



the dti

Department:
Trade and Industry
REPUBLIC OF SOUTH AFRICA

COMPARATIVE ANALYSIS OF CHAPTER 6 OF THE SOUTH AFRICAN COMPANIES ACT, NO. 71 OF 2008 (Business Rescue Proceedings)

Presentation to the Company Law Symposium organized by
The South Africa Department of Trade and Industry &
The Specialist Committee on Company Law

Johannesburg, South Africa

March 1, 2013

Philip Mindlin

WACHTELL, LIPTON, ROSEN & KATZ

Part I. General observations on reorganization proceedings under the U.S. Bankruptcy Code as contrasted with Business Rescue Proceedings under Companies Act, No. 71 of 2008

Part II. Features of practice under the U.S. Bankruptcy Code that contribute to its success

Part III. Current issues in U.S. bankruptcy practice

Part IV. Comments on specific provisions of Chapter 6 of the Companies Act, 2008 in light of U.S. experience

Part I

General observations on reorganization proceedings under the U.S. Bankruptcy Code as contrasted with Business Rescue Proceedings under Companies Act, No. 71 of 2008

Comparison of United States and South African Corporate Reorganization Law

- Reorganization v. Liquidation
- Role of the practitioner
- Who can commence proceedings
- Automatic Stay / Moratorium
- Use or Sale of Collateral / Leased Assets
- Post-commencement financing
- Manner of voting
- How to impose plan on dissenting parties
- Impact on contracts
- Special treatment of labor contracts and retiree benefits
- Asset sales before plan adopted
- Personal liability of directors

Comparison: Role of the Practitioner

11 U.S.C. § 1104(a); 1107

- The “debtor in possession” is left in control of the business and bankruptcy proceedings.
- For first 120 days, debtor has exclusive right to propose plan, though period can be shortened or extended up to 18 months for cause.
- A trustee may only be appointed for cause, including “fraud, dishonesty, incompetence.”

Act §§ 138 - 143

- The practitioner controls the proceedings after an application has been filed.
- He may delegate his powers to directors or managers.
- He negotiates and prepares the business rescue plan.
- He controls the operation of the business

Comparison: Who Can Commence Proceedings

11 U.S.C. § 303

- A petition for reorganization may only be filed by the company or its creditors.
- There are potentially severe penalties for wrongful filing of an involuntary petition.

Act § 131

- Any “affected person” may apply for a court order to commence proceedings.
- This includes individual shareholders, trade unions and individual employees (who do not have to be creditors of the company).

Comparison: Automatic Stay / Moratorium I

11 U.S.C. § 362

- The automatic stay can be lifted by the bankruptcy court on request if (i) a secured creditor is not provided “adequate protection” or if (ii) there is no equity in the asset and it is not necessary for an effective reorganization.

Act §§ 133 and 134(2)

- There is no formal mechanism for obtaining relief, but presumably a creditor could seek relief under § 134(2).
- There is no explicit requirement that the practitioner protect lessors and secured creditors when continuing to use their property

Comparison: Automatic Stay / Moratorium II

11 U.S.C. § 362

- An act in violation of the stay can result in a civil contempt citation and is null and void.
- The stay concludes at the end of the Chapter 11 proceedings.
- Guarantors not protected.
- Action under derivatives contracts not stayed.

Act §§ 133, 136(2A), 150(2)(b)(1)

- No explicit provision addressing violations of the stay.
- It appears the moratorium can continue even after the business rescue plan is adopted.
- Guarantors not protected.
- Derivatives contracts protected.

Comparison: Use or Sale of Collateral / Leased Assets I

11 U.S.C. § 363

- The debtor is free to “use, sell or lease” assets in the ordinary course of business.
- If transaction is not in the ordinary course of business, notice and a hearing are required.
- Special provisions for “cash collateral”: debtor may not use, sell or lease without court authorization.

Act § 134

- Property may be disposed of outside ordinary course of business if transaction is approved in writing by practitioner, without need for court approval.

Comparison: Use or Sale of Collateral / Leased Assets II

11 U.S.C. § 363

- Any creditor that has an interest in property may object to use, sale or lease.
- Court will prohibit or condition such use as is necessary to provide “adequate protection.”
- Debtor may sell property notwithstanding contrary provision in loan agreement, and creditor may “credit bid.”

Act § 134

- Under § 134(1)(c), it appears that the lessor of property to the company that is in business rescue proceedings cannot reclaim the leased property.
- Impossible to sell secured property without creditor consent or payment in full.
- No provision allowing for credit bidding.

