**COMPARATIVE ANALYSIS OF THE BALANCE BETWEEN RESTRUCTURING VS LIQUIDATION GOALS AND PROCEEDINGS IN THE NETHERLANDS AND SOUTH AFRICA.**

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6. **INTRODUCTION**

The goal of liquidation is to distribute the debtor’s assets among competing creditors in order of priority. The goal of restructuring on the other hand is to avoid liquidation by helping financially distressed companies recover and return to solvency. In this paper an examination will be made of the Dutch and South African liquidation and restructuring regime. The comparison is made between a developed and emerging country’s insolvency regime. For purposes of this paper the focus will be on corporate insolvencies and hence the discussion is limited to liquidation, suspension of payments, the scheme of arrangement commonly referred to the **WHOA** and business rescue. The paper will state why formal restructurings were introduced into the insolvency laws where liquidations were not suitable remedies to preserving the assets of a debtor in financial distress for the benefit of its creditors. The paper will analyse the shortcomings of the **WHOA** in the Netherlands and **Business Rescue** proceedings in South Africa.

1. **LIQUIDATION**
	1. **The Netherlands**

The Dutch Bankruptcy Act dating back to 1893 forms the foundation of insolvency law in the Netherlands.[[1]](#footnote-1) Dutch bankruptcy is liquidation focused as the goal is to liquidate and distribute a debtor’s assets in an orderly fashion.[[2]](#footnote-2) A debtor may file for bankruptcy on the instruction of its shareholders at a general meeting. A debtor can be declared bankrupt when the following circumstances are apparent namely:

* when it is no longer able to pay its debts when due;
* the debtor has ceased to pay its debts.
* two or more creditors initiate the bankruptcy.

The debtor loses its power to administer and dispose of its assets, to the trustee who is responsible for administering and liquidating the insolvent estate for the benefit of the general body of creditors. The order suspends all claims, priority and ranking as of the date of the bankruptcy order and results in an automatic stay. Secured creditors have more rights than unsecured creditors in that they can enforce their security rights even during any insolvency procedure unless a cooling-off period is granted.[[3]](#footnote-3) Unsecured creditors are not entitled to initiate proceedings against the debtor and any attachments upon insolvency are released by operation of the law. The bankruptcy ends if all the assets of the company have been liquidated and distributed to the creditors in terms of the distribution plan approved by creditors and the court.

* 1. **South Africa**

Similarly in South Africa the goal of liquidation is to hold and administer the estate and distribute the proceeds among the competing creditors in the manner and order of preference specified in the Insolvency Act as well as the Companies Act of 2008.[[4]](#footnote-4) Liquidations are either voluntary or compulsory. Voluntary when a company initiates the process by passing a resolution to do so. Compulsory when liquidation proceedings are initiated by an application to the court, usually by a creditor of the company. A liquidator is appointed to wind up the company's affairs. The liquidator must notify the creditors of the liquidation, invite them to submit their claims and then sell the company's assets and use the proceeds to repay creditors. Once all the company's assets have been sold and its creditors have been paid, any remaining funds are distributed to the company's shareholders.[[5]](#footnote-5)

1. **RESTRUCTURING**

Volberda stated that restructuring proceedings enable a business that struggles financially to restructure before bankruptcy becomes inevitable[[6]](#footnote-6). This is economically beneficial as the going concern value of a financially distressed company is often higher than its liquidation value.[[7]](#footnote-7) The liquidation value of a company is the value of a company when all of its assets are liquidated and sold in bankruptcy proceedings.[[8]](#footnote-8) The going concern value is the value of a company when it can be either preserved and restructured or sold with its current business structure.[[9]](#footnote-9) Restructuring agreements can be used to preserve viable businesses, retain their going concern value and avoid liquidation.

* 1. **The Netherlands**

**Suspension of payments**

The Dutch Bankruptcy Act provides for a suspension of payments as a restructuring process aimed at restructuring and reorganizing the debtor and its debt.[[10]](#footnote-10) Only the debtor can file for a suspension of payments. There is no statutory requirement for shareholder approval; the management board in its sole discretion may file the petition. A suspension of payments maybe requested if the debtor foresees it will not be able to continue to pay its debts as and when they fall due. After a petition is filed with the district court, the court will appoint an administrator to manage the debtor’s assets jointly with the board of the debtor. The court will set the suspension of payments for not more than one and a half years- with the option to extend for another one and a half years. Suspension of payments only affects ordinary creditors in that they cannot enforce their claims against the debtor’s assets but rather enforce their claims through the administrator. Secured and preferential creditors can continue to enforce their rights regardless of the suspension of payments. Legal proceedings are not stayed and new proceedings can be initiated against the debtor. In the same way the debtor is not excused from performance in contracts. A cool down period ordered by the court prevents all creditors including secured and preferred creditors from seeking recourse against the debtor’s assets without the permission of the supervisory judge. A debtor can offer a composition plan, allowing it to bind all ordinary, unsecured creditors, including those who do not agree to the plan, provided that a qualified majority has accepted the plan. The plan can be made simultaneously with the request for preliminary suspension of payments or at any time thereafter. [[11]](#footnote-11)

