action against the company or its property.[113]

The secured creditors will, by the command of law, have no choice but to either cooperate with the rescue practitioner to develop a proper rescue plan that caters for their rights. They can also apply for consent from the business rescue practitioner or apply for leave of the court before they can commence or continue with any enforcement or legal process against the company assets.[114] This provision is a very strong tool for guaranteeing stability and continuity of operations during business rescue. It ensures orderly and equitable treatment of all creditors.[115]

The same law does not require the company or any other affected person, to first obtain approval of secured creditors before causing the company to enter into business rescue. This is another strong weapon against any potential selfish actions by secured creditors, who would otherwise not be bothered to participate in the meetings and other processes concerning the future of the company because of them holding secured interests against the company's most valuable assets. This position is further reinforced by section 152(4) of the Companies Act, which provides that a business rescue plan that has been adopted is binding on the company and on each of the creditors of the company and every holder of the company's security, whether such a person was present at the meeting, voted in in favour of its adoption or had proved his or her claim against the company.

This study has confirmed that the South African framework sufficiently balances the rights of secured creditors with the rights of other affected parties. However, the Companies Act does not have expressly protect companies in business rescue against invocation of *ipso facto* contractual clauses to, for instance, cancel contracts or discontinue supply of critical services to companies on account of their entry into business rescue.[116] South African law makers should consider adding this provision to further protect companies against unfair application of *ipso facto* clauses. In Uganda,[117] the framers of the Insolvency Act 2011 failed to moderate the rights of

113 Cassim and others, *Contemporary Company Law* 879.
114 Section 133(1)*(a)* and *(b)* of the Companies Act 2008.
115 Cassim and others, *Contemporary Company Law* 879.
116 This is discussed under 5.5.4.3.
117 See the discussion under 6.7.1.

secured creditors against the wider objective of promoting corporate rescue of financially distressed in Uganda. The Insolvency Act 2011 gives secured creditors lee way to frustrate efforts by the provisional administrators and the administrators to rescue companies. First, section 142(2)(c) of the Insolvency Act 2011 still provides that the provisional administrator must obtain written consent from every secured creditor holding a charge over the whole or substantially the whole of the property and undertaking of the company before his or her appointment can be registered by the official receiver. In practical terms, it is inconceivable that a secured creditor can give consent to a process that directly threatens his or her chances to recover his or her debt.

Although the law does not expressly prescribe any specific penalty for failure by the provisional administrator to obtain the consent of all secured creditors and, consequently, have his or her appointment registered, it is argued that this can be a ground upon which administration can be terminated by court because of non–compliance with this mandatory legal requirement.[118]

Secondly, Uganda's Insolvency Act does not prevent secured creditors from commencing or continuing to exercise their power to enforce rights arising from charges created by the company before entry into administration.[119] The law does not oblige secured creditors to participate in the administration proceedings, and considering that the creditors will have obtained security over the most critical assets of the company, it remains obvious that without their voluntary support for the rescue effort, resuscitating of financially distressed companies is bound to remain a tall order in Uganda. Therefore, just as the UK revisited this position when they removed the rights of floating charge holders to veto entry into administration by companies in the UK through the Enterprise Act 2002,[120] Uganda should urgently review the provisions of the Insolvency Act to deliberately moderate the rights and powers of secured creditors during corporate rescue.[121]

With respect to application of *ipso facto* clauses,[122] both Uganda and South Africa should consider improving their laws by including express provisions that restrict the

118 Section 169 of the Insolvency Act of 2011.
119 See the discussion under 6.5.2.
120 See the discussion under 7.3.1.
121 See the proposed provision for inclusion in the Insolvency Act of 2011 under 8.3.
122 See the discussions under 6.7.4 and 7.3.1.1.

application of *ipso facto* clauses to companies during business rescue, in the same way as it is in section 365 of the US Bankruptcy Code 1978. More lessons can be drawn from the provisions in the UK's Insolvency (Protection of Essential Supplies) Order 2015, which amended section 233 of the Insolvency Act 1986, to provide that the supply of gas, electricity, water, communication services and related goods and services such as sale of terminals, computer hardware, technical advice and assistance in connection to the use of information technology, data storage and process and website hosting services are essential services and their suppliers cannot withdraw supply to companies in Administration or business rescue procedure.

8.3 Specific amendments proposed in Uganda's legislation

From the preceding comparative analysis, it is apparent that there are several gaps and weaknesses in Uganda's legislation.[123] These gaps are undermining efforts to nurture corporate rescue in the country. Similarly, Uganda needs to urgently undertake holistic legal reforms to close all the identified loopholes and weaknesses. It is expected that once the identified legislative gaps are closed, the general attitude towards corporate rescue procedures such as provisional administration and administration will change, and the country will see more debtors and creditors preferring formal corporate rescue procedure to the traditional debt collection procedures and liquidation.

In view of many strong points we have already identified in the South African regime[124] and the fact that Uganda and South Africa's economies have a lot of common features, it is highly recommended that Uganda's reform process should be benchmarked on the provisions of the Companies Act of South Africa. The reform process may also occasionally pick on the notable positives from the UK[125] and US[126] legal systems. This will help to improve Uganda's legal framework on corporate rescue and naturally change people's attitude towards corporate rescue procedures.

123 See the discussions in 8.2 and 6.7.
124 This is discussed in 5.9.1.
125 See the discussion under 7.3.1.1
126 Discussed under 7.3.2.1.

8.3.1 Simplify the commencement procedure

In Chapter Six,[127] I argued that the cumbersome commencement procedure is one of the main weaknesses in Uganda's system; section 139 of the Insolvency Act allows only the company to start the process for entry into provisional administration. The process starts when a company convenes a members' general meeting where the members are supposed to pass a special resolution agreeing to make a settlement with its creditors[128] and then authorise the company board of directors to pass a special board resolution appointing a particular insolvency practitioner to become the provisional administrator.[129] This is supposed to be followed by a petition to the High court for an interim protective order.[130] In terms of section 142 of the Insolvency Act, the appointment of the provisional administrator only takes effect and the company is deemed to commence provisional administration only after court has issued an interim protective order.

From whatever angle one looks at this procedure, it is certainly onerous, and must be contributing to the low uptake of provisional administration and administration in Uganda.[131] Therefore, the procedure for commencement of provisional administration should be improved by instituting the following specific legislative reforms.

(1) **The Insolvency Act should be reformed to provide for both voluntary and involuntary commencement procedure**.

Uganda's policy makers should consider adopting the approach that was taken by the referenced jurisdictions of South Africa,[132] the UK[133] and the US,[134] which all provide that corporate rescue proceedings may be commenced voluntarily by the company itself or, involuntarily/compulsorily through a petition to court by one of the eligible persons.

In South Africa, for instance, a company can voluntarily enter into business rescue when the board of directors of the company resolve that the company should

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127 See the discussion under 6.7.2.
128 Section 139(3) of the Insolvency Act.
129 Section 139(1) of the Insolvency Act.
130 Section 139(4) of the Insolvency Act.
131 See the discussion under 6.7.2.
132 See the discussion under 5.5.2.1
133 See the discussion under 7.3.1.1.
134 Discussed under 7.3.2.1

voluntarily begin business rescue proceedings and place the company under supervision of a business rescue professional.[135] Section 129 of the Companies Act details the procedure through which this mode of commencement can be utilised.

On the other hand, the US the Bankruptcy Code provides that reorganisation proceedings can be commenced voluntarily by the debtor[136] or involuntarily by company creditors.[137] The US approach is not ideal for Uganda; it requires the debtor company, even after deciding to voluntarily enter into reorganisation proceedings, to petition court for a Chapter 11 order before it is deemed to enter into Chapter 11 reorganisation proceeding.[138] Whereas the US model would be ideal in a country where there are special bankruptcy courts as it is in the US, this is not ideal for Uganda, where insolvency matters are handled by the general courts. Uganda should adopt the South African approach, which only requires the directors to make a resolution and file it with the CIPC (equivalent to the Official receiver in Uganda) for registration. This procedure is simpler, easier and more efficient.

To effect this change, it is recommended that Part VI of Uganda's Insolvency Act should be amended by introducing a section on voluntary entry into provisional administration. This provision should read as follows:

Voluntary entry into provisional administration

139(1) <u>Subject to subsection (2)(a), the board of a company may resolve that the company voluntarily begins provisional administration and place the company under the power and supervision of a provisional administrator, if the board has reasonable grounds to believe that-</u>

(a) <u>the company is unable to pay its debt; and</u>
(b) <u>there appears to be a reasonable prospect of rescuing the company.</u>

(2) <u>a resolution contemplated in subsection (1)– -</u>

<u>(a) may not be adopted if liquidation proceedings have been initiated by or against the company; and</u>

<u>(b) has no force or effect until it has been filed.</u>

(3) <u>Within five business days after a company has adopted and filed a resolution as contemplated in subsection (1), or such longer time as the Registrar, on application by the company, may allow, the company must-</u>

135 Section 129 of the Companies Act 2008 discussed under 5.5.2.1.
136 Section 301 of the US Bankruptcy Code 11 of 1978.
137 Section 303 of the US Bankruptcy Code 11 of 1978. Also see Broude *Reorganisations under Chapter 11 of the Bankruptcy Code* 2–2.
138 This is discussed under 7.3.2.1.

