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THE IMPACT OF THE BUSINESS RESCUE MORATORIUM ON CREDITORS

By

HULISANI KEVIN MMBARA

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ABSTRACT

A temporary moratorium on the rights of claimants against a company during business rescue proceedings is a universally acknowledged measure to facilitate the rehabilitation of a financially distressed company. In this regard, section 133(1) of the Companies Act 71 of 2008 provides for a general moratorium on legal proceedings against a company or property lawfully in its possession. This short dissertation critically analyses the impact of the section 133(1) moratorium on creditors. The moratorium is effective automatically, upon commencement of business rescue proceedings. The legal effect of the moratorium is that the right of creditors to enforce their claims against the company is suspended for the duration of business rescue proceedings. However, the moratorium may be lifted upon the written consent of the business rescue practitioner or the leave of the court. Further, certain proceedings or actions are automatically excluded from the operation of the moratorium. This research analyses the objectives of business rescue, the rationale, scope, and duration of the moratorium, in order to ascertain the possible impact of the moratorium on the creditors. In conclusion, the research analyses measures to mitigate unwarranted prejudice to the interests of creditors within the current legislative scheme of Chapter 6 of the Companies Act 2008 and proposes alternatives thereto, where appropriate.



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1. INTRODUCTION

The purpose of the Companies Act, Act No. 71 of 2008 (“the Companies Act 2008”) is, amongst others, to “provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders.”¹

In terms of the Companies Act 2008, business rescue means proceedings to facilitate the rehabilitation of a financially distressed company through the temporary supervision of the company, management of its affairs, business and property; a temporary moratorium on the rights of claimants against the company or property in its possession; and the implementation of a business rescue plan in order to maximize the prospects of the company continuing to exist on a solvent basis, failing which, to achieve a better return for creditors or shareholders, than they would receive from immediate liquidation.²

The purpose of the moratorium is to provide the company with a temporary breathing space, whilst the company finds a solution to its financial difficulties, as one of the three pillars to facilitate rehabilitation of a financially distressed company as contemplated in section 128(b).³

It is important to note that the objectives of Chapter 6 of the Companies Act 2008 can be achieved, if the rescue of a financially distressed company is pursued in a manner that balances the rights and interests of all relevant stakeholders⁴, including creditors. In this regard, the spirit and purport of the Companies Act 2008 requires business rescue to be approached in a manner that balances the rights and interests of affected stakeholders. To that extent, this research on the impact of the business rescue moratorium on creditors, considers a number of relevant issues which are outlined below.

The starting point is a reflection on the objectives of business rescue in order to give context to the discussion on the moratorium. In this regard, the impact of section 133(1) on creditors will be

¹ s 7(k). In this dissertation, all references to sections are, unless stated otherwise, references to the sections of the Companies Act 71 of 2008.

² s 128(1)(b).

³ Meskin, Galgut, Magid, Boraine, Kunst and Burdette *Insolvency Law and Its Operation in Winding Up*, Service Issue 37 (2011) 18 - 3; Cassim FHI, Cassim MF, Cassim R, Jooste R, Shev J and Yeats J *Contemporary Company Law* 2012 879.

⁴ s 7(k).

assessed with a focus on the rationale for the moratorium and the provisions of the Companies Act 2008, which seek to protect or minimize adverse effect on the interests of creditors.

The creditors of a company in business rescue may, in varying degrees, suffer some prejudice as a result of the inability to enforce their legal rights, due to the moratorium, including claims against a company in business rescue for services rendered, goods supplied or damages suffered.

The scope of the moratorium should be clear so that there is certainty in commerce as to the precise nature of proceedings which can be impacted by the moratorium. This involves the courts' interpretation of what constitutes legal proceedings.

The moratorium is effective for the duration of business rescue proceedings. In this regard, there must be certainty regarding the commencement and termination of business rescue proceedings, to avoid unnecessary litigation regarding whether the moratorium is in effect or has terminated.

Further, the moratorium in terms of section 133(1) is briefly compared with the stay of proceedings in terms of section 440D of the Australian Corporations Act, Act No.50 of 2001 ("Australian Corporations Act") and section 362 of the United States Code, Title 11, Chapter 11 ("Chapter 11"). The South African lawmakers and the courts can learn from these jurisdictions.

In addition, the research considers the relevant provisions of the UNCITRAL Legislative Guide on Insolvency Law ("UNCITRAL Legislative Guide"), as adopted by the United Nations Commission on International Trade Law to foster and encourage countries to adopt effective corporate insolvency laws.⁵ This will indicate the extent to which the section 133(1) moratorium is aligned to principles which are considered international best practices.

⁵ UNCITRAL Legislative Guide iii.

2. THE CONTEXT OF THE MORATORIUM

2.1 Brief Exposition of the Moratorium under the Companies Act 1973

In South Africa, the corporate rescue mechanism, in the form of judicial management, was initially provided for in the repealed Companies Act 61 of 1973 (“the Companies Act 1973”).⁶ In this regard, section 427(1) provided that where a company, due to mismanagement or any other cause, is unable to pay its debts or appears to be unable to meet its obligations and has not become or is being prevented from becoming a successful concern, the court is empowered to place such a company under judicial management, if it appears just and equitable to do so. The Companies Act 1973 did not have a procedure for voluntary judicial management similar to voluntary business rescue as provided for in section 129 of the Companies Act 2008.

An order to place a company under judicial management could be made by the court, pursuant to an application by any person entitled to apply for the winding up of a company⁷ or during an application for the winding-up of a company, if it appears to the court that placing the company under judicial management, would remove the grounds for its winding-up; the company will become a successful concern; and the granting of a judicial management order is just and equitable.⁸

In addition, the court could order a moratorium on commencement or continuation of all actions, proceedings, the execution of all writs, summonses and other processes against the company.⁹ In this regard, the Companies Act 1973 did not make provision for an automatic moratorium on legal proceedings against a company under judicial management as provided for in section 133(1) of the Companies Act 2008, in respect of companies under business rescue proceedings. Further, in contrast to the provisions of section 133(1)(a) and (b), only the court and not the provisional judicial manager, could lift the moratorium and grant any person leave to initiate or continue proceedings against a company under judicial management.¹⁰

⁶ s 427(1) of the Companies Act 1973.