Comparison: Post-commencement financing I

US -- Debtor in Possession (“DIP”) Financing Generally

- Under the U.S. Code, the DIP can obtain unsecured credit outside the ordinary course of business after notice and a hearing. **11 U.S.C. § 364(a).**
- The DIP can seek to obtain credit as an “administrative expense.” If such financing is not obtainable, the DIP loan can be given “superpriority” over other administrative expenses, secured against any unencumbered property, or secured by a junior lien on property that is already encumbered. **11 U.S.C. § 364(b) and (c).**
- If the DIP is unable to obtain financing on these terms, it can grant the creditor a senior or equal lien on encumbered property of the estate so long as there is “adequate protection.” **11 U.S.C. § 364(d).**
- As a practical matter, DIP loans often offer attractive interest rates at relatively low risk, and the DIP creditor often has substantial control over the bankruptcy process.

Comparison: Post-commencement financing II

South Africa -- § 135

- Post-commencement financing may be secured by any asset “to the extent unencumbered” and will have preference in the order incurred over all unsecured claims against the company. Not clear whether this allows junior security interests on already encumbered assets in which there is equity value.
- Employee claims arising during proceeding (including management severance?) take precedence over all post-commencement financing, whether or not secured.

Comparison: Manner of voting I

11 U.S.C. § 1129

- Creditors vote by classes, with those who have “substantially similar claims or interests.”
- Voting takes place by ballot, and creditor only votes if claim or interest is impaired.
- Class deemed to vote “no” if it receives nothing under the plan.

Act § 152(2) and (3)

- Affected persons vote in person, and do not appear to be divided into classes.
- Secured claims vote as if they are unsecured.
- Affected persons vote even if they receive nothing under the plan, as do creditors who will be paid in full.

Comparison: Manner of voting II

11 U.S.C. § 1129

- A class accepts if at least 1/2 of members of the class representing 2/3 of debt owed vote in favor the plan.
- A creditor's vote can be disregarded if the creditor's motives are deemed improper.

Act § 152(2) and (3)

- 75% of creditor's voting interest by value, and 50% of independent creditor's voting interest by value, plus a majority vote of all security holders if interest is impaired.
- Plans can be forced on unwilling creditors if their vote is treated as "unreasonable."

Comparison: Imposing a plan on dissenting parties

11 U.S.C. § 1129(b)

- Plan may be imposed on dissenting classes so long as it “does not discriminate unfairly” and is “fair and equitable.”
- This is colloquially referred to as “cram down.”

Act § 153(1)(b)(ii)

- After a business rescue plan has been rejected, any affected person or persons acting together “may make a binding offer to purchase the voting interests” of any persons who opposed the adoption of the plan.

Comparison: Ability to negate contract obligations

11 U.S.C. § 365

- Ipso facto clauses denied effect.
- Automatic acceleration of debt, though can reinstate.
- Most restrictions on assignability overridden.
- Only executory contracts (those not yet fully performed on either side) may be assumed or rejected, and only in whole

Act § 136

- Practitioner given the right to suspend or cancel entirely, partially, or conditionally **any provision** of an agreement (except a pre-commencement employment agreement or a derivatives contract), despite contract provision to the contrary.
- Practitioner's power not limited to executory contracts.
- Act does not address restrictions on assignment.

Comparison:

Special treatment of labor; retiree benefits

11 U.S.C. §§ 1113; 1114

- Before rejecting collective bargaining agreement (“CBA”), debtor must propose to modify in a way “necessary to permit the reorganization.”
- Union must have rejected this proposed modification without good cause, and “balance of equities” must favor rejection.
- Same applies to pension plans provided for in CBA

Act §§ 130, 131, 135, 136, 144, 148, 152

- Unions and unrepresented workers protected from dismissal. § **136**.
- Right to payment is given priority. § **135**.
- Employment contracts may not be suspended or cancelled. § **136**.
- Right to initiate proceedings, object to initiation, and form committees. §§ **130, 131, 148**.
- Right to be consulted on the plan, propose an alternate plan, and generally to participate fully in the proceedings. §§ **144, 152**.

Comparison: Asset sales before plan adopted

11 U.S.C. § 363

- The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate.
- Sale of substantially all assets pre-plan common
- Security interests attach to proceeds

Act § 134(1)(a)(ii)

- A company may dispose of property “in a bona fide transaction at arm’s length for fair value approved in advance and in writing by the practitioner.”
- However, shareholder approval required under Act § 112 if all assets
- Secured creditor approval may also be required

Comparison: Personal liability of directors

11 U.S.C. § 303

- U.S. generally has a deferential standard toward the decisions of directors: the “business judgment rule.”
- U.S. has no provision requiring companies that are insolvent or nearly insolvent to cease doing business.
- Filing must be in “good faith,” but there is minimal litigation in the U.S. over insolvency and eligibility to file.

