



Queue Politely! South African Business Rescue Practitioners and their fees in Liquidation.

Diener N.O. v Minister of Justice and Correctional Services and Others [2017] ZASCA 180; [2018] 1 All SA 317 (SCA); 2018 (2) SA 399 (SCA)[†]

Dr Lézelle Jacobs and Dr David Burdette*

I. Introduction

In May 2011 South Africa's new corporate rescue procedure, known as "business rescue", came into operation. The mechanism is contained in Chapter 6 of the Companies Act 2008 (the SA Companies Act) and replaces the previous corporate rescue mechanism known as judicial management. While business rescue appears to have worked quite well since its inception eight years ago, there have been a number of court judgments that have been critical of the fact that many provisions of the new procedure have not been well drafted.² One of these provisions, relating to the payment of unpaid remuneration of the business rescue practitioner (BRP) where a company's business rescue procedure is converted to a liquidation, recently gave rise to litigation with the Courts focusing on the interpretation of the relevant statutory provisions.

The remuneration of insolvency practitioners is a contentious issue as much in the UK as in South Africa (and is indeed a bone of contention throughout the world). In February of this year the right honourable Frank Field MP, the chair of the UK House of Commons' Work and Pensions Committee, commented on the £44.2 million to be paid in fees to Price Waterhouse Coopers in relation to one year's Insolvency work on Carillion as "milking the cash cow".³

[†] The appellant in this case, Mr Diener, who was appointed as the business rescue practitioner, sought leave from the Constitutional Court to appeal the decision of the Supreme Court of Appeal. Although the Constitutional Court dismissed the application for leave to appeal (*Diener N.O. v Minister of Justice and Correctional Services and Others* [2018] ZACC 48), the Court did comment on some of the aspects covered by the judgment of the Supreme Court of Appeal. Where appropriate, the judgment of the Constitutional Court in refusing leave to appeal will also be referred to in this note.

* Dr Lézelle Jacobs is a Senior Lecturer at the University of Wolverhampton and a Research Associate at the University of the Free State, South Africa. ORCID ID: 0000-0001-8217-8467. Dr David Burdette is Senior Technical Research Officer at INSOL International, London, United Kingdom and an Extraordinary Professor at the Department of Mercantile Law, University of the Free State, South Africa.

² See, for example, para 18 of the case under discussion.

³ The Times, 7 February 2019. Referring to the Insolvency practitioners' fees he commented: "In this they are ably assisted by a merry little bank of advisors and auditors, conflicted at every turn and with every incentive to milk the cash cow dry."

This note endeavours to comment on the South African Courts' interpretation of provisions relating to the payment of remuneration to BRPs in the event that the business rescue procedure is superseded by liquidation.

It might be noteworthy to mention the position in England and Wales where a former administrator's remuneration and expenses are charged and payable out of property over which he or she had control immediately before cessation of the administration and are payable in priority to any security based on a floating charge.⁴ This arrangement also applies if the administration is converted to liquidation proceedings and in essence provides for a very high ranking ahead of most secured and unsecured creditors.

Before providing our analysis and commentary on the SA Court's decision, it is worth mentioning that section 143(5) of the SA Companies Act envisages the BRP's fees and disbursements being paid as a first priority before the payment of any other claims against the corporation, both pre-and post-commencement of the business rescue proceedings. In line with the possibility that a rescue attempt may not be successful and that the business rescue proceedings could be converted to liquidation proceedings, the legislature had the foresight to include a provision allowing for the preferential payments provided for by section 135 to be retained in the event of a business rescue being converted to a liquidation (section 135(5)). Although the manner in which this provision has been drafted creates some ambiguity and will be discussed in more detail below, in our view it is clear that the intention of the legislature was that the BRP should retain the preferential status afforded the BRP's fees and disbursements under the business rescue procedure in the subsequent liquidation of the company, subject only to the priority afforded the costs of liquidation.

II. Facts and background

On 13 June 2012, the members of the business JD Bester Labour Brokers CC (the corporation) passed a resolution under section 129(1) of the SA Companies Act, voluntarily placing the corporation in business rescue. One Mr Diener was nominated as the BRP for the corporation under the enabling provisions of the Act.