⁷ s 427(2) of the Companies Act 1973.

⁸ s 427(3) of the Companies Act 1973.

⁹ s 428(2) of the Companies Act 1973.

¹⁰ s 428(2) of the Companies Act 1973.

2.2 The Objectives of Business Rescue

The objective of business rescue is to facilitate the rehabilitation of a financially distressed company¹¹ in order to maximize the likelihood of the company continuing to exist on a solvent basis, failing which, to achieve a better return for creditors or shareholders than they would receive from immediate liquidation.¹² The rehabilitation of a company to achieve any of the aforesaid objectives is facilitated through the temporary supervision of the company by the business rescue practitioner, a temporary moratorium on legal proceedings, and the development and implementation of a business rescue plan.¹³

The moratorium in section 133(1) is thus one of the crucial pillars of business rescue. In this regard, there is recognition that a modern and an effective business rescue procedure requires a moratorium to be effected in order to allow a company in business rescue a breathing space to find solutions to its financial problems.¹⁴

In the decision of the court *a quo* in *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others*,¹⁵ Claassen J states that the philosophy underlying business rescue is the recognition of the value of the business as a going concern rather than the juristic person itself, hence the emphasis is placed on rescuing the business and not necessarily the company. Further, this approach seeks to secure and balance the opposing interests of creditors, shareholders and employees. Accordingly, this approach represents a paradigm shift from seeking to secure the interests of creditors to looking at a broader range of interests as the preservation of the business together with its skilled and experienced human resources may, in the end prove to be a better option for creditors.¹⁶ The above rationale was cited with approval in *Madodza (Pty) Ltd v Absa Bank Ltd and Others*.¹⁷

¹¹ Sharrock, Van der Linde and Smith *Hockly's Insolvency Law* (2012) 275; Cassim et al (n 3) 275 861.

¹² s 128(1)(b); *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami) (Pty) Ltd and Others* 2013 4 SA 539 (SCA) par 23 and 26.

¹³ s 128(1)(b).

¹⁴ Meskin et al (eds) (n 3) 18 - 3.

¹⁵ [2012] 2 All SA 433 (GSJ).

¹⁶ *Oakdene Square Properties (Pty) Ltd and Others v Farm Bothasfontein (Kyalami)* (n 12) par 12.

¹⁷ [2012] ZAGPPHC 165 par 15.

There is recognition that the insolvency of a company does not only affect the private interests of the insolvent debtor but has adverse impact on other groups in society who have vested interests in the debtor company.¹⁸ In this regard, Binns-Ward J submits that business rescue was born out of recognition by the legislature that more often than not, the liquidation of companies led to serious collateral damage economically and socially, and the need to protect public interest against such adverse socioeconomic consequences, where reasonably possible, by saving the business of a company in financial distress, or alternatively, securing a better return to creditors than would result in the immediate liquidation of a financially distressed company.¹⁹

2.3 The Rationale for the Moratorium

The moratorium in section 133(1) “is designed to provide the company with a breathing space” and is a crucial element of business rescue as it affords the company sufficient time to develop and implement appropriate measures to rescue the company.²⁰ The moratorium seeks to protect a company, during business rescue proceedings, against claims by creditors so as to prevent the business rescue practitioner from being inundated with litigation while the focus should be on rescuing the business of the company.²¹

Anderson submits that any corporate rescue system needs a circuit breaker to give the company a breathing space to consider the prospect of rescuing the company.²² A respite from the claims of creditors, in order to allow a business to dedicate its resources to measures that will contribute towards recovering the business out of financial difficulty, instead of using the already constrained resources towards paying off existing debts, is one of key success factors for any business rescue efforts.²³ This protects the business against a rush of creditors seeking to enforce claims which in all probability would exacerbate the financial woes of the company and distract the business's management team from focusing on rescuing the business.²⁴

¹⁸ Cassim et al (n 3) 862

¹⁹ *Koen and Another v Wedgewood Village Golf & Country Estate (Pty) Ltd and Others* [2011] ZAWCHC 464 par 14.

²⁰ Delpont and Vorster *Henochsberg on the Companies Act 71 of 2008* (2012) 478; Meskin et al (n 3) 18 – 29.

²¹ *Chetty v Hart and Another* (20323/14) 2015 ZASCA 112 par 39.

²² Anderson C “Viewing the proposed South African Business Rescue Provisions from an Australian perspective” 2008 *PER* 1 17/31; Cassim et al (n 3) 879.

²³ Bradstreet “The new business rescue: will creditors sink or swim” 2011 *South Africa Law Journal* 372.

²⁴ Bradstreet (n 23) 372.

From the Australian perspective, Fridman submits that the moratorium seeks to give the administrator time to assess the affairs of the company in order to determine whether the company can be saved²⁵, and stop “the proverbial race to the courthouse door.”²⁶

In terms of Chapter 11 of the US Bankruptcy Code, the automatic stay is aimed at providing critical protection to the debtor against “a race of diligence” among its creditors and it assures the debtor of relief from collection and enforcement actions by creditors.²⁷

Similarly, the UNCITRAL Legislative Guide provides that a stay during reorganization proceedings facilitates continued operation of a business and affords the debtor an opportunity to organize its affairs, prepare a rescue plan and, where appropriate, take steps to discontinue unprofitable activities and onerous contracts. Further, the stay is crucial to achieving the objectives of company reorganization, provides an incentive for debtors to initiate reorganization proceedings²⁸ and is one of the key elements of reorganization proceedings.²⁹

3. ANALYSIS OF SECTION 133(1)

3.1 Scope of the Moratorium

Section 133(1) of the Companies Act 2008 makes provision for a general moratorium on legal proceedings against a company in business rescue.³⁰ The effect of this moratorium is that once

²⁵ Fridman “Voluntary administration: use and abuse” 2003 *Bond Law Review* 336.

²⁶ Lewis “Trouble Down Under: Some Thoughts on the Australian- American Corporate Bankruptcy Divide” 2001 *Utah Law Review* 194.

²⁷ Hamilton “Automatic stay – Chapter XI Rule 11-44: Rationale, Application, Implication” 1978 *Suffolk University Law Review* 925.