**Advantage of a Bankruptcy or Suspension of Payments**

They both provide the debtor with the opportunity to offer a composition plan to its joint ordinary creditors. The plan is flexible, aimed at reorganisation or a controlled liquidation of the estate. An example is the Lehman Brothers Treasury Co BV[[12]](#footnote-12) , where the composition plan provided that the estate would be liquidated outside bankruptcy and in accordance with the rules and guidelines agreed in the plan.

**Disadvantage of a Bankruptcy or Suspension of Payments**

The lack of an effective restructuring tool can allow creditors to block a necessary restructuring, to enable it to exert leverage and enable it to be in a more favourable position than in the event of a liquidation of the debtor’s assets. The available Dutch processes of suspension of payments and bankruptcy both had proven largely ineffective because they do not offer the possibility to bind secured and preferential claims, and result in loss of control to court ap-pointed insolvency practitioners.

* 1. **South Africa**

**Scheme of Compromise**

Within a liquidation or at the initiative of a company, a scheme of compromise can be entered into between a company and its Creditors. This is governed by section 155 of the Companies Act. The section provides for a debtor-in-possession to propose a business rescue plan to its creditors, outside of the formal procedures required in an ordinary business rescue in terms of Chapter 6, without the involvement of a business rescue practitioner. This is considered to be a more cost-effective and less cumbersome process. Although the section 155 compromise is available to the liquidator of a company that is being wound up, who may propose the arrangement or compromise to creditors instead of the board, this procedure is not available to a close corporation or a company that is under business rescue proceedings.[[13]](#footnote-13)

* 1. **WHOA as a pre-insolvency restructuring tool**

The objective of a pre-insolvency restructuring is for the debtor to restructure his business to enable him to continue his activities and avoid liquidation. Due to the weaknesses in Bankruptcy and Suspension of Payments as restructuring tools in that amongst other things, they cannot bind secured creditors or keep the debtor in control of the business, the 2021 enactment of the Court Confirmation of Extrajudicial Restructuring Plans, commonly referred to as **WHOA** or the **“Dutch Scheme of Arrangement”,** was incorporated in the **DBA**. The **WHOA** can be characterized as a **debtor-in-possession procedure.[[14]](#footnote-14)**  The debtor’s management remains in full control of the business throughout the entire procedure without the need to appoint an administrator or trustee unlike in a bankruptcy or suspension of payments procedure. The legislator's primary aim with the WHOA was to provide an accessible and efficient framework that could be used by both larger groups and small and medium-sized enterprises (SMEs), and also as an instrument to effect cross-border restructurings of international groups of companies.' [[15]](#footnote-15)

 The objective of a **WHOA** is to facilitate the confirmation of a restructuring plan and to bind all dissenting minority of creditors of any class, or an entire dissenting class, to an out-of-court restructuring agreement, as long as the agreement has the consent of a majority of that class, or of a higher-ranking class respectively.

The test to initiate the proceedings is whether, at the time the court is first addressed, the debtor is or can reasonably be expected to become insolvent. Ipso facto clauses providing for the termination of contracts based purely upon the commencement or implementation of restructuring proceedings are invalid. No special priority applies to emergency funding provided in this context (for example, no priming liens). The debtor may offer a composition to all or some of its creditors. Ordinary, preferred and secured creditors, as well as shareholders, can be bound to the composition. The WHOA also allows for the restructuring of guarantees provided by the debtor's group companies (as long as these companies would otherwise also become insolvent). WHOA offers cross-class cram-down mechanisms, moratoria on enforcement and bans on ipso facto clauses.[[16]](#footnote-16)

* 1. **Business Rescue in South Africa**

The Companies Act 71 of 2008 provides for business rescue and the objective is to provide for the efficient rescue and recovery of financially distressed companies in a manner that balances the rights and interests of all stakeholders. [[17]](#footnote-17) Similarly in South Africa the trend is moving away from liquidation towards business rescue as stated in *Southern. Palace Investments 265 (Pty) Ltd v Midnight Storm Investments 386 Ltd.[[18]](#footnote-18)* Business rescue should also generally be attractive to creditors because it aims to achieve a result that is more favourable for them than immediate liquidation. Essentially a creditor would benefit much more from having the debtor trading than from suing him into extinction'.[[19]](#footnote-19)