(a) *Publish a notice of the resolution, and its effective date, in the prescribed manner to every affected person, including with the notice a sworn statement of the facts relevant to the grounds on which the board resolution was founded; and*

(b) *appoint a licensed insolvency practitioner who satisfies the requirements of section 204, and who has consented in writing to accept the appointment.*

(4) *After appointing a practitioner as required by subsection (3)(b), a company must-*

(a) *file a notice of the appointment of a practitioner within two business working days after making the appointment; and*

(b) *publish a copy of the notice of appointment to each affected person within five business days after the notice was filed.*

(5) *If a company fails to comply with any provision of subsection (3) or (4)-*

(a) *its resolution to begin provisional administration and place the company under supervision lapses and is a nullity; and*

(b) *the company may not file a further resolution contemplated in subsection (1) for a period of three months after the date on which the lapsed resolution was adopted, unless a court, on good cause being shown on an ex parte application by the company, approves the company filing a further resolution.*

(6) *A company that has adopted a resolution contemplated in this section may not adopt a resolution to begin liquidation proceedings, unless the resolution has lapsed in terms of subsection (5), or until the provisional administration or administration has ended as determined in accordance with section 151.*

(7) *If the board of a company has reasonable grounds to believe that the company is unable to pay its debts, but the board has not adopted a resolution contemplated in this section, the board must deliver a written notice to each affected person, setting out the criteria referred to in section 3(1) that are applicable to the company and its reasons for not adopting a resolution contemplated under this section.*

If the above provision is adopted, it will be easier for companies suffering financial distress to voluntarily enter business rescue procedure, without necessarily having to first petition to court.

With the above change in procedure, section 142(1) of the Insolvency Act on commencement of provisional administration should also be naturally amended to incorporate voluntary commencement.

It is recommended that new section 142(1) should read as follows:

(1) *Provisional administration shall commence, and the appointment of a provisional administrator shall take effect from the date when the company files its resolution to voluntarily enter into provisional administration under section 139(4) or on the date when court makes an order for compulsory appointment of a provisional administrator.*

To avoid the concern that the Companies Act of South Africa excludes shareholders in the process through which the decision to place a financially distressed company in business rescue is made,[139] it is recommended that Uganda should introduce an additional requirement for the directors of the company to first notify the shareholders of their intention to pass a resolution to place their company in provisional administration. The notice to shareholders should be for a period of not less than fourteen (14) days before the directors can pass the resolution to cause the company to voluntarily enter into business rescue.

This will allow the shareholder to at least have prior notice of this critical decision before it is taken. It is argued that this additional step will further improve the process by ensuring that the shareholders, who are the owners of the company, are made aware of the financial status of their company before it is placed under provisional administration. If any shareholder has any objection to the proposed decision by the directors, they can at least utilise this notice period to either stop the board from passing the resolution or otherwise prepare for the outcome.

Furthermore, it is proposed that section 139 should include a subsection (8) that provides as follows:

(8) *Before the board of a company may exercise its powers under subsection (1) to pass a resolution to voluntarily place a company that is unable to pay its debts under provisional administration, the board shall give notice of not less than fourteen (14) days to every shareholder of the company informing him or her of the intention to pass the resolution contemplated under subsection (1). For avoidance of doubt, the notice contemplated under this subsection may be transmitted to any or all shareholders through any medium of communication, including email, WhatsApp or any other electronic means.*

139 See the discussion under 5.9.2(e).

The previously mentioned provision would balance the objective to facilitate early recourse to business rescue, while at the same time, give the shareholder prior notice of the intention make such a big decision about the future of their company.

(2) Introduce procedure through which an affected person can object to or challenge the voluntary commencement of provisional administration

Given the level of legal immunity which companies immediately acquire upon entry into provisional administration and how it restricts the rights of several parties,[140] if the law is amended to provide for voluntary commencement of provisional administration as has been recommended herein above, some unscrupulous company directors may use this procedure to hide under the cover provided by entry into provisional administration to frustrate efforts by creditors and other parties to exercise their legitimate rights against the company and its property.

While improving Uganda's rescue framework, the Insolvency Act should be amended to introduce a clear procedure through which an aggrieved party may challenge and/or oppose the company's decision to voluntarily enter into provisional administration. This is especially important because with the introduction of voluntary commencement, creditors and other affected persons will no longer have the opportunity to appear in court to either oppose or support the petition for the interim protective order as it is currently provided under Regulations 138-141 of the Insolvency Regulations 2013.[141]

In reforming this procedure, it is recommended that a provision like section 130 of the South African Companies Act is adopted.

The Insolvency Act should be amended by introducing section 140 as follows:

140. Objections to company resolution

(1) <u>Subject to subsection (2), at any time after the adoption of a resolution in terms of section 139 until the adoption of the business rescue plan and execution of the Administration Deed, in terms of section 150 of the Act, an affected person may apply to a court for an order-</u>

(a) <u>Setting aside the resolution, on the ground that– -</u>

140 Section 143 of the Insolvency Act 14 of 2011; See the discussion under 6.4.4.

141 Insolvency Regulations SI No.36 of 2013.

(i) *there is no reasonable basis for believing that the company is unable to pay its debts.*
(ii) *that there is no reasonable prospect for rescuing the company; or*
(iii) *the company has failed to satisfy the procedural requirements in section 139;*

(b) *setting aside the appointment of the practitioner on the ground that the practitioner-*
(i) *does not satisfy the requirements of section 204;*
(ii) *is not independent of the company or its management; or*
(iii) *lacks the necessary skills, having regard to the company's circumstances;*
or
(c) *requiring the practitioner to provide security in an amount and on terms and conditions that the court considers necessary to secure the interests of the company and any affected persons.*

(2) *An affected person who, as a director of a company, voted in favour of a resolution contemplated in section 139 may not apply to a court in terms of-*

(a) subsection (1)(a) to set aside that resolution; or

(b) subsection(1)(b) to set aside the appointment of the practitioner appointed by the company,

Unless that person satisfies court that the person, in supporting the resolution, acted in good faith based on information that has subsequently been found to be false or misleading.

(3) *An applicant in terms of subsection (1) must-*

(a) serve a copy of the application on the company and the Registrar of companies;

and

(b) notify each affected person of the application in the prescribed manner.

(4) *Each affected person has a right to participate in the hearing of an application in terms of this section.*

(5) *When considering an application in terms of subsection (1)(a) to set aside the company's resolution, the court may-*

(a) *set aside the resolution-*

(i) *on any grounds set out in subsection (1); or*

(ii) *if, having regard to all of the evidence, the court considers that it is otherwise just and equitable to do so;*

(b) *afford the practitioner sufficient time to form an opinion whether or not-*

(i) the company appears to be financially distressed; or

(ii) there is a reasonable prospect of rescuing the company,

And after receiving a report from the practitioner, may set aside the company's resolution if the court concludes that the company is not unable to pay its debts or there is no reasonable prospect of rescuing the company; and

(c) if it makes an order under paragraph (a) or (b) setting aside the company's resolution, may make any further necessary and appropriate order, including-

(i) an order placing the company under liquidation; or

(ii) if the court has found that there were no reasonable grounds for believing that the company would be unlikely to pay all of its debts as they become due and payable, an order of costs against any director who voted in favour of the resolution to commence provisional administration, unless the court is satisfied that the director acted in good faith and on the basis of information that the director was entitled to rely on in terms of the Companies Act.

(6) If, after considering an application in terms of subsection (1)(b), the court makes an order setting aside the appointment of a practitioner-

(a) the court must appoint an alternative practitioner who satisfies the requirements of section 204, recommended by, or acceptable to, the holders of a majority of the independent creditors' voting interest who were represented in the hearing before court; and

(b) the provisions of subsection (5)(b), if relevant, apply to the practitioner appointed in terms of paragraph(a).

This provision is rich and would adequately protect the country against potential misuse of provisional administration by undeserving companies while at the same time provide genuine companies an easy route to corporate rescue.

(3) Introduce procedure for compulsory placement under provisional administration

Uganda should also introduce a window for other affected persons, besides the company itself, to petition the High Court for an order to place a company under provisional administration. In introducing this mode of commencement, Uganda should pick a leaf from the provision of section 131 of the Companies Act of South Africa.

The Insolvency Act should be amended to introduce section 141, on compulsory commencement of provisional administration. The provision should provide as follows:

141. Compulsory commencement of provisional administration

(1) *Unless a company has adopted a resolution contemplated in section 129, an affected person may apply to a court by way of a petition at any time for an order placing the company under provisional administration.*

(2) *An applicant in terms of subsection (1) must—*

(a) serve a copy of the application on the company and the Commission; and
(b) notify each affected person of the application in the prescribed manner.

(3) *Each affected person has a right to participate in the hearing of an application in terms of this section.*

(4) *After considering an application in terms of subsection (1), the court may—*
(a)make an order placing the company under supervision and commencing provisional administration proceedings, if the court is satisfied that—
(i) the company is financially distressed;
(ii) the company has failed to pay over any amount in terms of an obligation under or in terms of a public regulation, or contract, with respect to employment-related matters; or

(iii) it is otherwise just and equitable to do so for financial reasons, and there is a reasonable prospect for rescuing the company; or

(b)dismissing the petition, together with any further necessary and appropriate order, including an order placing the company under liquidation.