²⁸ UNCITRAL Legislative Guide (n 5) 84.

²⁹ UNCITRAL Legislative Guide (n 5) 28.

³⁰ This section provides that “During business rescue proceedings, no legal proceeding, 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 proceeded with 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 those 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 powers of a trustee; or
- f) proceedings by a regulatory authority in the execution of its duties after written notification to the business rescue practitioner.”

business rescue proceedings have commenced, all legal proceedings against a company in business rescue are prohibited.³¹

There is recognition for the need to include secured creditors under the moratorium because if the secured creditors are allowed to freely exercise their rights in terms of the security they hold, this may frustrate the objectives of business rescue proceedings.³² Under the Companies Act 2008, the moratorium on legal proceedings applies to all the creditors³³ including secured creditors.³⁴

However, section 133(1) makes provision for certain exceptions to the moratorium on legal proceedings. In this regard, legal proceedings against a company in business rescue may be commenced or continued with the written consent of the business rescue practitioner or with the leave of the court.³⁵ Therefore, the moratorium on legal proceedings is clearly not an absolute bar.³⁶

The general moratorium on legal proceedings has a wide scope³⁷ and therefore requires a clear determination of the meaning of legal proceedings as contemplated in section 133(1). The words “legal proceedings” are not defined in the Companies Act 2008. This has led to disputes regarding whether certain proceedings constitutes legal proceedings.³⁸ The determination of the meaning of legal proceedings will facilitate clarity amongst the relevant stakeholders, including creditors, as to which actions are prohibited by the moratorium.

Since the words legal proceedings are not defined in the Companies Act 2008, legal scholars and the courts have sought to ascribe meaning to these words in accordance with the principles of interpretation of statutes.

³¹ *Redpath Mining South Africa (Pty) Ltd v Marsden No and Others* 2013 SA 148 (GPJHC) par 55.

³² Burdette “Some initial thoughts on the development of a modern and effective business rescue model for South Africa (Part 2)” 2004 *South African Mercantile Law Journal* 418.

³³ s 133(1); Cassim et al (n 3) 878.

³⁴ Cassim et al (n 3) 879.

³⁵ s 133(1)(a) and (b).

³⁶ *Chetty* (n 21) par 40 and 45; Cassim et al (n 3) 880.

³⁷ Cassim et al (n 3) 879; Delpont and Vorster (n 20) 478; Meskin et al (n 3) 18 – 29.

³⁸ In *Chetty* (n 21), the Supreme Court of Appeal had to determine an appeal, amongst others, dealing with the question whether arbitration constitutes legal proceedings for purposes of the moratorium in terms of section 133(1).

Delpport and Vorster submits that the intention of section 133(1) “is to cast the net as wide as possible” to prevent any conceivable type of action against the company in business rescue, including liquidation and quasi-judicial proceedings before bodies like the National Consumer Commission, the Competition Commission and the Commission for Conciliation, Mediation and Arbitration.³⁹

In *Chetty*, the supreme court of appeal (SCA) was, amongst others, seized with the question whether arbitration constitutes legal proceedings for purposes of section 133(1). The court *a quo*,⁴⁰ citing the decisions in *Van Zyl v Eudia Trust (Edms) Bpk*⁴¹ and *Lister Garment Corporation (Pty) Ltd v Wallace NO*,⁴² held that arbitration proceedings were not legal proceedings. In a unanimous judgment, the SCA held that taking into account the purpose of business rescue, which includes a general moratorium on the rights of creditors to enforce their rights against the company in business rescue, and the fact that arbitrations are often used to resolve commercial disputes, legal proceedings as contemplated in section 133(1) should be interpreted to include arbitrations.⁴³

3.2 Exclusions from the Moratorium

Section 133(1) excludes certain legal proceedings from the general moratorium. In this regard, the legal proceedings specified in section 133(1)(c) to (f) are not subject to the moratorium and may be instituted or continued without the consent of the business rescue practitioner or the leave of the court.

The moratorium on legal proceedings does not apply to a set-off against any claim made by the company in business rescue in any legal proceedings, whether the proceedings were commenced prior or after the commencement of business rescue proceedings.⁴⁴ Thus the right of setoff can be exercised in any legal proceedings, against a company in business rescue, without the need to

³⁹ Delpport and Vorster (n 20) 478.

⁴⁰ 2012 SA (12559) (KZNHC).

⁴¹ 1983 3 SA 394 (T) 397.

⁴² 1992 2 SA 722 (D).

⁴³ *Chetty* (n 21) par 28 and 29.

⁴⁴ s 133(1)(c).

notify or obtain consent from the business rescue practitioner or the leave of the court.⁴⁵ Set-off occurs where two parties have mutual debts against one another. In such a case, both debts between the parties are extinguished, if requirements of set-off are met and the debts are of the same amount, otherwise only the smaller debt is extinguished and the larger debt merely reduced by the amount of the smaller debt as aforesaid.⁴⁶ The rationale for the exclusion of set-off rights from the application of the moratorium is justifiable and aims to do justice between the parties.⁴⁷

However, the set-off against a claim by the company in business rescue as contemplated in section 133(1)(c) must satisfy the requirements of set-off. In this regard, the debts between the parties must be similar in nature; the debt to be set-off must be liquidated; and the debt being set-off must be claimable (due and payable) and between the same parties.⁴⁸ In addition, the set-off against a company in business rescue will not apply if the contract between the said company and the party seeking to invoke set off against a claim by the company in business rescue prohibits such party from applying set off against claims by the company.⁴⁹

It is not clear why the Companies Act 2008 specifically mentions exclusion of criminal proceedings against the company, its directors or officers and proceedings in respect of any property or rights over which the company exercises the powers of a trustee, from the general moratorium on legal proceedings,⁵⁰ except to ensure legal certainty. The exclusion of the application of the moratorium in respect of proceedings concerning property or rights over which the company exercises the powers of a trustee is understandable as the trust property does not form part of the estate of the trustee, except in so far as the trustee is a beneficiary of the trust.⁵¹ Such proceedings are for all intents and purposes not against the company in its own name but against the company as a trustee. Further, such proceedings will be in relation to matters of the trust and not the company.