Act §§ 22(1) and (2); 77; 130(5)(c)(iii)

- Directors are liable if they carry on the business recklessly, with gross negligence, or for any fraudulent purpose. § **77, 22(1)**.
- Carrying on the business while unable to pay debts additional basis for shutting down. § **22(2)**.
- If no reasonable grounds for believing company “unlikely to pay all of its debts,” court may order directors who voted in favor of resolution to pay costs of application. § **30(5)(c)(iii)**.

Part II.

Features of practice under U.S. Bankruptcy Code that
contribute to its success

Creditors play an active role

- The official committee of unsecured creditors is very influential in bankruptcy proceedings.
- OCUC typically has sophisticated advisors, paid at estate expense, and debtors consult with it before filing any significant motion.
- Other advisors may be compensated by the estate if creditor is over-secured and loan documents so provide, or if creditor has made a “substantial contribution” to the case. Otherwise, they are compensated by the holders or groups of holders themselves.
- In general, large creditors are influential players in the proceedings and often are sophisticated repeat players
- Large creditor may have purchased claims in order to pursue an active role in the case.
- Substantial ongoing information rights

Bankruptcy is practical

- Bench and bar quick to adapt to changes in broader economy
- Court has broad authority to issue any order that is “necessary and appropriate”. **11 U.S.C. § 105.**
- No obligation to file; allows time for work-out/pre-pack
- Examples:
 - Allowing “roll ups” for DIP lenders during the financial crisis
 - “Critical vendor” status
 - When debtors unable to cover operating expenses or asset depreciating, courts allow for rapid sale of assets
 - The “confirmation express”
 - Dealing with “bankruptcy remote” entities
 - “Gifting” plans

Deep and liquid market for claims

- Creates liquidity for unwilling holders such as trade creditors
- Brings in sophisticated repeat players with high IRR expectation, who press for rapid progress
- Depth of market is sufficient to allow for published indications of price and fair prices
- Purchase of trade and bond debt is standardized and thus relatively frictionless
- Ready access to information facilitates informed transactions

Finality and substantial certainty as to outcome

- Similarly situated creditors will receive similar distributions (no “unfair discrimination”)
- Senior claims must be paid in full before junior claims receive anything, unless agreed otherwise (“fair and equitable” rule, which embodies “absolute priority” principle)
- This certainty allows parties to bargain in the shadow of the law, and to adopt out-of-court solutions
- Because preferences and fraudulent transfers will be reversed in bankruptcy, there is little pressure from creditors to coerce such transactions
- Key transactions are insulated from appeal, specifically:
 - Validity of and collateral for post-bankruptcy financing (**11 U.S.C. § 364(f)**)
 - Sale or lease of assets. (**11 U.S.C. § 363(m)**)
 - Implementation of plan (“equitable mootness” doctrine)