(5) *If the court makes an order in terms of subsection (4)(a), the court may make a further order appointing as a licensed insolvency practitioner who satisfies the requirements of section 204, and who has been nominated by the affected person who applied in terms of subsection (1), subject to ratification by the holders of a majority of the independent creditors' voting interests at the first meeting of creditors, as contemplated in section 146.*

(6) *If liquidation proceedings have already been commenced by or against the company at the time an application is made in terms of subsection (1), the application will suspend those liquidation proceedings until—*
(a) the court has decided on the application; or
(b) provisional administration or administration proceedings end, if the court makes the order applied for.

(7) *In addition to the powers of a court on an application contemplated in this section, a court may make an order contemplated in subsection (4), or (5) if applicable, at any time during any liquidation proceedings or proceedings to enforce any security against the company.*

(8) *A company that has been placed under provisional administration in terms of this section—*

(a) *may not adopt a resolution placing itself in liquidation until the provisional administration proceedings have ended as determined in accordance with section 148(3) or 151 and*

(b) *must notify each affected person of the order within five business days after the date of the order.*

With this provision, more creditors and other affected parties are likely to petition courts to place financially distressed companies under provisional administration and eventually administration, instead of just going straight for liquidation, which ends up killing otherwise treatable companies. This procedure would also minimise the risk associated with directors nursing financially distressed company for too long until it becomes late for the company to be salvaged, thereby prompting creditors to petition for their liquidation.

This will further increase the uptake of provisional administration and help to engender corporate rescue.

8.3.2 Define the persons with interest and capacity to cause and participate in rescue proceedings

Reforming the Insolvency Act should clearly define the category of stakeholders that can commence proceedings to place a company under provisional administration. This should be achieved by introducing a specific definition for persons who are deemed to have sufficient interest in the affairs of a financially distressed company and, therefore, eligible to commence and/or participate in its rescue proceedings. For example, this may be done by either introducing a definition of 'affected person' in section 2 of the Insolvency Act, or by introducing a specific definition section at the beginning of Part VI of the Act. For consistency, the latter is a better alternative.

In defining the scope of 'affected persons', it is recommended that the South African approach, which encompasses a wide range of persons, beyond just the creditor, should be adopted. This is because corporate rescue, by its very nature, seeks to facilitate the rehabilitation of financially distressed companies with the hope that its stakeholders, including employees, creditors, shareholders and the community will continue to reap benefits from its continued existence. Therefore, section 2 of the Insolvency Act should be amended to include a definition of the term 'affected person', which should be defined in broad terms as it is under section 128(a) of the Companies Act of South Africa.

Section 2 should thus be amended as follows:

***<u>'affected person</u>**<u>' in relation to a company, means</u>*-

- *(i)* *<u>a shareholder or creditor of the company;</u>*
- *(ii)* *<u>any registered trade union representing employees; and</u>*
- *(iii)* *<u>if any of the employees of the company are not represented by a registered trade union, each of those employees or their respective representatives.</u>*

8.3.3 Designate the High Court Commercial Division as the Insolvency court.

It has been noted in the preceding discussions that court plays a significant role in the adjudication of insolvency related disputes. In Uganda, the role played by courts is even more pronounced. According to the Insolvency Act 2011, most corporate rescue procedures such as entry into provisional administration are either commenced by a court order or require sanctioning by court. Even in the course of provisional administration or administration, there is a lot of reliance on court to either approve the proposed actions by the administrator or to provide other necessary directions and supervision over the insolvency practitioner.

In terms of section 2 of the Insolvency Act, the definition of court is however too broad. Court means the High court and any court presided over by a chief magistrate. This is further clarified in section 254(1) of the Insolvency Act 2011 that only the High Court shall have jurisdiction over all matters concerning companies under the Act. In essence, a person can file an insolvency matter in any division of the High court, including the upcountry registries.

Considering the nature and intricacy of disputes that might however arise in the course of implementation of the insolvency Act, and in view of the potential effects such decisions of court can have on the future of companies and the businesses involved, it is recommended that Uganda should consider establishing a specialised insolvency court.

The ideal option would be to create a specialised insolvency division of the High court. However, in view of the current resource limitations in the country, and the fact that there are currently not many insolvency disputes, it is recommended that Government should consider designating the High Court Commercial Division as the Insolvency Court. This can be achieved by amending the Insolvency Act to expressly provide that all matters arising out of the Insolvency Act shall be presided over by the Commercial Court Division of the High Court. This will ensure that insolvency matters are adjudicated upon by only the Commercial Court Division of the High court, and not every registry of the High Court.

Implementing this recommendation will facilitate specialisation amongst judicial officers and also save on the amount of time that insolvency matters take before the ordinary High Court registries. This can be followed by other administrative interventions to ensure that of the judges deployed at the Commercial court division, only those with specialised training in insolvency matters are assigned to handle insolvency disputes.

This, it is argued, will potentially increase the quality of decisions delivered in insolvency matters as well as improve supervision by court of insolvency practitioners. It will also improve turnaround time in the resolution of insolvency related disputes in Uganda.

To achieve the above recommendation, the definition of court in section 2 of the Insolvency Act should be amended as follows:

Section 2*. "Court" means the Commercial Division of the High Court.*

With that amendment in section 2 of the Act, section 254 of the Act should be repealed, such that even for personal insolvency matters, only the High Court Commercial Division exercises jurisdiction over them.

8.3.4 Clearly define what 'provisional administration' and 'administration' mean

Although provisional administration and administration were introduced under part VI of the Insolvency Act as observed in Chapter Six,[142] neither the Act nor the Insolvency Regulations define what both procedures mean. This creates uncertainty about what they mean and what they seek to achieve. For ease of application of the law, just like

[142] See the discussion under 6.4.1.

the Companies Act of South Africa expressly defines what business rescue means in section 128(b) of the Companies Act, Uganda's Insolvency Act should adopt the same approach by amending section 2 of the Insolvency Act to provide a clear definition for the terms 'provisional administration' and 'administration'. This will make it easy for all users to have clarity about what these procedures mean and simplify the process for determining their success or failure as the case may be.

It is recommended that '**provisional administration'** should be defined as follows:

'Provisional Administration' *means the proceedings aimed at facilitating the rehabilitation of a company that is unable to pay its debts by providing for-*

(i) the temporary supervision of the company, and of the management of its affairs, business and property;
(ii) a temporary moratorium on the rights of claimants against the company or in respect of the property in its possession; and
(iii) the development and implementation, if approved, of a plan to rescue the company by restructuring its affairs, business, property, debt, and other liabilities and equity in a manner that maximises the likelihood of the company continuing in existence on a solvent basis or, if it is not possible for the company to so continue in existence, results in a better return for the company's creditors or shareholders than would result from the immediate liquidation of the company

With respect to 'administration', it is recommended that it is also expressly defined in the Insolvency Act as follows:

'administration' *means a corporate rescue procedure which a company enters immediately after the creditors have approved the provisional administrator's proposal and passed a creditors' resolution authorising the company to execute an administration deed with the administrator.*

By introducing these definitions in the Insolvency Act, all stakeholders will have clarity about what provisional administration and administration entail, and eventually attract more people to embrace them as better alternatives to liquidation.

8.3.5 Extend the duration of provisional administration

Section 145 of the Insolvency Act provides that provisional administration is supposed to last for a limited period of only thirty (30) days. Although the law mandates the provisional administrator,[143] in exceptional circumstances to apply to court for an order of extension of this period, the default thirty days is too short a period for the provisional administrator to meaningfully execute his or her duties.[144] Moreover, even the possibility for extension of the period is not automatic. The provisional administrator must prove existence of exceptional circumstances in the application to court before a judge can grant or refuse the extension.

This period and the procedure for its extension is a big distraction to the provisional administrator.[145] For instance, in South Africa, section 132(3) of the Companies Act clearly provides that business rescue proceedings can last for three months or such longer period as court can allow on the application of the practitioner.

In addition to the South African law allowing three months as the default period, it does not impose the onerous burden on the practitioner to prove any exceptional circumstances, which means that any reasonable explanation by the practitioner can be sufficient to justify an extension of the period. Therefore, section 145 of the Insolvency Act should be amended to extend the default period to at least 90 days as it is under the South African regime and to also remove the burden on the practitioner to prove any special circumstances before obtaining an order of extension of the period. It should be sufficient for the practitioner to just show that there is good cause for extending the period.

It is recommended that section 145(1)(a) of the Insolvency Act should be amended to replace the current provision with the following:

145. Duration of provisional administration

(1) A provisional administration shall terminate when-

> *(a) a period of three months has ended from the time when the company passed a resolution to voluntarily enter into provisional administration, or from the time when a court order appointing a provisional administrator was made, or such*

143 See the discussion under 6.4.6.
144 Sections 140–141 of the Insolvency Act 14 of 2011.
145 See the discussion under 6.4.6.

longer time as court may, on the application of the provisional administrator allow.

The provisional administrator will have ample time to execute his or her duties, prepare and undertake the requisite consultations to facilitate the development of a more convincing and easier to sell proposal for consideration by creditors. It will allow the provisional administrator to have a longer period to verify the information provided by the company and for him or her to make more realistic assumptions in the business rescue plan (proposal) to inform the preparation of the administration deed.