⁴⁵ Delpont and Vorster (n 20) 478.

⁴⁶ Hutchison, Pretorius, Du Lessis, Eiselen, Floyd, Hawthorne, Kuschke, Maxwell, Naude and Stalder *The Law of Contract in South Africa* 2nd ed Oxford University Press Southern Africa 382.

⁴⁷ Cassim et al (n 3) 880.

⁴⁸ Havenga P, Havenga M, Hurter E, Kelbrick R, Manamela E, Manamela T, Schulze H and Stoop P *General Principles of Commercial Law* (2010) 143; Hutchison et al (n 46) 382.

⁴⁹ *Blakes Maphanga Incorporated v Outsurance Insurance Company Limited* [2010] ZASCA 19 par 15.

⁵⁰ s 133(1)(d) and (e) respectively.

⁵¹ s 12 of the Trust Property Control Act 57 of 1988.

The Companies Act 2008 also excludes proceedings by a regulatory authority⁵², in the execution of their duties, from the moratorium on legal proceedings.⁵³ A common example of a regulatory authority is the South African Revenue Services,⁵⁴ which is entrusted with the authority to charge and collect taxes through various pieces of legislations.

I submit that this exclusion from the moratorium does not apply to all legal proceedings by a regulatory authority, but only to those proceedings which the authority is mandated to carry out pursuant to its founding legislation. For example, the exclusion will not apply in respect of legal proceedings in terms of which the regulator seeks to recover a debt owed to it by a company in business rescue proceedings in terms of a contract or damages, except in the case of set-off as per section 133(1)(c).

Further, it must be noted that the regulator must still notify the business rescue practitioner in writing before commencing or continuing with such proceedings,⁵⁵ although the business rescue practitioner has no power to veto the commencement or continuation of such proceedings. It appears that this requirement is merely for noting by the business rescue practitioner, so that if the proceedings are likely to have a negative impact on the efforts to rescue the company, the business rescue practitioner can take appropriate mitigating measures.⁵⁶

3.3 Commencement and Termination of the Moratorium

The commencement and termination of business rescue proceedings determines the effective and end dates of the moratorium on legal proceedings. The use of the words “during business rescue” in section 133(1), makes it clear that the moratorium on legal proceedings against a

⁵² s 1 defines a regulatory authority as “an entity established in terms of national or provincial legislation, responsible for regulating an industry, or sector of an industry.”

⁵³ s 133(1)(f).

⁵⁴ Established in terms of section 2 of the South African Revenue Service Act 34 of 1997; Cassim et al (n 3) 879

⁵⁵ s 133(1)(f).

⁵⁶ It is interesting to note that in terms of section 359(2) of the 1973 Companies Act, any person who intended to continue proceedings which were suspended in terms of section 359(1) of the Companies Act 1973 pending the appointment of a liquidator, or to institute proceedings to enforce a claim which arose before the commencement of winding-up, was required to give the liquidator not less than three weeks written notification within four weeks after the appointment of the liquidator before continuing or commencing with such proceedings. Similarly with section 133(1)(f), this requirement appears to have been for noting purposes.

company in business rescue takes effect upon commencement of business rescue proceedings,⁵⁷ and terminates when business rescue has ended.⁵⁸

Voluntary business rescue proceedings commence when a company files a board resolution to place itself under supervision and publishes the notice of the resolution, and its effective date, to every affected person, together with a sworn statement regarding the grounds on which the resolution of the company's board of directors is based upon and appoint a person, who has consented in writing thereto, as a business rescue practitioner.⁵⁹ The company needs the approval of the court to file a resolution within three (3) months if the resolution has lapsed, as a result of its failure to comply with the requirements of section 129(3) and (4).⁶⁰

On the other hand, compulsory business rescue proceedings commence when an affected person lodges an application in court, seeking an order to place the company under supervision and commencing business rescue.⁶¹ Further, compulsory business rescue proceedings also commence upon the court making an order placing the company under supervision, during liquidation proceedings or proceedings to enforce a security interest.⁶²

In *Blue Star Holdings (Pty) Ltd v West Coast Oyster Growers CC*⁶³ the court had to interpret the meaning of the word “during” business rescue as used in section 133(1). In this regard, the court had to determine, for purposes of ascertaining the effective date of the moratorium as contemplated in section 133(1), whether the intention of the legislature was that business rescue commences upon the filing of the application papers with the registrar of the court, the first hearing of the application in court or the actual granting of a court order to place the company under business rescue.⁶⁴ The court concluded that the application for voluntary winding-up of the company may not be proceeded with during business rescue proceedings without the leave of the

⁵⁷ Delpont and Vorster (n 20) 478.

⁵⁸ Cassim et al (n 3) 878.

⁵⁹ s 132(1)(a)(i) read with s 129(3).

⁶⁰ s 132(1)(a)(ii) read with s 129(5)(b).

⁶¹ s 132(1)(b) read with section 131(1).

⁶² s 132(1)(c) read with section 131(7).

⁶³ 2013 6 SA 540 (WCHC).

⁶⁴ *Blue Star Holdings (Pty) Ltd v West Coast Oyster Growers CC* (n 63) par 15.

court or the written consent of business rescue practitioner⁶⁵ as the winding up application is suspended in terms of section 131(6).⁶⁶ Similarly, in *Standard Bank of South Africa Ltd v A-Team Africa Trading CC*, the court held that section 131(6) has the effect of suspending an application for liquidation.⁶⁷

The moratorium on legal proceedings as contemplated in section 133(1) comes to an end when the court sets aside the resolution or order placing the company under supervision and commencing business rescue proceedings; has converted the proceedings to liquidation proceedings; or the business rescue practitioner has filed a notice of termination of the proceedings with the Companies and Intellectual Property Commission (“the Commission”); or a business rescue plan has been proposed and rejected, and no affected person has acted to extend the proceedings as contemplated in section 153; or a business rescue plan has been adopted and the business rescue practitioner has filed a notice of substantial implementation thereof.⁶⁸

3.4 Duration of the Moratorium

The moratorium lasts until the termination of business rescue proceedings when any of the instances described in section 132(2) occurs. The quicker the proceedings are completed, the lesser the prejudice to the creditors.⁶⁹

The Companies Act 2008 does not prescribe the duration of business rescue, although it contemplates a temporary supervision of the company⁷⁰ and a temporary moratorium on the rights of claimants against the company.⁷¹ However, there is no rule of thumb regarding the meaning of the word “temporary”. This depends on the given circumstances and will differ from one case to another.