Other Positive Aspects of US Code and Practice

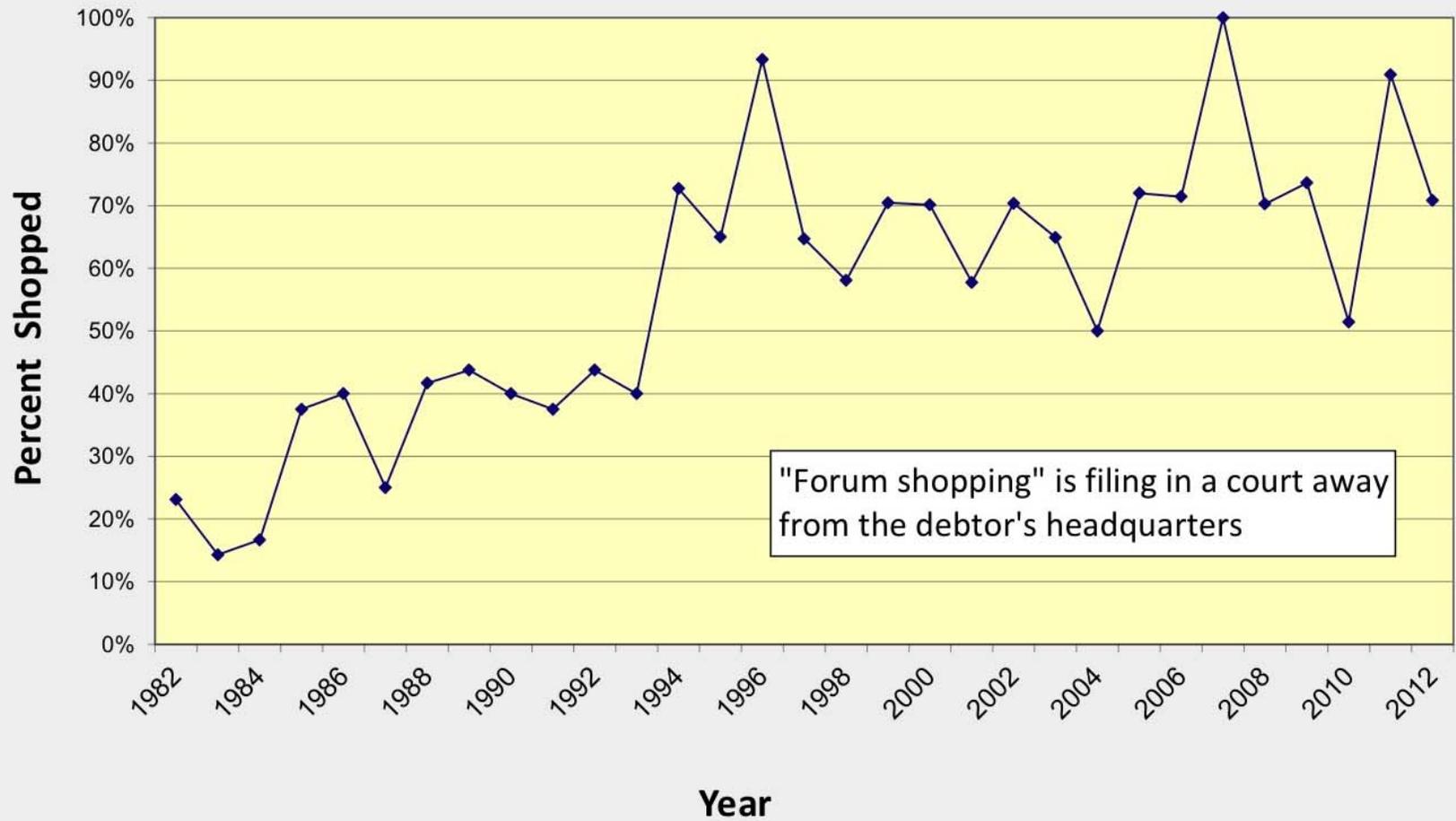
- Judges experienced specialists, typically have sound commercial judgment
- Little opprobrium attached to filing, especially if due to LBO debt or industry factors
- Companies given time to negotiate out-of-court work-outs and approach the court with a pre-negotiated plan
- Availability of post-bankruptcy financing, for both DIP loans and exit financing
- Active market for distressed companies due to Code provisions e.g. those allowing for § 363 sales, contract rejection and assumption, and minimal successor liability; no need for shareholder approval
- Good access to information, including debtor websites where all court filings may be viewed; substantial press coverage
- Sensible balance of power between the debtor and creditors, including vote thresholds, OCUC, cram-down, designation, initial period of exclusivity, right to trustee if appropriate, right to advisors
- Relatively easy to issue shares in a reorganized company ((**11 U.S.C. § 1145**))

Part III.