8.3.6 Remove the requirement for the Provisional administrator to obtain consent of secured creditors

Section 142(2)(c) of the Insolvency Act obliges a provisional administrator to obtain written consent from every secured creditor holding a charge over the whole or substantially the whole of the property and undertaking of the company before his or her appointment to serve as a provisional administrator can be registered with the official receiver and the registrar of companies.

As argued,[146] although the Insolvency Act does not expressly prescribe any specific legal effect for failure by the provisional administrator to obtain the requisite approval from secured creditors, this can be one of the grounds upon which a court may terminate the appointment of the provisional administrator or administrator.[147]

For all intents and purposes, this requirement is onerous and undermines the potential for provisional administration and administration to serve as tools for the rescue of financially distressed companies in Uganda. It is highly unlikely that a secured creditor, with contractual and legal rights under the security instrument to exercise individual debt enforcement rights against the company assets, can in their right state of mind voluntarily consent to the appointment of a provisional administrator, especially in view of the effects of the commencement of provisional administration on their contractual rights.[148] In fact, most secured creditors would be inclined to object to the appointment of a provisional administrator or undertake processes to delay the appointment to first

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146 See the discussion under 8.2.5.
147 Section 169 of the Insolvency Act 14 of 2011.
148 Section 143 of the Insolvency Act 14 of 2011.

exhaust their individual debt collection efforts against the company, even if doing so would leave the company more bruised and too sick to be rescued.

As Uganda works towards engendering corporate rescue and stand the chance to harness its benefits, section 142(2)(c) of the Insolvency Act should be repealed.

8.3.7 Abolish receiverships

In the UK where Uganda copied the bulk of its laws, including the Insolvency Act,[149] the existence of administrative receiverships as one of the procedures through which secured creditors could force a defaulting borrower to pay debts, was one of the main reasons why for the period between 1986 and 2002, the uptake of administration as a rescue procedure in the UK was dismal.[150] Floating charge holders had a right of veto over the appointment of administrators in the UK, almost the same way secured creditors can frustrate the appointment of a provisional administrator in Uganda today.

The UK government resolved this practical legal conundrum by abolishing administrative receiverships through the Enterprise Act 2002, which, together with other reforms, created the necessary attraction for the market to embrace administration as a rescue procedure.[151] Similarly, Uganda should consider deleting Part VII of the Insolvency Act on corporate and individual receiverships, and instead encourage creditors to utilise provisional administration and administration. This will minimise individualism in favour of collectivism in dealing with corporate distress. This measure will go a long way in protecting businesses against the risks associated with individual creditors, mostly financial institutions, unilaterally rushing to invoke their contractual powers to place financially viable but distressed companies under receivership, without first exploring rescue procedure, as was the case in a recent court matter involving *Mogas Uganda Limited v Stanbic Bank Uganda Limited & Kabiito Karamagi.*[152]

The brief facts of that case are that Mogas Uganda Limited, a company engaged in the business of operating fuel stations across Uganda, owed Stanbic Bank about UGX

149 See the discussion under 3.2.1 and 6.2.
150 See the discussion under 7.3.1; Finch and Milman, *Corporate Insolvency; Perspectives and Principles* 312.
151 See the discussion under 7.3.1; Goode *Principles of Corporate Insolvency law* 385–390.
152 High Court Misc. Application No. 1358 of 2021.

43,181,259,828 (approximately 191,188,063 South African Rands), arising out of 12 loan agreements that were executed by the parties between December 2018 and March 2021. The Bank alleged that Mogas defaulted on its loan obligations and in accordance with the loan agreements, the bank was expressly authorised to appoint a receiver to take over the management of the borrower's business and sell its assets. In exercise of its powers, Stanbic Bank decided to appoint Mr. Kabiito Karamagi, the second Respondent, as the receiver.

On appointment, Mogas alleged that the receiver closed all the borrower's petrol stations and advertised its assets for sale, without according the borrower sufficient time to rescue its business. The borrowers argued that the continued exercise of powers by the receiver was eroding the value of the company, with the risk that it would end up being wound up and its assets sold under distress.

Mogas accordingly applied for an order of a temporary injunction from court to suspend the Bank's decision to prematurely appoint a receiver in respect of the company and to order for his immediate removal. Mogas further pleaded that if given time, it would be able to conclude a transaction with a potential investor and be able to pay off the Bank's loan and ultimately save its business. On the other hand, the bank justified its decision and insisted that it was entitled to place the company under receivership to recover its overdue loan arrears.

After a lot of legal arguments, the trial judge, Justice Jeanne Rwakakooko, granted the application for a temporary injunction and suspended the appointment of the receiver for six months to allow the management of Mogas to resume operating its business and possibly pay off the loan.

Many lessons can be learnt from this case, but of relevance to this discussion is the fact that receiverships are by their nature, an individualistic procedure that may not often focus on the rescue of the defaulter, but the collection of what is due to the lender. If not properly used, receiverships can destroy businesses to the detriment of all parties, including the creditor who invoked it. The individualistic nature of receiverships renders them inappropriate for a business with many creditors, whose interest may only be fairly taken care of by a more neutral party, answerable to all creditors and not just the creditor who appointed the receiver. This is what administration seeks to achieve. As has already been proposed,[153] if the law is reformed to allow creditors, either individually or jointly to petition court for an order to place a delinquent borrower under administration, this will go a long way in nurturing the rescue culture in Uganda. Therefore, Uganda should consider amending the Insolvency Act to abolish the use of receiverships and instead permit creditors who would otherwise be entitled to place their defaulting borrowers under receivership, to instead place them (the defaulting borrowers) under administration. This will potentially benefit, not just the secured creditors, but the entire body of creditors, the company and the economy.

8.3.8 Improve the provision on moratorium

In Chapter Six,[154] I argued that whereas the framers of the Insolvency Act tried to provide a moratorium for companies undergoing provisional administration and administration, the manner in which the relevant provisions were written created a number of inherent loopholes which can be exploited by uncooperative stakeholders to undermine the rescue efforts.[155] For instance, a reading of sections 143 and 164 of the Insolvency Act leads to an absurd conclusion that the moratorium extended to companies during administration only binds the parties who are bound by the administration deed. In terms of section 164 of the Insolvency Act, the administration deed only binds the company, directors, secretary, shareholder, administrator, and creditors. This means that legal and other enforcement actions by non-creditor related parties like regulators, customers and others who are not legally bound by the administration deed are not affected by the moratorium. Similarly, sections 143(2) and 164(3) of the Insolvency Act provides that the moratorium enjoyed by companies during provisional administration and administration does not prevent secured creditors from exercising their powers of enforcement under the security instrument they signed with the company.

The action by such parties could be more dangerous to the entire rescue procedure than the actions of creditors. Presence of these provisions in the Insolvency Act is

153 See the discussion under 8.3.1(3).
154 See the discussions under 6.5.2 and 6.7.1.
155 See the discussion under 6.7.1

inimical to the realisation of corporate rescue in Uganda.[156] Parliament should consider replacing sections 143 and 164 of the Insolvency Act with a better provision, crafted along the same line as section 133 of the South African Companies Act.

The new provision should read as follows:

General moratorium on legal proceedings against company

(1) *During provisional administration and administration, no legal proceedings, including enforcement action by a creditor or any other person, against the company or in relation to any property owned by the company, or lawfully in its possession, may be commenced or proceeding within any forum, including a court of law or other administrative body, except-*
   (a) *With the written consent of the practitioner;*
   (b) *With the leave of the court and in accordance with any terms the court considers suitable;*
   (c) *As a set-off against any claim made by the company in any legal proceedings, irrespective whether those proceedings commenced before or after the commencement of provisional administration or administration;*
   (d) *Criminal proceedings against the company or any of its directors or officers; or*
   (e) *Proceedings concerning any property or right over which the company exercises the power of a trustee.*

(2) *During provisional administration or administration, a guarantee or surety by a company in favour of any other persons may not be enforced by any person against the company except with leave of the court and in accordance with any terms the court considers just and equitable in the circumstances.*

(3) *If any right to commence proceedings or otherwise asset a claim against a company is subject to a time limit, the measurement of that time must be suspended during the period when the company is provisional administration or administration.*

(4) *The practitioner and/or court may not unreasonably withhold consent in terms of this section, but in exercising the discretion to grant or reject the consent, the practitioner or court shall have regard to-*
   (a) *The purpose of provisional administration and administration;*
   (b) *The circumstances of the company;*
   (c) *The relevancy of the subject property to the attainment of the objectives of provisional administration or administration; and*
   (d) *The nature of the property and the rights claimed in respect of it.*

156 See the discussion under 6.7.1.

8.3.9 Introduce a provision on rescue finance

Absence of rescue finance is one of the apparent weaknesses in Uganda's corporate rescue framework.[157] This study has revealed that the way the framers of the South African law crafted section 135 of the Companies Act is one of the conspicuous strengths of the South African rescue framework.[158] Therefore, Uganda should consider reforming the Insolvency Act by introducing an express provision on rescue finance. The provision should be modelled along the wording in section 135 of the Companies Act of South Africa.

Given that the South African provision has not created the anticipated attraction amongst lenders to advance rescue finance to companies during business rescue,[159] it is recommended that Uganda should make additional strategic provisions to further incentivise lenders to finance companies during provisional administration and administration. Specifically, the incentive should be done in three strategic ways. First, exempt all legal instruments upon which lenders advance money to companies in provisional administration or administration from stamp duty. This will reduce the costs incurred by the already sick companies in having their loan instruments such as debentures, mortgages and others similar instruments registered.