Further, the Companies Act 2008 provides that if business rescue proceedings have not ended within three (3) months after they have commenced, or such other period as determined by the

⁶⁵ *Blue Star Holdings (Pty) Ltd v West Coast Oyster Growers CC* (n 63) par 14.

⁶⁶ *Blue Star Holdings (Pty) Ltd v West Coast Oyster Growers CC* (n 63) par 36.

⁶⁷ 2015 ZAKZPHC 51 par 21.

⁶⁸ s 132(2).

⁶⁹ Cassim et al (n 3) 877.

⁷⁰ s 128(1)(b)(i).

⁷¹ s 128(1)(b)(ii).

court on application by the business rescue practitioner, the latter must prepare a progress report and update it at the end of each subsequent month until the end of the proceedings.⁷² It is indirectly implied that business rescue proceedings of a company are anticipated to take a period of ninety (90) days to complete, but the court may on application, by the business rescue practitioner, allow the proceedings to be continued for a longer period.⁷³

In *Koen and Another v Wedgewood Village Golf & Country Estate (Pty) Ltd and Others*, Binns-Ward J submits that the intention of the legislature is for business rescue proceedings to be expedited as delays in implementing rescue measures will lessen or negate the prospect of effective rescue, and the commencement of business rescue proceedings materially affects the rights of third parties to institute legal proceedings against a company in business rescue.⁷⁴ Similarly, Traverso DJP, stated that a short period of business rescue is envisaged to ensure that there is certainty in the commercial world as ‘creditors cannot be left in a state of flux for an indefinite period.’⁷⁵

In *AG Petzetakis International Holdings Ltd v Petzetakis Africa (Pty) Ltd & Others*,⁷⁶ the court states that Chapter 6 of the Companies Act 2008 demonstrates a legislative intention that the rescue proceedings must be conducted with reasonable speed as these proceedings results in an arbitrary and temporary moratorium on legal proceedings by creditors of the company to recover legitimate claims. In light of these considerations and based on certain prescribed timelines governing business rescue processes, the court suggested that the proceedings should take between two to three months.⁷⁷

Further, section 150(2)(b)(i) provides that a business rescue plan may include a provision dealing with the nature and duration of any moratorium. This means that the duration of the moratorium in respect of a specific creditor can be fixed in the business rescue plan.

⁷² s 132(3).

⁷³ Cassim et al (n 3) 877.

⁷⁴ *Koen and Another v Wedgewood Village Golf & Country Estate (Pty) Ltd and Others* (n 19) par 10.

⁷⁵ *Gormley v West City Precinct Properties (Pty) Ltd and Another, Anglo Irish Bank Corporation Ltd v West City Precinct Properties (Pty) Ltd and Another* (19075/11, 15584/11) [2012] ZAWCHC 33 (18 April 2012) par 11.

⁷⁶ 2012 5 SA 515 (GSJ).

⁷⁷ *AG Petzetakis International Holdings Ltd v Petzetakis Africa (Pty) Ltd & Others* (n 76) par 29.

Delport and Vorster submits that, the moratorium contemplated in the abovementioned section is not as wide as the one envisaged in section 133(1) but specific to a particular creditor or creditors or particular circumstances, which necessitate the extension of the moratorium after termination of business rescue proceedings.⁷⁸

I submit that the powers of the business rescue practitioner in terms of section 150(2)(b)(i), does not include the power to reduce or expand on the nature of legal proceedings as contemplated in section 133(1). Section 150(2)(b)(i) is not aimed at creating an unfettered moratorium over and above the moratorium contemplated in section 133(1) but is merely a guide on the structure and contents of the business rescue plan. In this regard, the plan may include and record certain moratoriums applicable during the business rescue proceedings.

Accordingly, the business rescue practitioner may not, of his/her own accord, include a provision in the business rescue plan, which excludes the application of the moratorium to those legal proceedings which it ought to apply to in terms of section 133(1). Should the business rescue practitioner deem it appropriate to lift the moratorium, this can only be effected through his/her written consent in line with section 133(1)(a), as and when creditors approaches him/or her to commence or continue legal proceedings against the company in business rescue.

4. THE IMPACT OF THE MORATORIUM ON CREDITORS

4.1 The Protection of Property

The moratorium on legal proceedings against a company in business rescue prohibits creditors from instituting or continuing legal proceedings to enforce their rights. However, the rights of secured creditors in respect of the security over property or interests therein are protected.⁷⁹

In terms of the Companies Act 2008, a company in business rescue is allowed to dispose of property in the ordinary course of its business; in a *bona fide* transaction at arm's length for fair value approved in advance by the business rescue practitioner; or in relation to a transaction

⁷⁸ Delport and Vorster (n 20) 478.

⁷⁹ Section 134(3), *Standard Bank of South Africa Ltd v A-Team Africa Trading CC* (n 67) par 18.

contemplated in the approved business rescue plan.⁸⁰ Thus the property can only be disposed of under any of the three circumstances listed above.⁸¹

If another person has security or title interest in relation to the property in question, the disposal of the property by the company is subject to the prior consent of the person concerned, except if the proceeds of the disposal will cover the indebtedness of the company to that person in full.⁸² In addition, the company must, after the disposal, promptly pay to the holder of security or title interest, the proceeds from the sale to discharge the company's indebtedness; alternatively, the company must provide that person with security for the amount of such proceeds.⁸³ Therefore, section 134(3) protects the property interests of secured creditors. It is a sensible provision, as to do otherwise would compromise creditor's security, create uncertainty in commerce and give rise to a substantial and unmitigated risk to secured creditors.

Like section 134(3) of the Companies Act 2008, a number of jurisdictions such as the United Kingdom, United States and Australia, where secured creditors are included under the stay of proceedings, provides measures to protect the interests of secured creditors.⁸⁴ As already stated above, the Companies Act 2008 provides this protection under section 134(3).