Current Issues in U.S. bankruptcy practice

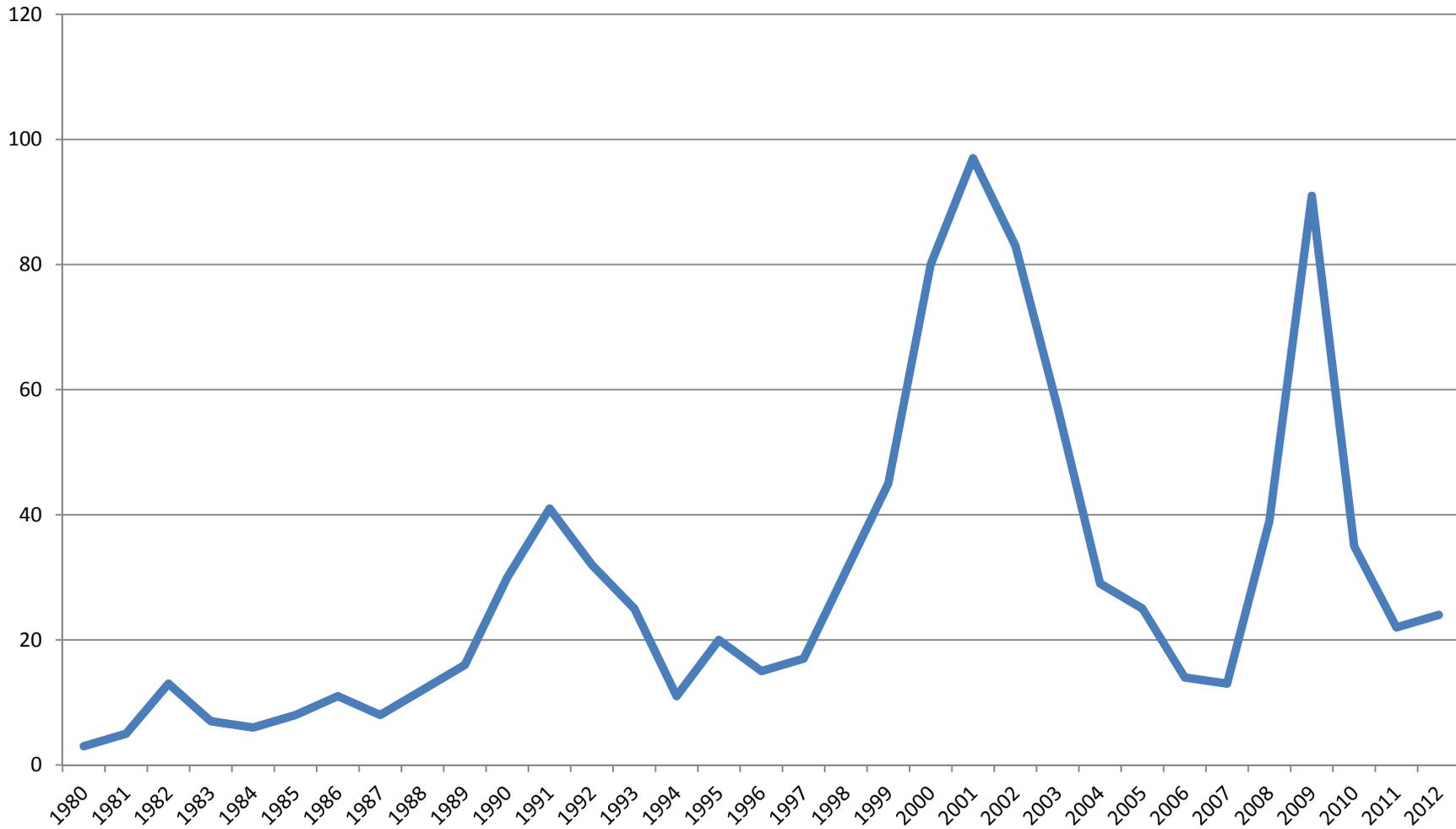
Rate of Forum Shopping 1982 – 2012

Source: UCLA-LoPucki Bankruptcy Research Database



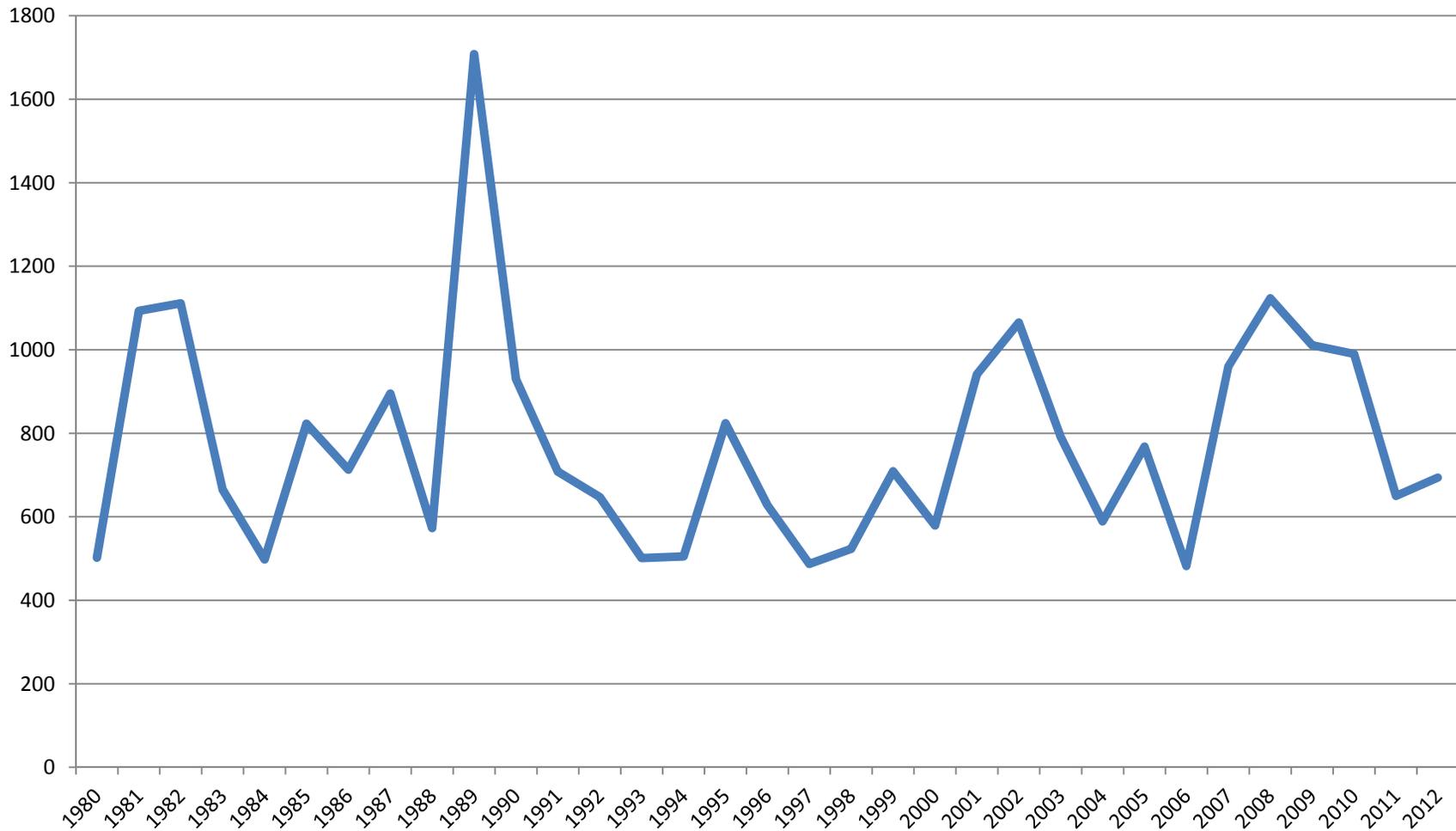
Frequency of Large, Public Company Bankruptcy Filings, by Year of Case Disposition