Secondly, create an incentive for lenders to assume the risk to lend to companies in provisional administration and administration by making it clear that if they (lenders) fail to recover the money lent to companies during rescue procedure, such bad loans are treated as allowable business expenses in determining their liability for corporation tax.

Thirdly, exempt interest earned from loans advanced to companies during provisional administration and administration from income tax and create longer credit classification timelines for such loans.

The financial institutions (Credit Classification) Regulations[160]should also be amended to allow banks and other financial institutions longer periods before they are required

[157] See the discussion in 6.7.3.
[158] See the discussion under 5.9.1.
[159] See the discussion under 8.2.3.
[160] Financial Institutions (Credit Classification) Regulations SI 43 of 2005.

to provision for non-performing loans advanced to companies undergoing provisional administration and administration.

It is recommended that the Insolvency Act should be amended to introduce a new provision on post-commencement finance as follows:

Post-commencement finance

(1) *To the extent that any remuneration, reimbursement for expenses or other amount relating to employment becomes due and payable by a company to an employee during provisional administration or administration, but is not paid to the employee-*
   (a) *The money owed to the employee is regarded as post-commencement financing; and*
   (b) *Will be paid in the order of preference set out in subsection (3)(a).*

(2) *During its provisional administration or administration, the company may obtain financing other than as contemplated in subsection (1), and any such financing-*
   (a) *May be secured to the lender by utilising any assets of the company to the extent that it is not otherwise encumbered; and*
   (b) *Will be paid in the order of preference set out in subsection (3)(b).*

(3) *After the payment of the practitioner's remuneration and costs incurred during provisional administration or administration, all claims contemplated-*
   (a) *In subsection (1) will be treated equally, but will have preference over-*
      (i) *All claims contemplated in subsection (2), irrespective whether or not they are secured; and*
      (ii) *All unsecured claims against the company; or*
   (b) *In subsection (2) will have preference in the order in which they were incurred over all unsecured claims against the company.*

(4) *If provisional administration or administration is superseded by an order for the liquidation of the company, the preference conferred in terms of this section will remain in force, except to the extent of any claims arising out of the costs of liquidation.*

(5) *Any legal instrument prepared to secure a loan extended to a company during provisional administration or administration for purposes of funding the rescue strategy or the achievement of the administration deed is exempted from payment of stamp duty.*

(6) *A lender who fails to recover money advanced to a company during provisional administration or administration due to the failure by the practitioner to rescue the company shall be entitled to treat such unrecovered loan balances as an allowable business expense for purposes of computing its income tax obligation.*

(7) *Interest income earned from loans lent to a company during provisional administration or administration shall be exempt from income tax.*

(8) *For purposes of determining a financial institution's compliance under the Financial Institution (Credit Classification and Provisioning) Regulations 2005, a credit facility obtained by a company under provisional administration or administration shall be considered to be non-performing assets if the principal or interest is due for a period of twelve months from the due date, and the financial institution shall not be required to make any provision for such loans.*

It is argued that with this provision, lenders will be further motivated to provide rescue finance to companies in provisional administration and administration.

8.3.10 Other finance-related structural changes

In addition to introducing the above provision on post-commencement finance, the Government of Uganda should consider creating a special corporate rescue fund in lending institutions such as the Uganda Development Bank, Uganda Development Corporation, or the Uganda Microfinance Support Centre. This will allow provisional administrators and administrators of companies to borrow rescue financing from these specialised institutions to fund their rescue strategies, on condition that the rescue funds shall be categorised as a cost of administration and hence be payable ahead of other creditors.

Provision of rescue funding to provisional administrators and administrators of companies in the selected strategic sectors could be a more viable avenue for resuscitating financially distressed companies than directly advancing discounted loans to such businesses. It is easier to subject administrators of companies in administration to external scrutiny since an administrator is an independent professional, answerable to his or her professional body[161] and already bound by the terms of the administration deed and continuously answerable to more stakeholders, including the creditors, the licensing authority[162] and court.[163] This means that it is both structurally and practically easier to hold an administrator accountable for the rescue funds borrowed than the company directors who might obtain the supposedly rescue funds and instead misappropriate them to other non-rescue related activities. These strategic measures, if well formulated, can create the requisite impetus for financial

161 Section 204 of the Insolvency Act 14 of 2011.
162 Section 209 of the Insolvency Act 14 of 2011.
163 Sections 173 and 174 of the Insolvency Act 14 of 2011.

institutions to design specific loan packages and products for companies in provisional administration and administration, which may further engender the corporate rescue agenda in Uganda.

8.3.11 Introduce a provision to suspend application of *ipso facto* clauses

It has already been noted that *ipso facto* clauses are contractual provisions that allow one party to terminate or modify a contract on the occurrence of a trigger event, insolvency or entry into corporate rescue procedure being one of the most common trigger events.[164] This means that unless there are clear legal provisions to suspend or restrict parties from invoking *ipso facto* contractual provisions against companies that enter into provisional administration or administration, there is a big risk that entry into provisional administration and administration could cause more harm than good. Companies that choose to undergo rescue proceedings might become more vulnerable to unfair pressure from their counterparties who might demand for ransom payment from the already distressed company as a condition for them to keep the contract valid. This was identified as one of the weaknesses in Uganda's rescue framework.[165]

It is recommended that Uganda should consider amending the Insolvency Act by introducing a provision similar to what is captured in section 365(e)(1) of the US Bankruptcy Code of 1978, which expressly prevents counterparties from terminating or modifying the terms of any executory contract or unexpired lease held by companies that enter into reorganisation procedure merely on the basis of their entry into Chapter 11 proceedings.[166] If well crafted, introducing this kind of restriction in the law will render clauses in executory contracts which entitle counterparties to terminate or modify the terms of the contract on account of the debtor's entry into business rescue procedure unenforceable,[167]at least during the period when the company is still

164 See the discussion under 4.8. Also see Chong, 2019 *SAL Prac* 27.

165 See the discussion under 6.7.4.

166 See the discussion under 7.3.2; Rosenthal, Bouslog and Cassidy, 'Bankruptcy Court upholds the enforcement of the *ipso facto* clause against a foreign debtor' 2018 American Bankruptcy Institute Journal 2. Available at https://www.gibsondunn.com/wpcontent/uploads/2018/02/RosenthalBouslogCassidyBankruptcyCourtUpholdstheEnforcemntoftheIpsoFactoClauseAgainstaForeignDebtorABIFeb2018.pdf (Date of use: 16 April 2020).

167 See the discussions under 7.3.2 and 4.8.3.

undergoing provisional administration or administration. It is proposed that the import of the law should be to suspend, and not to completely avoid the rights of the counterparties to enjoy their contractual rights. The suspension should only be available during the period when the company is undergoing rescue proceedings, and the law should allow room for the counterparty to apply to court for leave to exercise his or her rights, where it can be proved that the exercise of right by the counterparty will not affect the rescue efforts. Thus, the Insolvency Act should be amended to introduce a new provision on this matter as follows:

No suspension or modification of contract

(1) *Notwithstanding any provision of law to the contrary, or a clause in an executory contract or lease, a person shall not terminate or modify the terms of any contract which was entered into with a company on account of its entry into provisional administration or administration.*

(2) *A person who is otherwise entitled under any law or contract to terminate or modify an existing contract with the company under provisional administration or administration may:*

(a) *lodge his or her claim with the provisional administrator or administrator for consideration in accordance with this Act, or*

(b) *apply to court for leave before he or she may exercise his or her right or power to terminate or modify the terms of the contract with a company under provisional administration or administration.*

(3) *A court to which an application in subsection 2(b) is made may only grant the leave sought where the applicant can demonstrate existence of exceptional circumstances to prove that denial of the leave sought shall cause more harm to the applicant than the company and the general body of creditors than if leave is granted to the applicant to terminate or otherwise modify the contract.*

8.3.12 Introduce restriction on withdrawal of essential goods and services to companies in provisional administration and administration

Discontinuation of supply of essential services is one of the common challenges that companies often face when they enter into insolvency procedure, including corporate rescue procedure.[168] Providers of essential services, such as utilities, IT and Telecom services, are often not patient with customers who may not be able to make timely or upfront payments for services consumed. Although there are no documented records on the magnitude of this problem in Uganda, reports from countries such as the UK indicate that on average, IT suppliers withdrew their supply in 46 percent trading

[168] See the discussion in 7.3.2.

insolvencies, while telecoms and utility suppliers withdrew their supply in 26 percent and fourteen percent of such cases respectively.[169] A 2013 survey of 249 insolvency practitioners in the UK found that in 41 percent of cases, key suppliers withdrew their supply and in 49 percent of cases, key suppliers asked for ransom payment.[170]

It is probable that a similar trend is happening in Uganda, and this could be one of the silent reasons why few financially distressed companies in Uganda consider entry into formal insolvency procedure as a useful option.

