



INSOL
INTERNATIONAL



The effect of business rescue on shareholders and directors

Gareth Cremen (Cox Yeats, Johannesburg)

RIGHTS OF SHAREHOLDERS AND THEIR PARTICIPATION IN THE BUSINESS RESCUE PROCEEDINGS

What is a shareholder?

A shareholder is a holder of a share issued by a company, who is entered as such in the certificated or uncertificated securities register and includes a person who is entitled to exercise any voting rights in relation to a company.

RIGHTS OF SHAREHOLDERS

- Shareholders (together with employees, trade unions and creditors) are “*affected persons*” and, as such, are afforded certain rights.
- They have the right to:
 - be notified of the proceedings;
 - participate in the proceedings;
 - object to the proceedings; and
 - bring an application to commence business rescue proceedings.

RIGHTS OF SHAREHOLDERS...

- Shareholders are also entitled to notice of and the right to participate in, court proceedings and other business rescue meetings and, if the proposed business rescue plan alters the rights of the holders of any class of the company's securities (that is, the rights attached to their shares), to vote on the approval or rejection of the proposed business rescue plan.

ALTERING RIGHTS OF HOLDERS OF ANY CLASS OF THE COMPANY'S SECURITIES

- In business rescue, the alteration in the classification or status of any issued securities can only be affected via either a business rescue plan or through a court order.
- Altering via a court order will only be followed by the Business Rescue Practitioner (“BRP”) as the last resort, most likely against the wishes of the shareholders affected by the alteration.

VOTING ON A BUSINESS RESCUE PLAN

- Shareholders are often also creditors who may be entitled to vote on a business rescue plan in both or one of those capacities.
- Shareholders who are also creditors may, in certain circumstances, be found to not be independent or subordinated, which will impact on the voting interest accorded to the creditor for voting purposes.

CONSULTING WITH “AFFECTED PERSONS”

- The BRP has an obligation to consult with creditors, other affected parties and management of the company before preparing a business rescue plan for consideration and possible adoption.
- *Hlumisa Investments Holdings (RF Limited and Another) v Van der Merwe NO and Others*:
 - The court found that there is a clear distinction between “informing” and “consulting”.

CONSULTING WITH “AFFECTED PERSONS”...

- The court stated that at a substantive level, consultation entails a genuine invitation to give advice and a genuine receipt of the advice.
- Consultation is not to be treated perfunctorily or as a mere formality. This means that engagement after the decision-maker has already reached his decision has already become ‘unduly fixed’. Is not compatible with true consultation; and

CONSULTING WITH “AFFECTED PERSONS”...

While at procedural level consultation may be conducted in any appropriate manner determined by the decision-maker, the procedure must enable consultation in the substantive sense to occur.

- ***Informing:***

- The court in Hlumisa found that informing creditors and shareholders of what was happening by way of Stock Exchange New Service announcements and in meetings with individual shareholders and a body of preferent shareholders, did not amount to “consultation” and granted an interim interdict preventing a meeting that was convened to vote in the proposed business rescue plan from proceeding.

LIMITATION OF SHAREHOLDER RIGHTS

- Business rescue also limits rights that shareholders would otherwise have held.
- For example, a special resolution of shareholders is not required to dispose of all or a greater part of the assets of a company, if that disposal is pursuant to an adopted business rescue plan.

THE RIGHTS AND DUTIES OF DIRECTORS IN THE BUSINESS RESCUE CONTEXT

- Ordinarily the powers of both governance and management of a company reside in the board of directors, as appears from section 66(1) of the Companies Act 2008, which reads as follows:

“the business and affairs of a company must be managed by or under the direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company, except to the extent that this Act or a company’s Memorandum of Incorporation provides otherwise.”

THE RIGHTS AND DUTIES OF DIRECTORS IN THE BUSINESS RESCUE CONTEXT...

- Upon a company being placed under supervision and in business rescue, the BRP assumes full management control of the company in substitution for its board and pre-existing management and may then delegate any power or function to a director or pre-existing management of the company.
- During business rescue, directors must continue to exercise their functions as directors, subject to the authority of the BRP and they owe a duty to the company to exercise any management function in accordance with the instructions of the BRP.

THE RIGHTS AND DUTIES OF DIRECTORS IN THE BUSINESS RESCUE CONTEXT....

- Directors also remain bound by the requirement of section 75 of the Companies Act 2008 (“**the Act**”), and to the extent that they act according to the instructions and subject to the authority of the BRP, they are relieved from the duties and liabilities set out in section 76 and 77, other than section 7(3)9a), (b) and (c) of the Act.
- If one or more directors or the board purports to take any action on behalf of the company that requires the approval of the BRP, that action is void unless approved by the BRP.

DUTIES OF DIRECTORS

Directors have mandatory statutory duties to co-operate with and assist the BRP.