On 14 June 2012, the corporation instructed a firm of attorneys to launch an urgent application against a secured creditor of the corporation who had a mortgage over the corporation's immovable property, its only asset of any value, and which was about to be sold in execution. An order to this effect was granted on the same day. The attorneys later submitted their account for services rendered to the BRP, who went on to claim the expense as part of the expenses incurred in the business rescue proceedings.

During August 2012, the BRP came to the conclusion that the corporation could not be rescued and instructed the same firm of attorneys to bring an application under section 141(2)(a) of the SA Companies Act, to convert the business rescue proceedings to liquidation proceedings. The order placing the corporation in liquidation was granted by the Court on 27 August 2012 and the Master of the High Court subsequently appointed three joint liquidators.

The BRP duly provided the liquidators with an account for his outstanding fees, as well as the accounts submitted by the firm of attorneys for the work conducted by them on behalf of the BRP and the corporation.⁵ The joint liquidators could not agree on how the costs of the

⁴ Paras 70 and 99, Schedule B1, Insolvency Act 1986.

⁵ It is worth mentioning that the firm of attorneys also proved a claim for the amounts owing to them as creditors in the liquidation.

BRP and the firm of attorneys should be dealt with in the liquidation and distribution account⁶ and the matter was referred to the Master for a decision. The Master agreed with the views of one of the joint liquidators, that the BRP had failed to prove for his debt in the liquidation, so went unpaid, and that the attorneys ranked merely as unsecured creditors. The Master subsequently approved the liquidation and distribution account based on these views.⁷

Thereafter the BRP launched an application in the High Court to review and set aside the Master's decision to approve the account submitted by the liquidators and sought an order whereby the Court could provide direction as to how the unpaid fees of the BRP and the expenses incurred by the attorneys during business rescue proceedings, should be dealt with in the account. The High Court dismissed the application, agreeing with the Master that fees and expenses incurred during business rescue, if not paid during business rescue proceedings, can only be paid as a priority claim from the free residue after the payment of costs of liquidation.

The matter was then brought to the South African Supreme Court of Appeal (SCA),⁸ where the BRP contended that, in terms of the provisions of the SA Companies Act, business rescue practitioners' claims for remuneration enjoy a "special and novel preference" which ranks them above creditors, whether secured or not.

In its judgment dismissing the BRP's appeal, the SCA determined that the issues that needed to be dealt with were:⁹ a) the order of preference of the BRP's claim for remuneration and expenses in the liquidation of the corporation; b) a determination of the date of liquidation where business rescue proceedings are converted to liquidation proceedings; and c) whether the BRP is required to prove his or her claim in terms of section 44 of the South African Insolvency Act 1936 (the SA Insolvency Act) and the effect of the BRP not having done so in this case.¹⁰ Each of these aspects will be dealt with separately below.

III. The SCA issues

a) *Order of preference of the BRP's claim*

The decision in this case hinged on an interpretation of two sections of the SA Companies Act, namely sections 135(3) and 143(5). The relevant part of section 135 reads as follows:

⁶ A liquidation and distribution account is an account of the administration of the estate by the liquidator and is submitted to the Master in terms of the liquidator's statutory obligations. It needs to be understood that, unlike most other jurisdictions, under South African insolvency law secured creditors generally may not deal with the object of their security outside the insolvency process. All assets of the estate, whether held as security or not, form part of the insolvent estate and are accounted for by the liquidator. However, secured creditors are entitled to be paid from the proceeds of their security, subject only to certain prescribed costs first being paid from the proceeds of the security. These include the costs of maintaining, preserving and realising the property in question, as well as certain fees (such as the liquidator's fees, a proportionate share of the Master's fees, etc). The end result is that although assets subject to security are included in the estate, the proceeds are ringfenced for the secured creditors who hold the assets as security. All unsecured or unencumbered assets fall in the "free residue" of the estate and this is the general account from which all general expenses of the liquidation are paid. If there is any free residue left after payment of the liquidation costs, this is used to pay the preferential and unsecured creditors in the estate in a specified order of preference.