The UK government deemed it necessary to preserve supply of essential services to companies undergoing formal rescue procedures[171] by promulgating the Insolvency (Protection of Essential supplies) Order 2015 to protect companies against the risk of unilateral withdrawal of essential supplies because of the customer's insolvency.[172] Uganda should consider applying a similar stance. The Insolvency (Protection of Essential supplies) Order 2015[173] amended the Insolvency Act 1986 by making explicit provision to restrain providers of essential goods and services to companies undergoing corporate rescue proceedings from withdrawing supply to such companies because of their insolvency state, without first obtaining a court order.[174]

Section 2 of the UK insolvency (protection of essential supplies) Order 2015 defines essential supplies to include supply of gas, electricity, water, communication services and the supply of IT related goods like terminals, computer hardware and software, information technology, data storage processing and website hosting. The law further provides that any insolvency related term of contract for the supply of essential goods

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169 Insolvency Service Impact Assessment Report on Continuity of essential supplies to insolvent businesses 2015. Available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/418435/Continuity_supply_IA_-.–_Final.pdf (Date of use: 04 November 2021) 3.

170 R3 and ComRes: Association of Business Recovery Professionals Membership Survey, August 2013, Termination Clauses; Insolvency Service Report on Corporate Insolvency and Governance Bill 2020 6. Available at: https://publications.parliament.uk/pa/bills/cbill/58-.–01/0128/IA200519.pdf (Date of use: 04 November 2021).

171 See the discussion in 7.3.1.1.

172 The Insolvency Service 'The Insolvency (Protection of Essential Supplies) Order 2015 Guidance for Insolvency Practitioners and Suppliers' (October 2015) 3. Available at https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/465979/Continuity_of_essential_supplies–_guidance_to_insolvency_practitioners_and_suppliers.pdf (Date of use: 06 November 2021).

173 Statutory Instrument no.989/2015.

174 See the discussion under 7.3.2; The Insolvency Service 'A review of the corporate insolvency framework; A consultation on options for Reform' May 2016, 19.

or services to a company ceases to have effect when the company enters administration or voluntary arrangement.[175] The same law creates several avenues through which suppliers of such essential services are protected against loss as a result of the obligation to continue supply to companies in rescue. The scope of the protection provided to companies during corporate rescue in the UK was further improved in 2020 when the UK government enacted the Corporate Insolvency and Corporate Governance Act 2020.[176] Similar protection is also enjoyed by companies during reorganisation procedure in the US.[177]

It is recommended that Uganda should consider amending the Insolvency Act by introducing clear provisions that guarantee supply of essential goods and services to companies during provisional administration and administration. The proposed provision should be formulated as follows:

Restriction on supplier of essential goods and services

(1) *Except as provided in subsections (2) of this section, a supplier of essential goods and services shall not alter, refuse, or discontinue service to, or discriminate against a company in provisional administration or administration on the basis of its financial status or on account of non-payment of the pre-commencement debt.*

(2) *A supplier of essential goods and services who intends to alter, refuse, discontinue service or discriminate against a company in provisional administration or administration shall:*

   (a) *First give notice to the provisional administrator or administrator of his or her intention to alter, refuse, discontinue supply of goods and services or discriminate against the Company.*

   (b) *Upon receipt of the notice in subsection 2(a), the provisional administrator or administrator, shall within a period of seven (7) working days assess the likely effect of the intended alteration, refusal or discontinuation of supply service or goods or discrimination on the rescue of the company. If the provisional administrator or administrator confirms that the intended alteration, refusal or discontinuation of service or discrimination is likely to negatively affect the rescue efforts, the provisional administrator or administrator shall respond to the supplier informing him or her of the findings and require the supplier not to proceed with his or her intended action against the company.*

175 Section 4 of the Insolvency (Protection of essential supplies) order 2015.
176 Chapter 12 of 2020. See the discussion in 7.3.1.1.
177 See the discussion under 7.3.3.

(c) *Where the supplier is dissatisfied with the provisional administrator or administrator's decision, he or she may apply to court for leave to alter, refuse, or discontinue service to the company or discriminate against the company. The court may grant leave to a supplier only if satisfied that the alteration, refusal, discontinuation of supply or discrimination against the company will not cause undue difficult and economic hardship to the company and will not materially undermine the objective of provisional administration or administration.*

(d) *A supplier who is denied permission to alter, refuse or discontinue supply of essential services or goods to a company under provisional administration or administration shall be entitled to claim for payment in respect of services or goods supplied before and after provisional administration or administration in accordance with the Act.*

(3) *For purposes of this section, essential supply means:*
(a) *The supply of electricity to the company or its business premises.*
(b) *The supply of water to the premises of the company.*
(c) *The supply of telecommunication services, including data and telephone services, to the business premises of the company;*
(d) *The supply of information technology services, including the terminals, computer hardware, data storage and processing services.*
(e) *The supply of website hosting services.*

8.3.13 Remove unpaid taxes and social security contributions from the list of preferential debts and make statutory debts payable after all other creditors

One of the strategic interventions which the UK government instituted in 2002 to further engender the rescue culture in the UK was the abolition of crown preferences.[178] This resulted into the removal of taxes and unpaid social security contributions from the list of claims to be paid in priority to other debts. This was in line with the original thinking of the Cork Committee, which had rejected the argument that debts owed to the community ought to be paid in priority to debts owed to private creditors.[179] It was argued that a bad debt owed to the government is likely to be insignificant in terms of total government receipts, whereas loss of a similar sum by a private creditor may cause substantial hardship and trigger other insolvencies.[180]

178 See the discussion under 7.3.1.1

179 Cork Insolvency Law and Practice: Report of the Review Committee (the Cork Committee) (Cmnd.8558) (1982) 1410 para 320; Goode *Principles of Corporate Insolvency Law* 248.White Paper, Productivity and Enterprise: Insolvency-A second Chance (CM 5234, July 2001). Available at:https://www.iiiglobal.org/sites/default/files/26-2nd-chance.pdf (Date of use: 09 Nov 2021) 12 para 2.19.

180 Cork Insolvency Law and Practice: Report of the Review Committee (the Cork Committee)

The reasoning of the members of the Cork Committee is still valid in Uganda today. By the time most companies become unable to pay their debts and hence consider resorting to insolvency proceedings, they will often owe a lot of money to the Uganda Revenue Authority (URA) and the National Social Security Fund (NSSF), and debts owed to both of these agencies enjoy preferential treatment during insolvency.[181]

Section 12 of the Insolvency Act is worded along the same lines as schedule 6 of the UK Insolvency Act and makes payment to URA for any tax withheld by the debtor for a period of twelve months prior to the commencement of insolvency and contribution to NSSF to have preference over payments to other unsecured creditors, which the UK experts confirmed to have been a big legal impediment to the realisation of corporate rescue in the UK.[182]

Just like the UK government took a bold step in 2002 and relegated all payments to the crown behind other creditors, as a necessary measure to preserve money for distribution to unsecured creditors and hence minimise their misery, Uganda should copy this thinking by removing subsection 12(6)(a) and (b) of the Insolvency Act.

This study further proposes that the government of Uganda should consider reforming the Insolvency Act to clearly provide that upon entry into provisional administration or administration, debts payable to government bodies, including URA, NSSF and other statutory bodies should rank behind other unsecured creditors. This will certainly give provisional administrators and administrators sufficient reprieve against pressure from government agencies, who, in most cases, enjoy dominant power over the debtor as regulators, landlords or licensing authorities, and can, in the absence of clear legal protection, exert a lot of unhealthy pressure on the administrator.

The proposed section should provide as follows:

Payment to Statutory bodies

(1) Notwithstanding any law to the contrary, upon entry of a company into provisional administration or administration, any debt owed to any organ of

(Cmnd.8558) (1982) 1410 para 320.

181 Section 12 of the Insolvency Act 14 of 2011.

182 White Paper, Productivity and Enterprise: Insolvency-A second Chance (CM 5234, July 2001). Available at:https://www.iiiglobal.org/sites/default/files/26-2nd-chance.pdf (Date of use: 09 Nov 2021) 12 para 2.19.

government including statutory bodies, shall not be collectible for the period when the company is still in provisional administration or administration.

(2) *The statutory creditor shall be entitled to participate in the proceedings and to exercise any rights available to other creditors, except that a statutory creditor shall not be paid until after the provisional administrator or administrator has either fully paid all other creditors or otherwise entered into an arrangement where all the non-statutory creditors have agreed to be paid partially in full settlement of their respective claims.*

(3) *Where, after distribution to other creditors, there are no more funds left to pay statutory creditors, their debts shall abate in equal proportion and the statutory creditors shall, without any further proof, be entitled to write off the unpaid debts from their books of account.*

If this proposal is adopted, we are likely to see more financially distressed companies entering corporate rescue, as opposed to just vanishing without following any formal procedure. This will create more opportunities for insolvency practitioners to help in resuscitating struggling businesses, which might ultimately improve the country's overall business survival index, thereby preserve more jobs and support economic development.

8.3.14 Improve employees' rights during corporate rescue.

It has already been argued that the Insolvency Act 2011 of Uganda does not protect the right of employees,[183] yet for South Africa, there is overwhelming evidence that employees are among the immediate beneficiaries of corporate rescue.[184] Similarly, Uganda should consider expunging section 158(2) of the Insolvency Act, and in *lieu* thereof introduce a specific section on the rights of employees. This should be benchmarked on the provisions of sections 136 and 144 of the Companies Act of

183 See the discussion under 8.2.4 and 6.5.6.2.
184 See the discussion under 8.2.4.

South Africa, which directly provide for the rights of employees.[185] The Insolvency Act should be amended by repealing section 158(2) and insert a new section below.