4.2 Prejudice to Creditors

The underlying philosophy for a moratorium during business rescue is that the moratorium facilitates a conducive environment for the company to be rescued without having to fend off claims and foreclosures by creditors. Further, if business rescue is successful, the company can return to deal with its creditors in the normal course of business.

⁸⁰ s 134(1)(a).

⁸¹ Cassim et al (n 3) 881.

⁸² s 134((3)(a).

⁸³ s 134(3)(b).

⁸⁴ s 27(1) and (2) of the UK Insolvency Act 1936, s 361 of Chapter 11 and s 442C(1) of the Australian Corporations Act. However, in the UK there does not appear to be any measures built into the statute, as the creditor or member is required to apply to the court for relief on the grounds that the company's affairs, business and property are being or have been managed by the administrator in a manner which is unfairly prejudicial to the interests of its creditors or members generally, or of some part of its creditors or members (including at least himself), or that any actual or proposed act or omission of the administrator is or would be so prejudicial. It also appears that the creditor can make this application on behalf of other affected creditors or members, provided that s/he also has an interest in the matter.

The moratorium may also enable the company to improve its financial situation which would enhance the value of what creditors may claim, if the business rescue proceedings are unsuccessful and the company is eventually liquidated.

Having said that, there is no doubt that the moratorium will prejudice creditors as they may only institute or continue legal proceedings in order to enforce their rights, upon the written consent of the business rescue practitioner or with the leave of the court. In this regard, Bradstreet argues that the moratorium is justified, as not to afford this protection to the company would unjustifiably prejudice a company in business rescue and potentially prejudice those creditors who prefer to see the rescue through, when the business rescue is unsuccessful due to certain claims having been enforced by other creditors who were not willing to give business rescue proceedings a chance.⁸⁵ Further, if the rescue process were to proceed with ease, the moratorium would, in most cases, not result in substantial prejudice to creditors.⁸⁶

In view of the fact that the moratorium has the effect of suspending or limiting the rights of creditors to institute or continue legal proceedings against a company in business rescue, the courts have emphasized that business rescue proceedings should be finalized within a reasonable period in order to ensure certainty in commerce and to mitigate prejudice to the creditors.⁸⁷

4.3 Benefits to Creditors

The advantage of business rescue is that the procedure may yield a better return for the company's creditors (or shareholders) as an alternative to the primary objective of business rescue, if the implementation of the business rescue plan does not achieve the continued existence of the company on a solvent basis.⁸⁸

⁸⁵ Bradstreet (n 23) 374.

⁸⁶ Bradstreet (n 23) 374.

⁸⁷ *Koen and Another v Wedgewood Village Golf & Country Estate (Pty) Ltd and Others* (n 19) par 10; *Gormley v West City Precinct Properties (Pty) Ltd and Another, Anglo Irish Bank Corporation Ltd v West City Precinct Properties (Pty) Ltd and Another* (n 75) par 11; *AG Petzetakis International Holdings Ltd v Petzetakis Africa (Pty) Ltd & Others* (n 76) par 29.

⁸⁸ Loubser A "Tilting at Windmills? The quest for an effective corporate rescue procedure in south African law" 2013 *South African Mercantile Law Journal* 447.

Bradstreet submits that although creditors may be inclined to see the moratorium as prejudicing their rights of recovery, the purpose of the moratorium is to facilitate a successful rescue, which may eventually result in creditors being repaid in full.⁸⁹

Despite the restrictions imposed on the creditors by the moratorium, the rescue of economically viable companies experiencing temporary financial distress is in the best interests of shareholders, creditors, employees, other stakeholders and society as a whole.⁹⁰

5. COMPARISON WITH THE AUSTRALIAN AND US MORATORIUMS

5.1 The Stay of Proceedings in Australia

5.1.1 The Stay of Proceedings

Section 440D(1) of the Australian Corporations Act provides for a stay of court proceedings or proceedings in relation to a property, during the administration of the company unless with the written consent of the administrator or with the leave of court.⁹¹ This provision is similar to the moratorium on legal proceedings in terms section 133(1) of the Companies Act 2008. The stay contemplated in section 440D(1) takes effect upon the appointment of an administrator of the company by the board of directors, the liquidator or a secured creditor of the company.⁹²

Contrary to the Companies Act 2008, the Australian Corporations Act has a separate section dealing with the stay of enforcement proceedings.⁹³ In this regard, enforcement actions may only be commenced or continued with the leave of the court, and the administrator does not have the authority to consent to the commencement or continuation of an enforcement action.

The moratorium contemplated in section 440D(1) does not apply to a criminal proceeding or a prescribed proceeding.⁹⁴ The Australian Corporations Act does not contain a definition of ‘prescribed proceeding.’

⁸⁹ Bradstreet (n 23) 373.

⁹⁰ Institute of Directors Southern Africa *King Code of Governance for South Africa (2009)* 15.

⁹¹ Blanchard “Harkness Henry Lecture: Approaches to business rehabilitation” 2005 *Waikato Law Review* 55.

⁹² s 436A, 436B or 436C of the Australian Corporations Act, respectively.

⁹³ s 440F of the Australian Corporations Act.

⁹⁴ s 440(2) of the Australian Corporations Act.

5.1.2 *The Protection of Secured Creditors*

The Australian Corporations Act makes provision for the protection of property interests of secured creditors during the administration of the company.⁹⁵ This provision is similar to section 134(3) of the Companies Act 2008. In this regard, the administrator of a company under administration or of a deed of company arrangement is prohibited from disposing a property of the company, that is subject to a security interest, or a property of another person, that is used, occupied or is in the possession of the company.⁹⁶ The above does not apply to the disposal of a property in the ordinary course of the company's business, or where the secured party, owner or lessor has consented to the disposal in writing or where the court has granted leave for the disposal.⁹⁷ Under the Companies Act 2008, unless the proceeds from the disposal of a property will fully discharge the indebtedness protected by that person, only the consent of the holder of the security is required, and the court is not involved.⁹⁸

The court may only grant leave for the disposal of the property as contemplated in section 442C(2), if it is satisfied that measures have been taken to adequately protect the interests of the secured party, owner or lessor.⁹⁹ This provision is similar to section 134(3)(b) of the Companies Act 2008, although the court is not involved. It is understandable not to involve the court as the measures to protect the secured creditor are spelled out in section 134(3)(b), whereas in the case of section 442C(2), the court is yet to decide, in its discretion, what measures would adequately protect the interests of a secured party, in a given case.