The goals of business rescue are set out in section 128(1)(b) of the Companies Act, the focus being on the Company.[[20]](#footnote-20) Nwafor argues that the target of business rescue is more the company than the business of the company. Fourie J confirms this position in the decision of *SARS v Beginsel NO[[21]](#footnote-21),* holding that the primary goal in business rescue is to rescue a financially distressed company by increasing its prospects of continued survival on a solvent basis. The secondary goal is to ensure better returns for the company’s creditors and shareholders. The intention of the legislature was to increase the capacities of both the government and the private sector to preserve existing jobs, create new employment opportunities, and make the country's economy competitive relative to its contemporaries.[[22]](#footnote-22) The first consequence of a business rescue petition is that the business and affairs are placed under the supervision and control of a "business rescue practitioner" to whom all the affected persons must now look for the possible rehabilitation of the company. The second major legal consequence is the moratorium which is immediate and automatic upon the commencement of proceedings, on legal proceedings, executions, and claims (secured and unsecured) against the company. This effectively protects a company undergoing rescue from legal or enforcement proceedings. While the effect of the moratorium does not alter existing rights acquired by the company's creditors in the period before business rescue, it freezes those rights in that creditors may not enforce their rights while the company is under the rescue process without the written consent of the business rescue practitioner or in certain circumstances, the court. A rescue plan is only approved if it is supported by seventy-five percent of the creditors out of which fifty percent must be claimants who qualify as independent creditors. Implementation of the plan can only be properly embarked upon by the business rescue practitioner if approval has been given in accordance with the requirements of the 2008 Companies Act. If the required level of creditor support for the plan is not received, the rescue proceedings automatically terminate.

 The disadvantage of Business rescue proceedings is that control is taken away from the company and given to an outsider Business Rescue Practitioner. The Act does not have built in shields for SMMES unlike the 20% Rule provided for under the Dutch WHOA. The statistics on the success of business rescue is not very encouraging. STATS SA recently reported that just over 1376 companies have closed their doors in 2023, with 136 companies filing for liquidation in October alone.[[23]](#footnote-23) When one takes a look at the outcomes of business rescue mandates in the last decade, the vast majority of business rescues in South Africa have focused on the wind down of a company in business rescue, as opposed to the implementation of a rescue plan which allows a struggling company to trade out of its financial distress intact, having been operationally restructured and where the company is returned into the South African economy on a restructured and solvent basis.

* 1. **Liquidation Versus Restructuring Goals**

There is a concern that WHOA favours big corporations at the expense of small ones. To mitigate the concern, the Dutch Legislator passed the 20%-rule.[[24]](#footnote-24) The rule provides Small and Midsized Enterprises (SMEs) in their capacity as creditors with a right to a reimbursement of 20% of their claims in case a court imposes a restructuring agreement on the class of creditors they belong to (cross-class cramdown). Volberda[[25]](#footnote-25) argues that a large infringement on the rights of secured creditors may lead to forum shopping. Restructuring proceedings are more beneficial to small SME-creditors, who can use the 20% rule to their favour. Secured creditors will prefer liquidation proceedings as they have a stronger position in these proceedings. It has been observed that creditors have an individual interest in using bankruptcy and restructuring proceedings respectively. [[26]](#footnote-26) As a result both classes of creditors are no longer motivated to use the proceedings that result in the highest value for the creditors as a group, but will strategically use that proceeding that is most beneficial to their respective class. In this situation the remaining assets of a financially struggling debtor are not used in the most efficient way. This undermines the effectiveness of pre-insolvency proceedings.

1. **CONCLUSION**

Liquidations divest control of a business from the debtor to a court appointed liquidator/trustee. The goal is to wind up the business of the debtor. Restructuring on the other hand aims to preserve the value of the business. The threshold for either proceeding is inability to pay debts when they become due for liquidations and a foreseeability that debts will not be serviced for restructurings. The reality argues Declercq[[27]](#footnote-27), is that restructurings often lead to liquidations and liquidation proceedings are often used to restructure a debtor’s business. The two proceedings are not in reality mutually exclusive. The objectives of liquidations and restructuring proceedings are similar in both countries. The difference is the protection of SME creditors provided for under the Dutch WHOA. South Africa could consider including provisions to its insolvency regime that protect the interests of SMEs.

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