⁷ The joint liquidator in question contended that the BRP had failed to prove a claim in terms of s 44 of the South African Insolvency Act and that the claim by the firm of attorneys was merely an unsecured claim against the estate. In regard to the payment of the BRP's fees, it is worth noting that there were insufficient funds in the free residue of the estate with which to pay the BRP's outstanding fees as a priority claim after the costs of liquidation. In the Court of the first instance, the Court held that the outstanding fees of the BRP can be categorised as a priority or preferential claim, but can only be paid from the free residue of the estate after the payment of the liquidation costs.

⁸ The South African Restructuring and Insolvency Association (SARIPA), the Banking Association of South Africa (BASA), the Independent Business Rescue Association of South Africa (IBRASA), and the Turnaround Management Association Southern Africa MPC (Turnaround Management) made submissions as *amici curiae* in the Supreme Court of Appeal.

⁹ At para 15 of the judgment.

¹⁰ There were two further questions the Court dealt with, relating to the fees charged by the attorneys, but these are unrelated to the question relating to the BRP's fees and will not be addressed in this note.

“135 Post-commencement finance

- (1) ...
- (2) ...
- (3) After payment of the practitioner's remuneration and expenses referred to in section 143, and other claims arising out of the costs of the business rescue proceedings, all claims contemplated—
- (a) in subsection (1) will be treated equally, but will have preference over—
 - (i) all claims contemplated in subsection (2), irrespective of whether or not they are secured; and
 - (ii) all unsecured claims against the company; or
 - (b) in subsection (2) will have preference in the order in which they were incurred over all unsecured claims against the company.
- (4) 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.”¹¹

The relevant part of section 143 reads as follows:

“143 Remuneration of practitioner

- (1) ...
- (2) ...
- (3) ...
- (4) ...
- (5) To the extent that the practitioner's remuneration and expenses are not fully paid, the practitioner's claim for those amounts will rank in priority before the claims of all other secured and unsecured creditors.”¹²

The BRP's interpretation of the relevant provisions (in the context of the business rescue having been converted to liquidation) was that he enjoyed, after the costs of liquidation, a 'super-preference' over all other creditors, whether secured or unsecured. The view of the BRP was based on an interpretation of section 143(5) of the SA Companies Act, which states that the BRP's outstanding fees rank in priority before the claims of all other secured and unsecured creditors (in the context of a business rescue proceeding).

After going through the process of interpreting the relevant statutory provisions, the Court held that the provisions of sections 143(5) and 135(3) should be read together and confirmed the limited preferential nature of the claim of the BRP for outstanding fees once a business rescue proceeding has been converted to liquidation. The Court, therefore, confirmed the view of the Court *a quo* that the BRP's fees are payable out of the free residue of the estate in liquidation, after the section 97 (liquidation) costs but before the payment of other preferential claims in terms of the SA Insolvency Act¹³ and that such fees are not amounts that can be paid out of the proceeds of assets of the secured creditors.

Having correctly stated that section 135 deals with post-commencement finance and section 143 with the rights of the BRP to remuneration, it is unclear why the Court then states that the two sections must be read together. If the two sections are unrelated, why should

¹¹ Section 135 SA Companies Act. Emphasis added.

¹² Section 143(5) SA Companies Act. Emphasis added.

¹³ Section 97 SA Insolvency Act 24 of 1936.

they be read together? In arriving at this conclusion, the Court states (at paragraph 43 of the judgment):

“The reference to secured and unsecured creditors must, in my view, be understood to be a reference back to section 135: to those persons who have, or who have been deemed to have, provided the company with post-commencement finance, both secured and unsecured, and not to the company’s pre-business rescue creditors. Simply put, the preference operates within this limited context.”

While an argument can certainly be made out that the (continued) preference (into liquidation) referred to in section 135(4) relates only to a preference the BRP may have in relation to the claims listed in that section, it does not make sense then to read section 143(5) together with section 135(4). Section 143(5) clearly states that the fees and expenses of a BRP rank in priority to the secured and unsecured claims and, despite the poor wording of section 135(4), the clear intention is that the preferential status of the BRP’s fees should remain in the event that the business rescue is converted to a liquidation.