If the administrator proposes to dispose of property of the company, the court may, on application by the secured party, lessor or owner, direct the administrator not to carry out such a proposal, if the court is not satisfied that measures have been taken to adequately protect the interests of the applicant.¹⁰⁰

⁹⁵ s 442C(1) of the Australian Corporations Act.

⁹⁶ s 442C(1) of the Australian Corporations Act.

⁹⁷ s 442C(2) of the Australian Corporations Act.

⁹⁸ s 134(3)(a)

⁹⁹ s 442C(3) of the Australian Corporations Act.

¹⁰⁰ s 442C(4) read with subsection (5) and (6) of the Australian Corporations Act.

5.2 The Automatic Stay in the United States of America

5.2.1 *The Automatic Stay*

Chapter 11 provides for an automatic stay of proceedings during proceedings for the reorganization of a company.¹⁰¹ The moratorium commences upon the filing of a bankruptcy case by the debtor¹⁰² or by three or more entities that holds undisputed claims totaling \$10, 000 more than the value of any lien on property of the debtor securing the claims held by the holders of such claims.¹⁰³

As is the case with section 133(1) of the Companies Act 2008, the stay in terms of section 362(a) does not apply to certain proceedings.¹⁰⁴ It is noteworthy that a total of 28 actions are excluded from the stay imposed in section 362(a). These include commencement or continuation of certain legal actions which apply to corporate entities, including a criminal action or proceeding against the debtor.¹⁰⁵

Unlike the moratorium in terms of section 133(1) of the Companies Act 2008, which applies to legal proceedings, the stay in terms of section 362(a) covers a wide scope and includes arbitration, administrative and all proceedings before or outside governmental tribunals.¹⁰⁶ In this regard, the stay also applies to the issuance or employment of process of an administrative nature or other action or proceeding against the debtor that was or could have been commenced prior to the commencement of the case; any act, to obtain possession of or exercise control of the estate property; to create or perfect any lien against estate property; to create or perfect any lien against property of the debtor to the extent that such lien secures a claim that arose prior to commencement of the case; and to collect, assess, or recover a claim against the debtor that arose prior to commencement of the case.¹⁰⁷ The scope of the stay in so far as it specifically refers to enforcement actions¹⁰⁸ appears to be similar to what is covered under the Companies Act 2008.

¹⁰¹ s 362(a) of Chapter 11.

¹⁰² s 301(a) of Chapter 11.

¹⁰³ s 303(b)(1) of Chapter 11.

¹⁰⁴ s 362(b) of Chapter 11.

¹⁰⁵ s 362(b)(1) of Chapter 11.

¹⁰⁶ Historical and Revision Notes, Senate Report No. 95 – 989

<http://uscode.house.gov/view.xhtml?req=granuleid:USC-prelim-title11-section361&num=0&edition=prelim>
(accessed on 4 February 2016).

¹⁰⁷ s 362(a)(1)(3)(4)(5) and (6) of Chapter 1 respectively.

¹⁰⁸ s 362(a)(2) of Chapter 11.

A set-off of any debt owing to the debtor and proceedings by the United States Tax Court have been included under the stay¹⁰⁹ whereas set-off and proceedings by a regulatory authority in the execution of its duties are excluded from the operation of the moratorium in terms of section 133(1) of the Companies Act 2008.¹¹⁰

In terms of the Companies Act 2008, the exclusion of set-off from the section 133(1) moratorium, is consistent with the current legal position in South Africa, in terms of which a set-off of mutual debts between the creditor and a debtor is allowed, subject to the requirements thereof. Although the inclusion of set-off under the stay in section 362(a) appears to be inequitable, this should significantly improve the financial situation of the company undergoing reorganization as it is in a legal position to enforce payment of its debts in full as they become due, without any deductions. The legal implications for the inclusion of set-off is that if a company under reorganization proceedings institute claims against a creditor, such creditor will not be able to raise the defense of set-off to reduce or extinguish its liability towards the company.

5.2.2 Adequate Protection

Chapter 11 protects the creditor's interest in property during the operation of an automatic stay.¹¹¹ In this regard, at the commencement of a Chapter 11 bankruptcy case, a secured creditor is entitled to require adequate protection as compensation or an adjustment for any depreciation, in the value of its property resulting from the automatic stay.

Adequate protection may be provided in a form of a lump sum or periodic cash payments to the creditor to the extent that the value of its interest in the property has decreased due to the stay or by way of providing the creditor with an additional or replacement lien to the extent that the stay has resulted in a decrease in the value of the creditor's interest in the property or by the granting

¹⁰⁹ s 362(7) and (8) of Chapter 11 respectively.

¹¹⁰ s 133(c) and (f) of Chapter 11 respectively.

¹¹¹ s 361 of Chapter 11.

to the creditor of such relief as would result in the realization by the creditor of the indubitable equivalent of the creditor's interest in the property.¹¹²

The term "adequate protection" is not defined under Chapter 11 but it is understood to mean that the debtor would "propose some form of relief that will preserve the secured creditor's interest in the collateral, pending the outcome of the bankruptcy procedure."¹¹³ The objective of adequate protection is to ensure that the creditor receives the value of its security as it was prior to bankruptcy.¹¹⁴ What constitutes adequate protection will depend on the circumstances of each case.¹¹⁵ In other words, adequate protection could be any form of instrument which the creditor deems satisfactory to secure its interest in a property.

