

**IS THE DIENER JUDGEMENT ANOTHER NAIL IN THE
COFFIN OF BUSINESS RESCUE?**

By

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In April 2011, with the introduction of Companies Act 71 of 2008 (Companies Act), South Africa was introduced to business rescue. This replaced the old judicial management system which generally failed and was often subject to abuse.

It is concerning to note that in terms of statistics published by the CIPC, from 2011 to 31 December 2016, out of 2433 business rescue proceedings started, only 385 were substantially implemented and a CoR125.3 form for the substantial implementation of the business rescue plan was lodged.

Business Rescue has had its share of problems which have hampered its success rate. The whole concept of Business Rescue is laudable as it aims to assist an ailing economy, if successful, in retaining jobs and contributing to the fiscus once the company under business rescue is turned around and becomes profitable. The interpretation of Chapter 6 of the Companies Act is but one of the problems affecting Business Rescue. Obtaining post commencement finance is another issue that has beset the Business Rescue Practitioner. The South African Revenue Service has also been a thorn in the side of the process by its, dare I say, underhand schemes of avoiding refunds where they are due, and in many case are substantial and potentially pivotal to the success of the business rescue. I have had the unfortunate experience of having to place a company under business rescue into liquidation due the fact that the company was owed several million rands in VAT refunds. If refunded timeously and in terms of the spirit of the VAT Act, this money would have gone a long way to saving the company and approximately 160 jobs. However, a protracted battle with SARS was unsuccessful due to the fact that one is dealing with a faceless organisation and dealing with them is like playing Russian roulette as one never knows who you are dealing with from one communication to the next.

The Companies Act defines business rescue as follows: -

“128(1)(b) *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; 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; “*

Section 135 of the Companies Act defines post commencement finance and Section 135(4) even deals with the preference conferred in terms of this section if the company goes into liquidation. With regard to the business rescue practitioner’s claims arising from unpaid remuneration, this is regarded as post commencement finance and is specifically dealt with in Sections 135 and 143 of the

Act. However, the recent judgement in the Diener¹ case heard in the Supreme Court of Appeal of South Africa has dealt with this differently and has ruled against the preference conferred. This article will deal more fully with the question of preference and set out the reasons why in my view the judgement is fundamentally flawed.

DIENER JUDGEMENT

This case was heard in the Supreme Court of Appeal on 13th November 2017 and the judgement was delivered on the 1st December 2017 – Case No.926/016. The issues to be considered were as follows:

1. The order of preference of the Business Rescue Practitioner's claim on liquidation;
2. Determination of the date of liquidation, when business rescue proceedings are converted into liquidation proceedings;
3. Whether the Business Rescue Practitioner is required to prove his or her claim in terms of Sect 44 of the Insolvency Act.

As indicated this discussion will address the first issue as it has, in my opinion, a major impact on the future of business rescue. The second and third issues above are, again in my opinion, straight forward and the judgements given on those are clear.

The judgement refers to virtually every section of Chapter 6 of the Companies Act which might be difficult to understand as much of it has nothing to do with the order of preference but rather sets out the procedures and responsibilities in business rescue. The learned Judges refers to the case of Natal Joint Municipal Pension Fund v Endumeni Municipality 2012 (4) SA 593 (SCA). In this case Wallis JA dealt with the approach to be adopted generally when meaning must be attributed to a written document. He stated: -

*'Interpretation is the process of attributing meaning to the words used in a document, be it legislation, some other statutory instrument, or contract, having regard to the context provided by reading the particular provision or provisions in the light of the document as a whole and the circumstances attendant upon its coming into existence. Whatever the nature of the document, consideration must be given to the language used in the light of the ordinary rules of grammar and syntax; the context in which the provision appears; the apparent purpose to which it is directed and the material known to those responsible for its production. Where more than one meaning is possible each possibility must be weighed in the light of these factors. The process is objective, not subjective. A sensible meaning is to be preferred to one that leads to insensible or unbusinesslike results or undermines the apparent purpose of the document. **Judges must be alert to, and guard against, the temptation to substitute what they regard as reasonable, sensible or businesslike for the words actually used. To do so in regards to a statute or statutory instrument is to cross the divide between interpretation and legislation; in a contractual context it is to make a contract for the parties other than the one they in fact made. The "inevitable point of departure is the language of the provision itself", read in context and having regard to the purpose of the provision and the background to the preparation and production of the document.'***

(Highlights made for emphasis)

¹ Diener N.O. v Minister of Justice and Others (926/2016) [2017] ZASCA 180; [2018] 1 All SA 317 (SCA) (1 December 2017)

Section 5 of the Companies Act states the following:

“Sect 5 (1) This Act must be interpreted and applied in a manner that gives effect to the purposes set out in section 7.

(2)

(3)

(4) If there is inconsistency between any provision of this Act and a provision of any other national legislation-

(a) the provisions of both Acts apply concurrently, to the extent that is possible to apply and comply with one of the inconsistent provisions without contravening the second; and

(b)(i) to the extent that it is impossible to apply or comply with one of the inconsistent provisions without contravening the second-

.....

(b)(ii) The provisions of this Act prevail in any other case”

It is quite clear from Section 5 that the Companies Act prevails over the Insolvency Act as that Act is not mentioned in the list of exceptions as set out in Section 5.

Sect 141(1) of the Act states the following; -

“As soon as practicable after being appointed, a practitioner must investigate the company’s affairs, business, property and financial situation, and after having done so, consider whether there is any reasonable prospect of the company being rescued.”