Source: UCLA-LoPucki Bankruptcy Research Database



Median Asset Value for Large, Public Company Bankruptcy Filings, by Year of Case Disposition (in millions)

Source: UCLA-LoPucki Bankruptcy Research Database

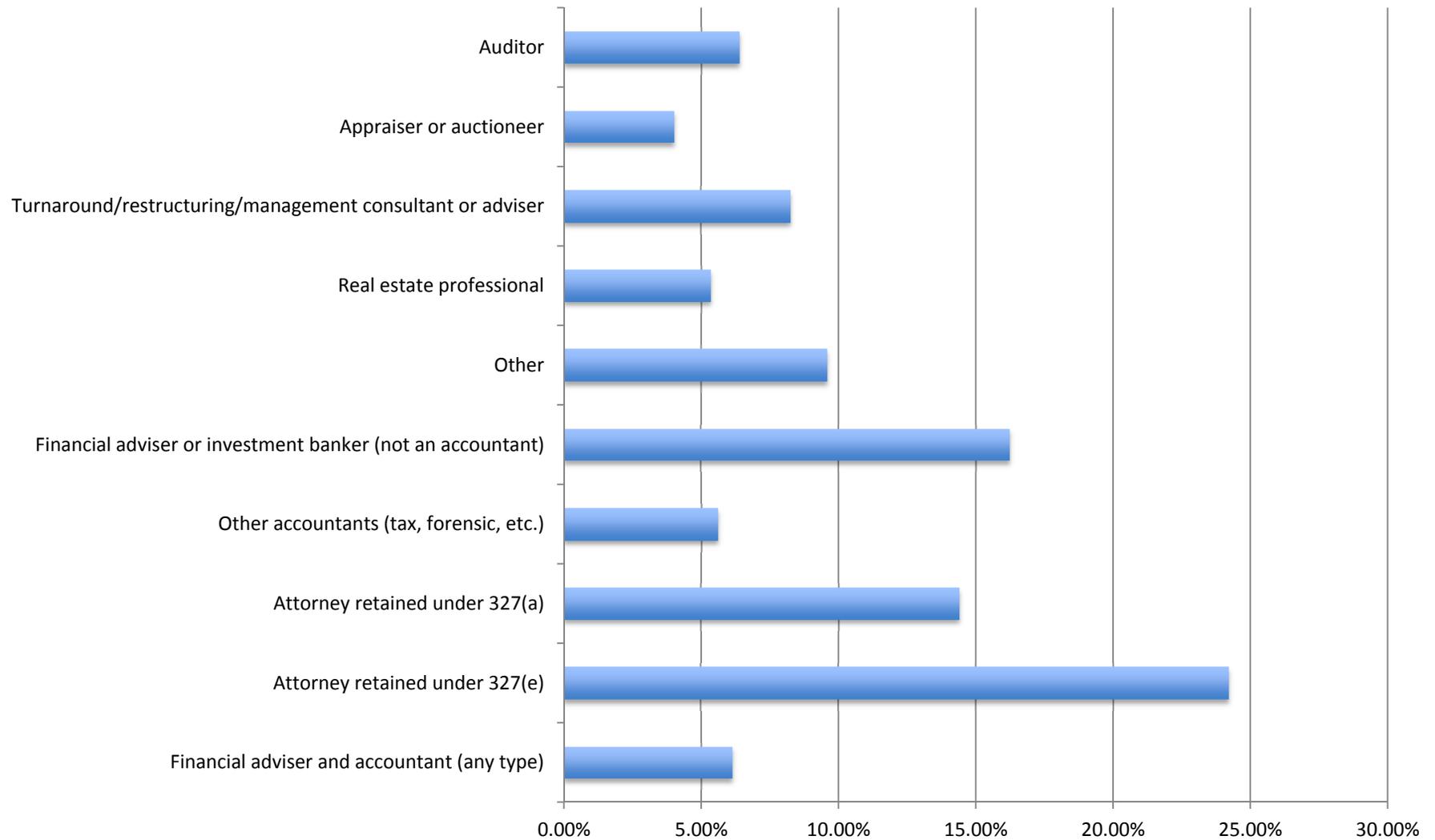


Illustrative Expense Issues

- Fees for law partners can exceed US\$1,000 per hour
- Bankers receive monthly fee plus “success fee”
- All fees require court approval; subject to hold-back until end of case