Effect of Provisional Administration and Administration on employees' contracts and rights of employees generally.

(1) Notwithstanding any provision in any agreement to the contrary-

(a) During a company's provisional administration or administration proceedings, employees of the company immediately before the beginning of those proceedings shall continue to be so employed on the same terms and conditions, except to the extent that-

(i) Changes occur in the ordinary course of attrition; or

(ii) The employees of the company, in accordance with the applicable employment laws, agree different terms and conditions; and

(b) Any retrenchment of any such employees contemplated in the company's business rescue plan shall be subject to the provisions of the employment Act and any applicable rules regarding termination of employee's contract and payment of any terminable benefits.

(2) During a company's provisional administration or administration, any employee of the company may individually or collectively with other employees participate in any meetings convened by the practitioner and is entitled to-

(a) Notice of each court proceedings, decision, meeting or other relevant event concerning the provisional administration or administration and such notice must be given to the employees at their workplace and served to any trade union representing such employees.

(b) Participate in any court proceedings, arising during the provisional administration or administration;

(c) Form a committee of employees' representatives.

(d) Be consulted by the practitioner during the development of the provisional administrator's proposal and shall be afforded sufficient opportunity to review the proposed plan and prepare a submission to other creditors during its consideration as contemplated under sections 147 and 148.

185 See the discussion under 8.2.4.

(e) _Be present and make a submission to the meeting of the holders of voting interest before a vote is taken on the provisional administrator's proposal as contemplated under section 148._

(f) _Vote with creditors on a motion to approve the proposal, to the extent that the employee is a creditor of the company._

(g) _If the provisional administrator's proposal is rejected, to-_

(i) _propose the development of an alternative proposal, in the manner contemplated under sections 147 and 148, or_

(ii) _Present an offer to acquire the interest of one or more affected persons._

(3) _The rights set out in this section are in addition to any other rights arising or accruing in terms of any law, contract, collective agreement, shareholding, security or court order which the employee may otherwise be entitled to._

8.3.15 Introduce a requirement for Provisional Administrators and Administrators to have practical experience

Section 204 of the Insolvency Act provides the qualifications which one must possess before they can be considered qualified and eligible for appointment as an insolvency practitioner, and by extension a provisional administrator or administrator.

Apart from prescribing the academic and professional qualifications that one must possess, the law does not require one to have any proven experience in management before they can be appointed to act as insolvency practitioners.[186] Since it is clear that the success of rescue efforts largely depend on the skill and expertise of the practitioner who is appointed to manage the rescue process,[187] and the fact that business rescue, unlike liquidation entails one running the business of the financially distressed company and proposing strategic interventions to revive it, it is ideal that the person assigned such an important task is not only qualified, but also possesses practical experience in managing businesses or companies.

It is recommended that Uganda should consider copying the South African approach which imposes restrictions on persons who can be appointed to practice as business

186 See the discussion under 6.5.4.
187 See the discussion under 7.2.4.

rescue practitioners,[188] and creates different levels of management experience requirements for persons who can be appointed as practitioners in respect of big and small companies.[189]

Section 204 of the Insolvency Act should be amended by introducing the following provision.

204A Restrictions to practice as provisional administrator or administrator

(1) *Notwithstanding subsection 204, a person shall not be eligible to be appointed as a provisional administrator or administrator in accordance with part VI of the Act, unless he or she satisfies the requirements specified in this Act.*

(2) *Companies undergoing provisional administration and administration are classified in the following three categories:*

(a) ***'Large companies'*** *being any company, whether public or privately owned whose annual gross turnover is Uganda shillings Ten billion and above.*

(b) ***'Medium Companies'*** *being any company, whether public or privately owned, whose annual gross turnover is Uganda shillings One Billion but less than Ten Billion.*

(a) ***'Small companies'*** *being any company whether public or privately owned, whose annual gross turnover is less than Uganda shillings One Billion Only.*

(3) *Persons eligible to be appointed as provisional administrator or administrators are classified in the following three categories:*

(a) ***'Senior Practitioner'*** *means a person who is qualified to be appointed as an insolvency practitioner in terms of section 204(1) and who, immediately before being appointed as a provisional administrator or administrator for a particular company, has been engaged in business rescue practice or in the management of a business in the same sector as the debtor company for a period of not less than 10 years.*

(b) ***'Experienced Practitioner'*** *means a person who is qualified to be appointed as an insolvency practitioner in terms of section 204(1) and who,*

[188] Regulation 127 of the Companies Regulations 2011; See the discussion under 5.6.2; Keay and Walton *Insolvency Law: Corporate and Personal* 35.

[189] Regulation 127 of the Companies Regulations, 2011.

immediately before being appointed as a provisional administrator or administrator for a particular company, has been engaged in business rescue practice or in the management of a business in the same sector as the debtor company for a period of not less than 5 years.

(c) ***'Junior Practitioner'*** *means a person who is qualified to be appointed as an insolvency practitioner in terms of section 204(1) and who, immediately before being appointed as a provisional administrator or administrator for the particular company, has been engaged in the business rescue practice or in the management of a business in the same sector as the debtor company for a period of not less than 2 years.*

(4) *A junior practitioner-*

(a) *May be appointed as a provisional administrator or administrator for any small company; but*

(b) *May not be appointed as the provisional administrator or administrator for any Medium or Large company unless as an assistant to an experienced or senior practitioner.*

(5) *An experienced practitioner-*

(a) *May be appointed as a provisional administrator or administrator for any Medium company; but*

(b) *May not be appointed as the provisional administrator or administrator for any Large company unless as an assistant to a senior practitioner.*

(6) *A Senior Practitioner may be appointed as a provisional administrator or administrator for any company.*

(7) *For purposes of this Section:*

(a) ***'business rescue practice'*** *means activities of a professional nature engaged in that are comparable to the functions of a provisional administrator or administrator in terms of the Act; and*

(b) ***'Management of a business'*** *includes being a director or professional employee in a company or public body engaged in a particular business activity or sector.*

If adopted, this provision will result in an improvement in the quality of service provided by insolvency practitioners in Uganda and improve the survival rate of companies from rescue procedure.

8.3.16 Extend the eligibility criteria for insolvency practitioners to persons appointed by BOU and IRA to manage distressed financial institutions and insurance companies.

It is recommended that section 204 of the Insolvency Act and the additional improvements that have been proposed in the preceding recommendation should be extended to also apply to the individuals that are appointed by sector regulators such as the Bank of Uganda (BoU) and the Insurance Regulatory Authority (IRA) to manage and oversee insolvencies in their respective sectors. It was noted in Chapter Three[190]that the application of the Insolvency Act was excluded from matters involving banks and other financial institutions regulated by BoU and some licensed provider of insurance services[191]regulated by the IRA. Considering however that neither the Financial Institutions Act 2 of 2004 nor the Insurance Act 6 of 2017, prescribe any clear eligibility criteria or qualification for the individuals that may be appointed to perform the duties of a statutory manager,[192]receiver[193] or liquidator[194] in respect of distressed financial institutions or insurance companies, it is recommended that the same qualifications we have proposed for insolvency practitioners should also apply to these office bearers.

This is because financial institutions and insurance companies are big companies and effective management of their affairs, especially when faced with financial distress, require extra skill and management experience, and any mistake in managing such companies can cause serious damage to the economy and result in the loss of many jobs.

190 See discussion in 3.2.3, at pp 68-.
191 Section129 of the Insurance Act 6 of 2017.
192 Section90 of the Financial Institutions Act 2 of 2004; ss.125 &126 of the Insurance Act 6 of 2017.
193 Part X of the Financial Institutions Act 2 of 2004.
194 Part XI of the Financial Institutions Act 2 of 2004; part XIV of the Insurance Act 6 of 2017.

It is recommended that the Insolvency Act should be amended by introducing section 204 C as follows:

204 C: ***<u>Notwithstanding any law or practice to the contrary, no person shall be eligible for appointment as a statutory manager or liquidator in respect of an insurance company in accordance with the Insurance Act 6 of 2017, or as a member of an interim board of directors for a financial institution, or be appointed by the Bank of Uganda to discharge the function of a receiver or a liquidator in respect of a financial institution in Uganda, unless such a person is eligible for appointment as an insolvency practitioner under this Act.</u>***

The said provision will improve transparency, professionalism and accountability amongst all persons charged to manage financially distressed companies in Uganda.

8.3.17 Introduce a cramdown provision

The Insolvency Act does not provide for the right to cramdown dissenting creditors, and where the dissenting creditor(s) hold a dominant percentage of the debt of the company, such creditor(s) can frustrate the process for approval of the proposal made by the provisional administrator or administrator, which can result into an abrupt end to provisional administration. This is a very dangerous legal situation; as was already argued,[195] absence of a cramdown provision through which the provisional administrator can override the selfish interests of an uncooperative creditor is a major weakness in any rescue framework.[196] In this regard, section 148 of the insolvency Act should be amended by introducing a provision similar to what is contained in section 152(4) of the South African Companies Act as follows:

195 See the discussion under 5.9.1.
196 See the discussion under 5.9.1.

Section 148 (4) *A proposal that has been adopted is binding on the company, and on each of the creditors of the company and every holder of the company's securities, whether such a person-*

(a) Was present at the meeting:
(b) Voted in favour of the adoption of the proposal; or
(c) In the case of creditors, had proven their claims against the company.