The fact is, and the Court did not address this issue, the BRP’s fees and expenses do enjoy a priority over the claims of all creditors in the context of business rescue proceedings. Generally no distinction is made between secured and unsecured creditors (except in the case of post-commencement lenders in the context of section 135) in a business rescue and all creditors’ claims rank behind the fees and expenses of the BRP. This is quite clear from the wording of section 143(5). The contrary general statement by the Court (in paragraph 44) in this regard, is simply not accurate.¹⁴ It also needs to be stated that the South African business rescue procedure does not make provision for placing creditors into classes; that being the case, secured and unsecured creditors are not dealt with separately in terms of the legislation. While it is conceded that secured creditors are in a stronger negotiating position than unsecured creditors due to the quantum of their claims and the fact that they hold security (for instance, they have a bigger influence on the outcome when voting on the plan), the truth is that all the creditors, whether directly or indirectly, are liable for the payment of the BRP’s fees. It is not only the unsecured creditors who are liable for the fees and this is why the BRP argued that should a business rescue be converted to a liquidation, both secured and unsecured creditors should be held liable for the payment of the outstanding fees in a subsequent liquidation. Using the Court’s own approach in interpreting the sections, it is not clear how it could conclude that section 143(5) refers back to section 135. There is absolutely nothing in the wording of section 143 that supports this interpretation or conclusion.

In dealing with the question as to whether the secured creditors are also responsible for a portion of the BRP’s fees carried over from a business rescue proceeding, the Court relied on the wording of section 95(1) (read with section 89(1)) of the SA Insolvency Act 1936, stating that the section does not cater for the proportionate payment of the BRP’s fees by secured creditors.¹⁵ It is quite obvious that the relevant section does not cater for this as the SA Insolvency Act was drafted a long time before the business rescue provisions in the SA

¹⁴ [2017] ZASCA para 44: “From the sections of chapter 6 that deal with security, it is apparent that security is treated in the same way as it is in the law more generally. There is, in other words, no indication that, in business rescue proceedings, security is to be diluted or undermined in any way. For instance, s 134(3) provides that if a company wishes, during business rescue proceedings, to dispose of property that is held as security by another person, it may only do so with that person’s prior consent, unless the proceeds of the disposal ‘would be sufficient to fully discharge the indebtedness protected by that person’s security’; and then the company must pay the person promptly up to the company’s indebtedness to him or her, or provide satisfactory security for that amount.”

¹⁵ The costs referred to in s 89(1) include the costs of maintaining, preserving and realising the property in question, as well as certain fees (such as the liquidator’s fees, a proportionate share of the Master’s fees, etc.).

Companies Act 2008 came into operation. By the same token, the provisions of the SA Insolvency Act also do not make provision for the outstanding BRP's fees to be paid as a preferential claim in the liquidation – ironically, it is the decision in this case that determined that the BRP's fees must be paid after the costs of liquidation (i.e., as a preferential claim) and has created a new preference that precedes payments to other preferential creditors under the relevant provisions of the SA Insolvency Act 1936 (sections 98 to 101).

The BRP's argument that secured creditors should also be held (proportionately) liable for the BRP's outstanding fees was based on the fact that, in the business rescue proceedings, they would be liable on the basis that creditors are not divided into classes. All the creditors, to one extent or another, are liable for the BRP's fees – this is clear from the plain wording of section 143(5).

b) Date of liquidation

The BRP also argued that the effective date of liquidation was the date on which the resolution for business rescue had been passed in terms of section 129, making all the costs incurred in the business rescue, costs of liquidation under section 97 of the SA Insolvency Act. In this regard the SCA held that the effective date of liquidation was the date on which the liquidation application was filed, which was a long time after the business rescue resolution had been passed. While it is submitted that in this specific case the SCA came to the correct conclusion regarding the date of liquidation, it needs to be borne in mind that this case dealt with a corporation that had entered business rescue voluntarily. The SCA did not deal with what the position would have been had the company already been in provisional or final liquidation at the time the business rescue application had been granted. In such a case the liquidation order will be suspended in terms of section 131(6).¹⁶ Had this been the case in this decision, the question arises as to what the SCA would have decided regarding the date of liquidation, as the date of liquidation would have preceded the business rescue proceeding and would merely have been suspended until the business rescue proceeding had terminated. Once the business rescue proceedings had ended, the liquidation proceedings would have revived, including the date of liquidation. Since the SCA did not deal with this scenario, the question remains unanswered as to whether the BRP's arguments in this regard had any merit.