- Lehman Bros example: Debtors’ fees in Lehman Bros (assets of \$500 billion) reached \$430 million, with 40 lawyers billing > US\$1,000 /hour; financial advisors’ fees for debtors exceeded US\$620 million; total fees for advisors exceeded US\$1.5 billion
- OCUC and debtor likely to each have legal (main and local), financial and other advisors, ditto for main creditors

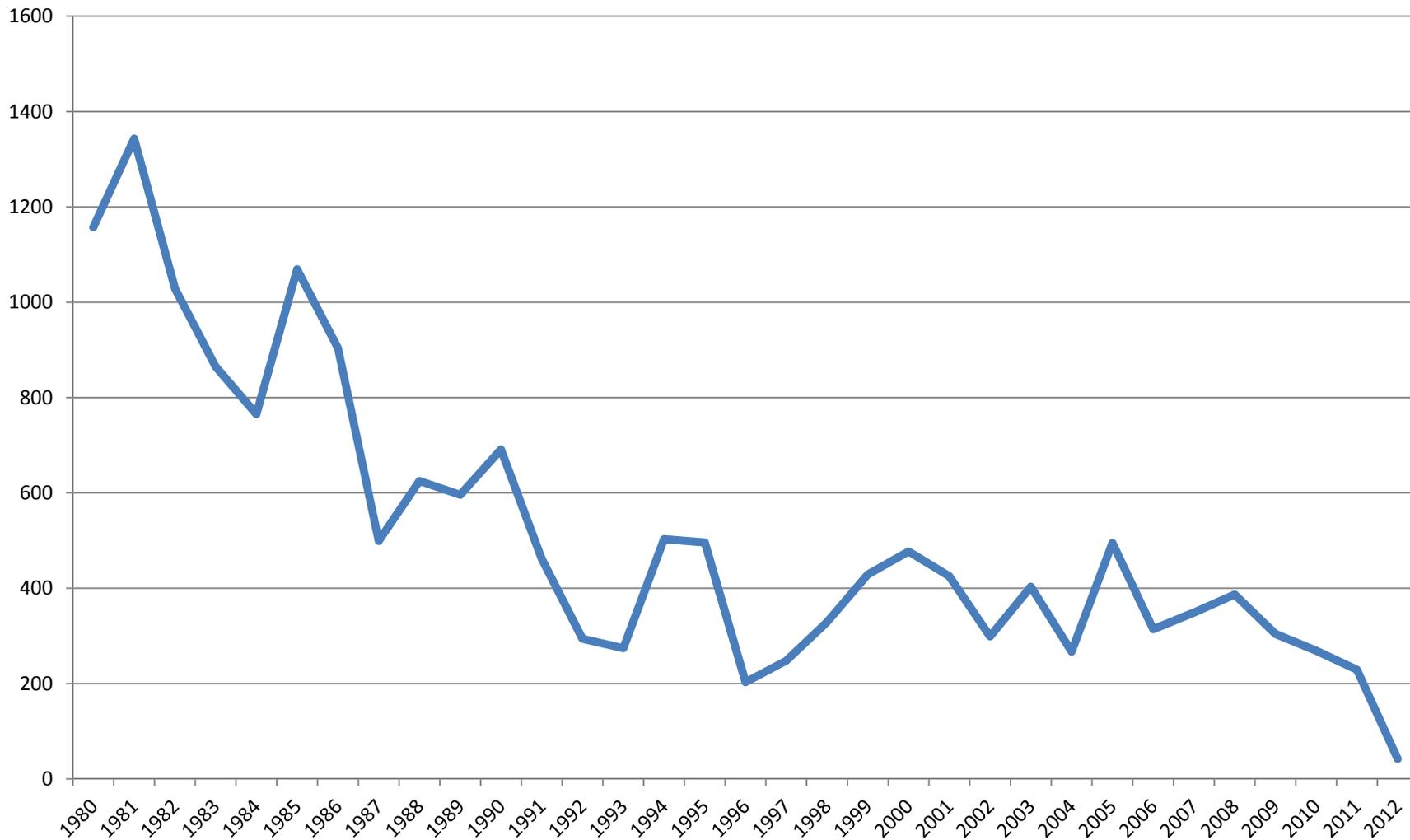
Professionals retained by debtors, as percent of total cost (big case sample)