Section 361 is not meant to be mandatory but merely illustrates the means or examples by which adequate protection may be provided.¹¹⁶ Therefore section 361(1), (2) and (3) were intended to operate as alternative means of satisfying the requirement of adequate protection and as such a debtor need only provide an undersecured creditor with protection from the depreciation of the value of its interest in the property for the duration of the stay.¹¹⁷

Marshack states that adequate protection in respect of an undersecured creditor, where the debtor needs the property to reorganize, has been held by some courts to mean that the creditor is entitled to periodic market interest payments to the extent of the security of the creditor's debt, although the author appears to disagree with the payment of interest on the value of the secured collateral.¹¹⁸ Further, the author indicates that other courts have declined to grant compensation for the time value of secured claims during the automatic stay and ordered the debtor to make periodic payments equivalent to the depreciation of the value of the collateral for the duration of the stay.¹¹⁹

¹¹² s 361(1)(2) and (3) of Chapter 11 respectively.

¹¹³ Marshack "Adequate protection for the undersecured creditor under the bankruptcy code" 1983 *Commercial Law Journal* 622.

¹¹⁴ Kupetz "The bankruptcy code is part of every contract: minimizing the impact of chapter 11 on the non-debtor's bargain" 1998-1999 *The Business Lawyer* 73.

¹¹⁵ Kupetz (n 114) 73.

¹¹⁶ Marshack (n 113) 622.

¹¹⁷ Marshack (n 113) 625.

¹¹⁸ Marshack (n 113) 623.

¹¹⁹ Marshack (n 113) 622.

Marshack concludes by saying that most courts that dealt with the issue of adequate protection, have concluded that all what adequate protection requires is that the debtor should make payments to the secured creditor if the collateral depreciates. While the stay gives the debtor an opportunity to reorganize, a temporary balance is thereby struck between the operation of the stay, which denies the secured creditor access to the collateral, and provision of adequate protection to ensure that the value of the creditor's interest in the collateral is maintained.¹²⁰

5.2.3 *Relief from the Stay*

A creditor is entitled to approach the court to seek relief from the stay by terminating, annulling, modifying, or conditioning such a stay, owing to a number of factors, including but not limited to lack of adequate protection of an interest in property of such party and, with respect to a stay of an act against property, where the debtor does not have an equity in such property and such property is not necessary to an effective reorganization.¹²¹

In light of the abovementioned grounds upon which an application for relief from the stay may be relied upon, if a debtor company has not provided adequate protection as contemplated in section 361, the court may deem it fit to terminate the application of the stay to the affected creditor to preserve the interests of such creditor.

In addition, if a debtor has no equity in a specific property and the property will not add value to the rehabilitation of the company, the court may also terminate the application of the stay in respect of the said property as the property does not enhance the efforts to reorganize the company.

However, a creditor who has been provided with adequate protection as contemplated in section 361 in respect of a specific property, is unlikely to succeed with an application for relief from stay in respect of the said property.

¹²⁰ Marshack (n 113) 628.

¹²¹ s 362(d) of Chapter 11.

6. CONCLUSION

The moratorium on legal proceedings against a company in business rescue is acknowledged internationally as a legal intervention necessary for any company in business rescue, given that the company is financially distressed and the business rescue practitioner needs to be afforded an opportunity to focus on rescuing the company. It is therefore important that creditors should be prepared to make sacrifices to give the company in business rescue an opportunity to recover from financial difficulties.

The moratorium creates an environment conducive for the rehabilitation of a financially distressed company in an efficient manner and enables the company to direct and dedicate its resources towards business rescue by suspending the rights of creditors to institute or continue with proceedings that may have a negative impact on business rescue proceedings.

The scope of the moratorium covers a wide range of proceedings which may frustrate the efforts to rescue the company. This should include any rights of claimants against the company, regardless of the nature of the forums in which such claims are pursued or enforced. Only criminal proceedings and actions of regulatory authorities must be excluded. However, the enforcement of sanctions sounding in money resulting from proceedings by regulatory authorities should be suspended for the duration of business rescue proceedings, as attempts to enforce the sanctions during the stay could worsen the financial situation of the debtor and distract the business rescue proceedings.

The duration of the moratorium is an important factor to take into consideration in relation to potential prejudice to creditors. The longer the duration of business rescue proceedings, the longer the moratorium will be and this may have the unintended consequences of causing some creditors to become financially distressed. The duration of the moratorium differs from one case to another depending largely on the magnitude of the company's financial distress, the root causes and the nature of the proposed business rescue plan. In addition, it is not practical to fix the duration of business rescue proceedings and therefore the moratorium, as the magnitude of financial distress and the efforts required to rehabilitate the company cannot be predicted.

The moratorium on legal proceedings suspends or limits the right of creditors to institute or continue legal proceedings to enforce claims against a company in business rescue. It is effective automatically, upon commencement of business rescue proceedings, and applies to all creditors. It is inevitable that the interests of creditors are adversely affected by the effect of the moratorium. The moratorium can only be lifted with the consent of the business rescue practitioner or the leave of court. In addition, the moratorium does not apply to certain proceedings, including criminal proceedings, set-off and proceedings by a regulatory authority.

As stated above, the Companies Act 2008 gives the business rescue practitioner the authority to grant consent for legal proceedings to be commenced or continued during business rescue proceedings. The requirement to approach the court is not ideal and may turn-out to be expensive and time consuming, given that a company under business rescue proceedings is financially distressed and need to optimize use of its resources. In addition to the right of creditors to request consent or apply for relief from the moratorium, the Companies Act 2008 makes provision for the protection of the interests of creditors under 134(3).

Most jurisdictions such as the United Kingdom, Australia and the United States provide for exceptions to the moratorium, which include relief from the moratorium, if the creditor has obtained the consent of the administrator or the court. In this regard, the administrator or the court gets an opportunity, before granting consent, to determine whether granting leave will not have a negative impact on the administration or reorganization of the company and whether such a decision is in the interests of justice.

Further, Australia and the United States have measures to protect the interest of creditors in section 442C(1) and 361 respectively. These measures are designed substantially to have the same effect and achieve the same objective of protecting the interests of creditors although provision of adequate protection in terms of section 361 is non prescriptive and therefore apposite as it allows the debtor to provide adequate protection within its available means unlike if the debtor is required to provide a specific instrument.

In light of the above, there is no substantive difference between the legal effect of the moratorium in terms of section 133(1) and the stay of proceedings contemplated in terms of section 440D(1) of the Australian Corporations Act and section 362(a) of Chapter 11. Similarly, the moratorium is in line with the recommendations contained in the UNCITRAL Legislative Guide.



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