c) Proof of claim

Referring to section 44 of the SA Insolvency Act, the Court held that the business rescue practitioner was required to prove a formal claim in the liquidation before his claim could be recognised and paid. In doing so, the Court drew a distinction between pre-liquidation creditors and claims by persons who had rendered services in connection with the sequestration (liquidation) or the administration of the estate, stating that the practitioner's claim did not fall into the latter category. The SCA's statement that all pre-liquidation creditors are required to prove a claim in terms of section 44 is not entirely accurate; for example, in terms of section 98A(3) of the SA Insolvency Act, employees are not required to prove claims for the preferential portion of their claims. If one refers back to the previous question

¹⁶ *Maroos and Others v GCC Engineering (Pty) Ltd* [2017] JOL 38084 (GP) (901/2017) [2018] ZASCA 178 (3 December 2018) where the court confirmed that liquidation proceedings are suspended in their entirety, including the powers of the liquidators appointed in the liquidation.

regarding the date of liquidation (see paragraph b) above), the question arises as to whether the BRP would have to have proved a claim if the business rescue had commenced after a liquidation order had been granted.

IV. ADDITIONAL ISSUES RAISED BY THE CONSTITUTIONAL COURT

In a unanimous judgment penned by Khampepe J, the South African Constitutional Court (CC)¹⁷ found that it was not in the interests of justice to grant leave to appeal because there were no reasonable prospects of success that the CC would reverse or materially alter the decision of the SCA. The CC, therefore, dismissed the application for leave to appeal.

a) *A purposeful reading*

The CC raised some interesting, yet arguable, points regarding the interpretation of the provisions. Whilst conceding that the drafting of the provisions created ambiguity,¹⁸ the CC attempted to resolve this by utilising a purposeful reading of the provisions. It concluded that "...when one considers the purpose of business rescue and the overall context of the relevant sections, [it does] not see any basis on which to interfere with the order of the Supreme Court of Appeal".¹⁹

This approach led the CC to consider the purpose of the Chapter 6 business rescue proceedings as having, as its primary goal, the avoidance of liquidation and its negative consequences on stakeholders and as a secondary purpose to achieve a better outcome for the creditors than the immediate liquidation of the corporation.²⁰ Moreover, the CC emphasised that this must be done while balancing the rights of all affected persons, including creditors, employees and shareholders as per section 7(k) of the SA Companies Act. Section 7(k), however, states that the rights and interests of all relevant stakeholders should be balanced.

In the CC's opinion, the BRP's interpretation of a 'super-preference' in liquidation in relation to his remuneration did not achieve a balance of the rights of all interested parties. The CC went even further, stating that the BRP's interpretation would also affect the rights of the liquidator (a party outside of the rescue proceedings) who will not be able to enjoy the same priority as the BRP in liquidation and would even rank after the BRP.²¹ In our view, the court did not consider that a BRP should also be regarded as a relevant stakeholder who agrees to take a difficult and complex appointment and that he is entitled to be remunerated as such even in the event of a failed rescue attempt. Moreover, the CC failed to recognise that its interpretation and the subsequent precedent could actually contribute to the disenfranchisement of stakeholders in business rescue in future. The less attractive ranking

¹⁷ The Constitutional Court of South Africa is the highest court in the country when it comes to the interpretation, protection and enforcement of the Constitution. Section 167(3)(b)(ii) of the South African Constitution empowers the CC to hear matters that raise an arguable point of law of general public importance. [2018] ZACC 48, para 30. "I am satisfied that this matter raises an arguable point of law of general public importance. The correct interpretation of sections 135(4) and 143(5) of the Companies Act and whether these sections confer a "super preference" on practitioners will have a significant impact on credit providers, and therefore the public, and should be considered. I will deal below with the question of whether the application has "reasonable" prospects of success. First, I consider the ancillary applications in this matter."

¹⁸ [2018] ZACC 48, para 47. "However, there is some ambiguity," and para 51 "Given that some ambiguity arises when sections 135(4) and 143(5) of the Companies Act are read together, it is necessary to interpret the sections having regard to their purpose...".

¹⁹ [2018] ZACC 48, para 71.

²⁰ [2018] ZACC 48, para 54.