- Directors must:
 - attend to the reasonable requests of the BRPs;
 - provide information about the company's affairs;
 - as soon as possible after the commencement of the business rescue proceedings, deliver to the BRP all the company's books and records that may be in their possession; and

- Within five business days of the commencement of the business rescue, provide the BRP with a statement of affairs containing details of any material transactions involving the company or its assets occurring within the previous 12 months, any –
 - ✓ legal proceedings;
 - ✓ assets;
 - ✓ liabilities;
 - ✓ income and disbursements;
 - ✓ employees;
 - ✓ debtors; and
 - ✓ Creditors

- In practice, a business rescue will have a better prospect of success if the directors or existing management take an active role in the matter and assist the BRP in the continuation of the business, with a view of successfully developing and implementing a business rescue plan.

POWERS OF DIRECTORS TO ACT ON BEHALF OF THE COMPANY DURING BUSINESS RESCUE PROCEEDINGS: CASE LAW

- *Ragavan v Optimum Coal Terminal (Pty) Ltd:*
 - “the applicants in Tegeta and Exploration and Resources, a creditor of the first respondent, Optimum Coal Terminal (OCT). Both companies were in business rescue. The applicants sought a declarator that they, instead of OCT’s BRPs should vote on behalf of OCT at any meeting of creditors in respect of s151(1) of the Act.
 - the court held that clarity is needed in the Act to resolve the tension between directors who still want to be in control and view matters subjectively and the BRPs who have a more holistic view of what is good for the company.

Ragavan Case...

- BRPs take over full management control of the company in substitution for its board of directors and pre-existing management.
- The BRP is tasked with developing and then implementing the business rescue plan which is in the best interest of all affected parties. This occurs while the board of directors retain obligations in terms of the Act.
- The court confirmed that the Act gives BRPs full management control. The court found that Chapter 6 made it clear that the powers of the Director are limited in business rescue proceedings and there is a legal transfer of power to the BRPs.

Ragavan Case...

- On a proper construction of chapter 6, the court held that the powers of the directors become substantially curtailed.
- Governance functions remain for the directors, but it is a neutral function far removed from full management control. Nothing of significance can be done by the directors during business rescue proceedings without the authorisation by the BRP.
- The court dismissed the application and the SCA subsequently dismissed the appeal.

- *Tayob and Another v Shiva Uranium (Pty) Limited and Others:*
 - The court found that if a BRP dies, resigns or is removed from office, a substitute must be appointed by the board of the company or by the affected persons who made the nomination and that the absence of approval by the relevant BRP would not render the decision made by the company void.
 - This judgment in the SCA was upheld by the Constitutional Court.

- *Tegeta Exploration and Resources (Pty) Ltd v National Director of Public Prosecutions and Others:*

- The court had to determine whether the attorneys has the authority to represent directors in an application to remove the BRPs.
- The court agreed with the Shiva judgment by stating that the powers of directors relating to governance functions such as the appointment and / or removal of directors and BRPs are not subject to the authority of the BRP.
- Section 139(3) of the Act provides a “board with the unfettered power to appoint a substitute practitioner”. Consequently, the court held that the directors of a company do not need to seek the approval of the BRPs to appoint attorneys to represent them in the removal application.

- *Tegeta Exploration and Resources (Pty) Ltd v National Director of Public Prosecutions and Others; in Re: National Director of Public Prosecutions v Templer Capital Ltd; in Re: National Director of Public Prosecutions v Kurt Robert Knoop No and Others:*
 - The court had to determine whether a board of directors of a company in business rescue had *locus standi* to oppose applications for a forfeiture order without the consent of the BRPs of the affected company.
 - The court held that section 133(1)(a) of the Act expressly indicated that any litigation against a company in business rescue should be authorised by the BRPs and, in the instance, the board of directors were not authorised by the BRPs.
 - As such, the court found that the board of directors has no *locus standi* in the forfeiture application to represent the company.

THE REMOVAL AND REPLACEMENT OF DIRECTORS BY THE BRP

- The BRP is only able to remove a director during business rescue proceedings by means of a court order, if the director has failed to comply with a requirement of Chapter 6 of the Act, or by act or omission has impeded or is impeding the BRP in:
 - the performance of his powers and functions, or
 - the management of the company by the practitioner, or
 - the development of a business rescue plan.
- Court ordered removals during business rescue rarely happen in that the BRP's powers in matters of importance will always trump those of directors.

THE REMOVAL AND REPLACEMENT OF DIRECTORS BY THE BRP...

- Further, litigation of this nature is costly and time consuming and not in the best interest of the rescue process. It is easier to remove directors by way of an ordinary resolution adopted at a shareholders' meeting.
- If a director is also an employee of the company in business rescue, his removal as a director will not automatically terminate his contract of employment. A BRP can only terminate a contract of employment in accordance with the Labour Relations Act.
- Chapter 6 does not specifically empower the BRP to appoint new directors. The appointment of directors is generally a matter for the shareholders of a company and it is submitted that this remains the position in business rescue.



THE END

THANK YOU

QUESTIONS ?