When a business rescue practitioner is appointed to a company under business rescue, unless he has had previous knowledge of the affairs of the company, he has very little knowledge of its financial status other than that it is financially distressed. The business rescue practitioner is in a rather challenging position, as in most cases he is only able to assess the prospects of a successful turnaround after he has carried out the investigation into the affairs of the company in terms of Section 141 of the Act. In the case of a large company under business rescue, this could take some considerable time resulting in the incurring of considerable costs for the business rescue practitioner. Practical experience has revealed that the books and records taken over at the commencement of business rescue do not necessarily reflect the true financial position of the company. Audits may have been delayed due to the inability to pay the auditors, the working capital may reflect the incorrect position and so on and so forth. Furthermore, in recent times much has been said about the quality of the audits, which could potentially not be of a satisfactory standard and as a result, the financial statements available may not reflect the correct financial position of the company.

From a practical point of view, the business rescue practitioner usually allows his remuneration to accumulate so as to assist with cash flow while doing his investigations, on the understanding that he has a ‘super’ preference in the event that the company has to be liquidated. In terms of Sections 135(4) and Sect 143(5) of the Companies Act the order of preference is clearly set out. These two sections indicate that the business rescue practitioner is first in line after the Master’s costs and the costs of liquidation and ranks before secured creditors.

Sect 135(4) clearly states the following: -

“If business rescue proceedings are superseded by a liquidation order, 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.”

Section 143 clearly defines the preferences in the case of business rescue and in para.4 of that section states the following: -

“To the extent that the practitioner’s remuneration and expenses are not fully paid, the practitioner’s claim will rank in priority before the claims of all other secured and unsecured creditors.

These sections could not be clearer. In the light of Section 5 of the Companies Act, I am of the opinion that the preferences conferred in terms of those sections must surely prevail. The argument could be put forward that this should be read in conjunction with Section 89 of the Insolvency Act 24 of 1936 (Insolvency Act). Section 89(1) of the Insolvency Act states *the “..... The trustees remuneration in respect of any such property and a proportionate share of the costs incurred by the trustee in giving security for his proper administration of the estate, calculated on the proceeds of the sale of the property, a proportionate share of the Master’s fees, and if the property is immovable, any tax as defined in subsection (5) which is or will become dueshall form part of the costs of realisation.”*

Therefore, by implication, the business rescue practitioner’s remuneration and expenses should at the very least be apportioned in terms of Section 89(1) of the Insolvency Act. After all, Section 140 places the practitioner in the position of an officer of the court and therefore should surely be protected for his fees and expenses.

The question may be asked as to why I am of this opinion. Let me explain the rationale behind my thinking: -

1. Section 140 of the Companies Act sets out the powers and duties of the business rescue practitioner. In terms of Section (1)(a) the practitioner *“has full management control of the company in substitution for its board and pre-existing management.”* The practitioner is in terms of Section (3) an officer of the court. The Master of the Supreme Court is referred to as *“a creature of statute and various Acts regulate the duties and powers of the Master.”*² In the same way the business rescue practitioner is a *“creature of statute”* and should therefore be accorded the same preferences as the Master. He is not responsible to the Master. In terms Section 128(1)(b)(iii) the practitioner is responsible for *“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.”* This effectively gives the business rescue practitioner, in my opinion, more responsibility than it would a liquidator. The liquidator is responsible for disposing of the assets of a company and distributing the proceeds. If the practitioner is unable to turn the company around, having investigated the affairs of the company in terms of Section 141, the practitioner must inform the company and place the company into liquidation. This process will result in the practitioner incurring costs in the form of remuneration and other expenses that cannot be recovered at the time of placing it in liquidation. The learned Judges have ignored Section 5 of the Act as well as Sections 135(4) and 143(4) by giving a different interpretation to the

² <http://www.justice.gov.za/master/about.htm>

meanings of those sections and furthermore they have ignored the guide-lines made by Wallis JA in the Natal Joint Municipal Pension Fund v Endumeni Municipality 2012 (4) SA 593 (SCA) and have substituted “what he regards as reasonable, sensible or businesslike for the words actually used. To do so in regards to a statute or statutory instrument is to cross the divide between interpretation and legislation.”

2. The comment given by the learned judges in respect of Section 95 of the Insolvency Act is, in my opinion, flawed, and simply creates confusion as they are effectively placing the Insolvency Act ahead of the Companies Act despite them referring to Section 5 of that Act. I would submit, a solution to the problem of the practitioner’s fees in insolvency would be to follow Section 89 of the Insolvency Act. In terms of Section 89, the costs of liquidation and the trustee’s remuneration are apportioned between secured assets and free residue. Surely, this method should also be used for the practitioner’s fees and expenses. This would be equitable to all parties.

CONCLUSION

It is my opinion that this judgement is a nail in the coffin of business rescue. I do not believe that the authors of Chapter 6 of the Companies Act would agree with the judgement delivered as they were meticulous in protecting the practitioner in terms of Sections 135 and Sect 143. There is nothing ambiguous in either of those sections and when read with Section 5, it entrenches the preference of the practitioner in the event of a liquidation.

Unfortunately, this case sets a precedent unless challenged in the Constitutional Court or an amendment is introduced in the Companies Act that further entrenches the rights of the practitioner in the event of liquidation.

As that judgement now stands, it paves the way for other actions and the position of SARS immediately comes to mind. At present, SARS is regarded as a concurrent creditor but in terms of the Insolvency Act, it is a preferred creditor. This judgement has, in my opinion, paved the way to challenge Section 5 of the Companies Act.