²¹ [2018] ZACC 48, para 56. "The effect of the 'super preference' contended for is that the claim for remuneration of the practitioner would, in fact, rank ahead of the costs of liquidation."

order for the BRP's remuneration in liquidation created by this decision, creates a self-interest threat in that the BRP's interest in the proceedings (the BRP's remuneration) could be in conflict with his or her statutory duties and duties as a fiduciary, in that he or she might be influenced by this not to convert rescue proceedings to liquidation proceedings when it is no longer feasible to rescue in fear of not being paid what he or she is due in a subsequent liquidation. This scenario will hamper the BRP's duty to exercise his or her powers in an independent and impartial manner and would most definitely not lead to a proper balancing of the rights and interests of other stakeholders. Lastly, we fail to see why the less beneficial position created for the liquidator due to the BRP's interpretation is indicative of a lack of balance in the rescue regime. Surely a BRP should not be penalised for the shoddy manner in which the SA Companies Act has been drafted? The CC cited the following in its judgment: "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."²² We agree wholeheartedly with this statement.

b) *The corporation not being a suitable candidate for rescue and Diener's bona fides*

A recurring theme in this case (before the court of first instance, the SCA and the CC) is mention of the fact that this corporation was not a suitable candidate for rescue, should not have been placed in business rescue in the first place and that this constituted a serious abuse of process by the debtor and BRP.²³ In our view, this recurring theme is irrelevant in the determination of the issues that were before the Courts. These are considerations specific to this case, for which alternative statutory and common law remedies for aggrieved parties exist,²⁴ and ought not to influence the underlying principles of the entire rescue regime.

c) *Comments on remuneration claimed by Diener*

Given the fact that the corporation only had one major creditor; one immovable property, no employees and only lasted two months, the BRP's fees appear to be high,²⁵ which probably did not help the BRP's cause in this case.²⁶

IV Conclusion

In our view, the judgments given by the Courts in this case show a lack of detailed understanding of the process of business rescue and were swayed by irrelevant considerations in determining the issues. Having decided that the BRP was not entitled to a 'super preference', the SA Companies Act was then interpreted to fit with this finding, without giving due regard to the consequences of the judgments issued.

²² *Natal Joint Municipal Pension Fund v Endumeni Municipality* [2012] ZASCA 13; 2012 (4) SA 593 (SCA) as quoted on p 20 n 35 of the judgment (excerpt from quote used).

²³ The resolution to initiate business rescue was in all probability filed in order to avoid the imminent sale in execution of the company's only asset. 2018] ZACC 48, para 10. "...a mere two days before the sale in execution..." and "It is common cause that at the time JD Bester was not conducting any business, had no employees and no assets other than the immovable property over which FRB held the mortgage bond."

²⁴ For example, any interested party (such as the major creditor in this case) could have applied to set aside the business rescue resolution by the corporation under the provisions of s 130 of the Companies Act.

²⁵ Mr Diener's fees amounted to ZAR 112 918.40 (approximately GBP 6 273). However, the breakdown of the BRP's fees is not evident from the decision, so a proper analysis of the fees claimed cannot be made.

²⁶ There has been much criticism of the fees claimed by BRPs since the legislation came into effect in 2011. An additional problem is that no provision is made for the proper taxation of the BRPs fees in a business rescue, resulting in no oversight of the amounts claimed.

The UNCITRAL Legislative Guide states that it is desirable that an insolvency law recognises the importance of according priority to payment of the insolvency practitioner's remuneration.²⁷ If BRPs are not certain of payment for the performance of the tasks in relation to the administration of the estate, why would they agree to taking such an appointment in the first place?

²⁷ UNCITRAL Legislative Guide on Insolvency Law 2005: p 182, para 57. Rankings are normally based upon commercial and legal relationships between the debtor and its creditors but distribution policies also very often reflect choices that recognise important public interests (such as the protection of employment), the desirability of ensuring the orderly and effective conduct of the insolvency proceedings (providing priority for the remuneration of insolvency practitioners and the expenses of the insolvency administration) and promoting the continuation of the business and its reorganisation. It is due to this competition between the broader public interests and private interests that a distortion of normal commercial incentives arises. Put more plainly, it is the interests of the insolvency practitioner competing with the interests of the creditors that give rise to a distortion of what is normal practice.