8.3.18 Creditors should not petition for liquidation without first exploring administration

Sections 92(1) of the Insolvency Act currently provides that court may appoint a liquidator on the application of the company, a director of the company, a shareholder of the company, a creditor of the company, a contributory or the official receiver. The law goes on to expressly provide that court may proceed to appoint a liquidator and place the company into liquidation for as long as the petitioner can satisfy court that the company is unable to pay its debts.[197] However, this open provision exposes virtually all trading companies to the risk of being subjected to liquidation proceedings by their creditors.[198]This is especially so because in terms of section 3 of the Insolvency Act, any company that fails to pay a debt of Uganda Shillings Two Million Only (Approximately United States Dollars 550 Only), is deemed to be unable to pay its debts and hence liable to liquidation.[199] Moreover, for companies, the debt need not to be a judgment debt.[200]

This partly explains why some creditors use liquidation proceedings as a debt collection tool, without minding about its effects on the survival of the company[201]and accounts for the decimal use of administration in Uganda.[202] This continues to expose viable companies with otherwise treatable short-term liquidity challenges to the risk of being buried alive through the often embarrassing and value eroding liquidation

197 Section 92(2) of the Insolvency Act 14 of 2011.
198 See the discussion under 1.3.
199 See the discussion under 3.3.
200 Section 4(2)(a)(ii) of the Insolvency Act 14 of 2011.
201 See the discussion under 3.3; Waiswa 'A comparative analysis of the legitimacy of the use of insolvency proceedings as a debt collection tool in the United Kingdom and Uganda' 82.
202 See the discussion under 3.3 and 6.7.

proceeding.[203] To cure this problem, section 92(2) of the Insolvency Act should be amended. Before court makes an order to appoint a liquidator on a petition by a creditor, the court must be satisfied that in addition to proving that the company is unable to pay its debts, there is evidence that the petitioner or another eligible person has in the last six months before date of the petition attempted to place the company under provisional administration, but the provisional administrator failed to achieve any of the outcomes in section 140(1)(b), namely

> (i) The survival of the company and the whole or any part of its undertaking as a going concern;
>
> (ii) the approval of an administration deed under section 150; and
>
> (iii) a more advantageous realisation of the company's assets than would be effected in a liquidation.

In addition, section 92(3) should also be amended to specifically empower court to order the placement of a company under provisional administration, where in the opinion of court, this might better serve the collective interests of the parties.

If adopted, these measures will introduce a layer of control over creditors. It will no longer be enough for just one creditor to wake up and petition court for the liquidation of a company, simply because the company has failed to pay a debt. The creditor will be required to first place the company under provisional administration, and only progress to liquidation after failing to secure recovery of his or her debt in a manner that does not directly affect the collective interests of the other stakeholders.

It is proposed that the amended section 92 should provide as follows:

92. Circumstances under which the court may appoint liquidator

(1) Subject to subsections (2) and (3), the court may appoint a liquidator on the application of-

(a) the company;

(b) a director of the company;

(c) a shareholder of the company;

(d) a creditor of the company;

[203] See the discussion under 6.7.

(e) *a contributory; or*

(f) *the official receiver.*

(2) *The court may make an order under subsection (1) if it is satisfied that;*

(a) *the company is unable to pay its debts within the meaning of section 3; and*

(b) *in the case of a petition by a creditor of the company, there is sufficient evidence that the petitioner or any other person has in the last six months before the date of presentation of the petition attempted to place to the company under provisional administration, but the provisional administrator failed to achieve any of the outcomes in section 140(1)(b) of the Act.*

(3) *On hearing a liquidation petition the court may dismiss it or adjourn the hearing conditionally or unconditionally, or make an interim protective order to place the company under provisional administration and immediately appoint any licensed insolvency practitioner to assume the management of the company in accordance with Part VI of the Act, or make any other order as it thinks fit, but court shall not refuse to make the liquidation order on the ground only that the assets of the company have been mortgaged to an amount equal to or in excess of those assets or that the company has no assets.*

8.3.19 Introduce measures against late payment of suppliers

It was already argued[204]that late payment of suppliers is one of the common causes of financial distress and insolvency.[205] Whereas businesses have freedom to contract, which includes the right of contractual parties to prescribe how and when suppliers are to be paid for goods and services, it is apparent that parties often don't follow their contractual commitments. This exposes businesses to the risk of insolvency due to delayed payment by their contractual parties. While there are remedies in law of contract for such delays, it is recommended that the government should consider coming up with deliberate administrative policies to commit contracting parties to honour their payment obligations.

Specifically, it is recommended that the government of Uganda should consider benchmarking on countries such as the UK and South Africa, which have tried to deal

[204] See discussion in 4.6.

[205] Intrum Justitia 2016 European Payment Report 9–46; Ladu IM 'Domestic arrears: Trouble of local suppliers owed by Government' *Daily Monitor New paper* 2019–07–09. Available at https://www.monitor.co.ug/Business/Prosper/Domestic–arrears–Trouble–of–local–suppliers–owed–by–government–/688616–5187816–amd6p6z/index.html (Date of use: 19 April 2020).

with this problem by encouraging businesses to adopt specific sector codes and standards that commit businesses to promptly pay their suppliers.[206] For instance, in 2008, the UK government introduced the Prompt Payment Code, which is an industry code of conduct, under which businesses commit to pay their suppliers promptly. The scope of the UK's Prompt Payments Code has been progressively reviewed and improved upon over time and in 2018, the government announced that suppliers and subcontractors on public projects must comply with the prompt payment code by paying their suppliers on time otherwise they would not be eligible to continue supplying government.[207] Where a supplier is reported not to be compliant with the code, he or she can be suspended from supplying goods and services to government.

In South Africa, similar approaches have been employed in some sectors, with the National Small Business Chamber championing the signing of the prompt payment code, which seeks to commit big businesses and government to pay SME suppliers within thirty days.[208] Although these initiatives have not fully solved the problem of late payment in the UK and South Africa, they are worth trying out in Uganda.

It is recommended that stakeholders in the various business sectors in Uganda, including the government of Uganda, should consider working with the relevant trade associations, banks and public procurement specialists to come up with practical measures through which delayed payments can be minimised. This, it is argued, will go a long way in minimising financial distress and ultimately improve the survival rate for businesses in Uganda.

https://www.gov.uk/government/news/government-tackles-late-payments-to-small-firms-to-protect-Jobs (Date of use: 29 May 2022).

207 https://www2.deloitte.com/content/dam/Deloitte/uk/Documents/audit/deloitte-uk-gib-prompt-payment-may-2019.pdf (Date of use: 29 May 2022).

208 https://www.nsbc.africa/prompt_payment_code (Date of use: 29 May 2022).

8.4 General conclusion

This study has illuminated the concept of corporate rescue. Corporate rescue is not just another western ideological concept, but rather a strategic economic policy measure, which all economies must now, more than ever before, embrace to guarantee the survival of their businesses, especially at this time when virtually all businesses are nursing the involuntary wounds inflicted upon them by the COVID-19 global pandemic.

The study has revealed that South Africa has been a consistent vanguard of corporate rescue.[209] Although its first attempt to embrace corporate rescue through the introduction of judicial management in the Companies Act of 1926 did not produce the expected results,[210] South African policy makers continued to push the rescue agenda up to when they finally made their mark by including Chapter 6 in the Companies Act 2008, which contains a number of enviable provisions with potential to facilitate efforts by companies, practitioners and courts to rescue the financially distressed but still viable businesses in South Africa.[211]

On the other hand, this study has revealed that Uganda's legal framework on corporate rescue does not adequately capture many of the salient features of a modern corporate rescue framework.[212] Rescuing of financially distressed companies in Uganda using the current framework can only happen by chance and not because of the strength of the legal framework. It is important to improve the legal framework to make it more facilitative to rescue efforts and hence guarantee all eligible businesses a chance to survive. Policy makers in Uganda should take serious note of the findings and recommendations contained in this study[213] and ensure that the requisite reform processes are started sooner than later to give financially distressed companies in Uganda an equal chance to be healed of their financial challenges, without necessarily dying because of treatable symptoms of financial distress.

It is argued that since Uganda is a resident of the global village, it is imperative that the reform process should not be closed but rather open to a consultative process that

209 See the discussion under 5.1.
210 Loubser, 'Some Comparative Aspects of Corporate Rescue in South African Company Law' 2.10.
211 See the discussion under 5.9.1.
212 See the discussion under 6.7 and 8.2.
213 See the discussion under 8.3.

will seek to localise the already tested international best practices on corporate rescue and incorporate them in Uganda's corporate rescue framework. A team that would be tasked with the reform agenda should undertake comparative studies on how to improve Uganda's corporate rescue system and should, as much as possible, be comprised of Ugandan experts with hands-on academic and practical experience on business rescue as opposed to experts from other countries. This will facilitate development of a framework that speaks to the local realities in Uganda as opposed to copying and pasting models from other countries.

Finally, considering the relevance of corporate rescue in the pursuit for socio-economic transformation of all societies, this study recommends that insolvency and business rescue should become part of all law and business schools' academic programmes. This will go a long way in creating a generation of business owners and advisors with a clear appreciation of the fundamentals of insolvency law and corporate rescue.

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