Source: Stephen J. Lubben, Chapter 11 Professional Fee Study (2007)



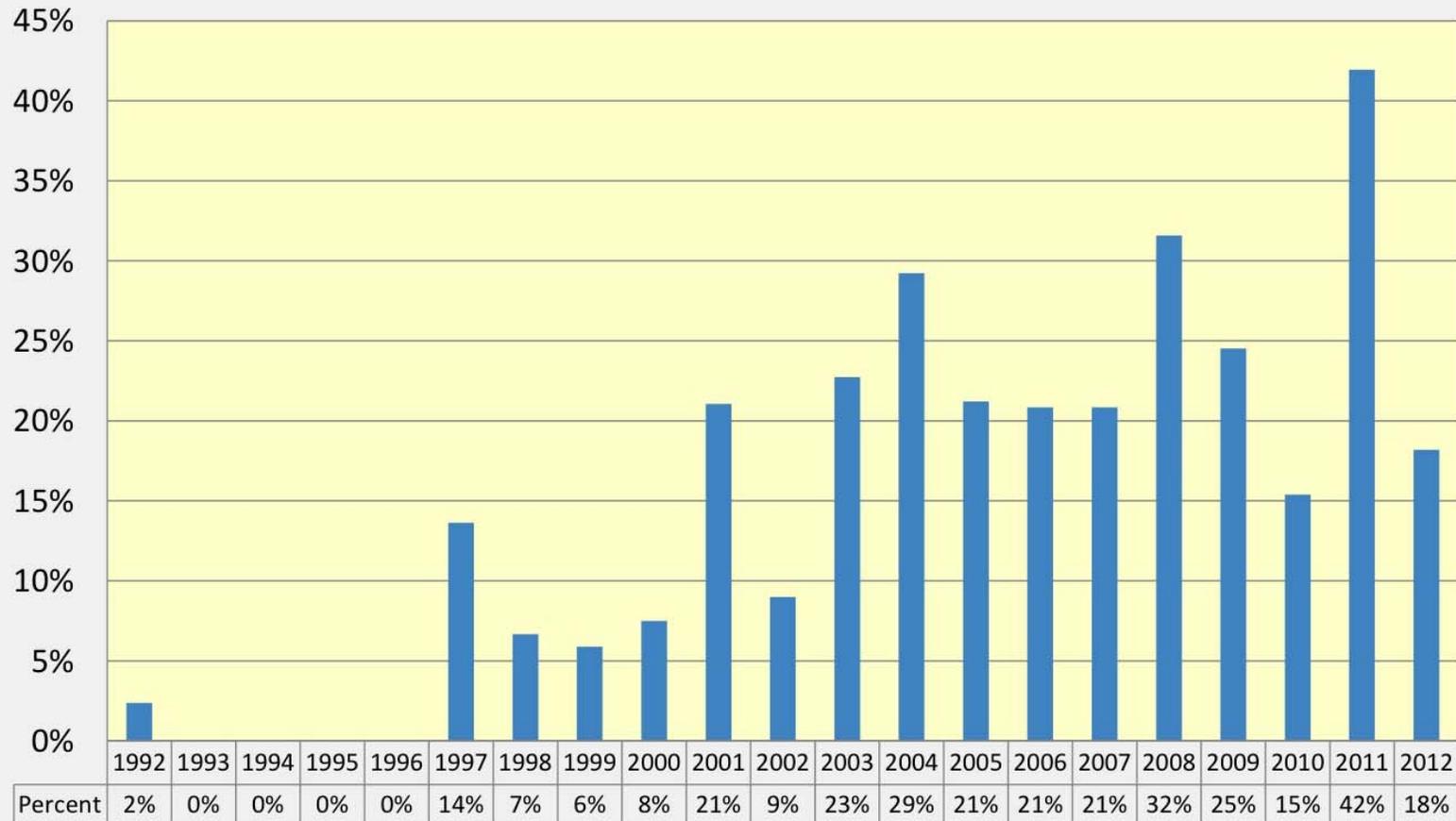
Median Duration for Large, Public Company Bankruptcy Filings, by Year of Case Disposition (in days)

Source: UCLA-LoPucki Bankruptcy Research Database



363 Sales of All or Substantially All Assets in Large, Public Company Bankruptcies, as a Percentage of all Cases Disposed, by Year of Case Disposition

Source: UCLA-LoPucki Bankruptcy Research Database



Section 363 Sale Examples

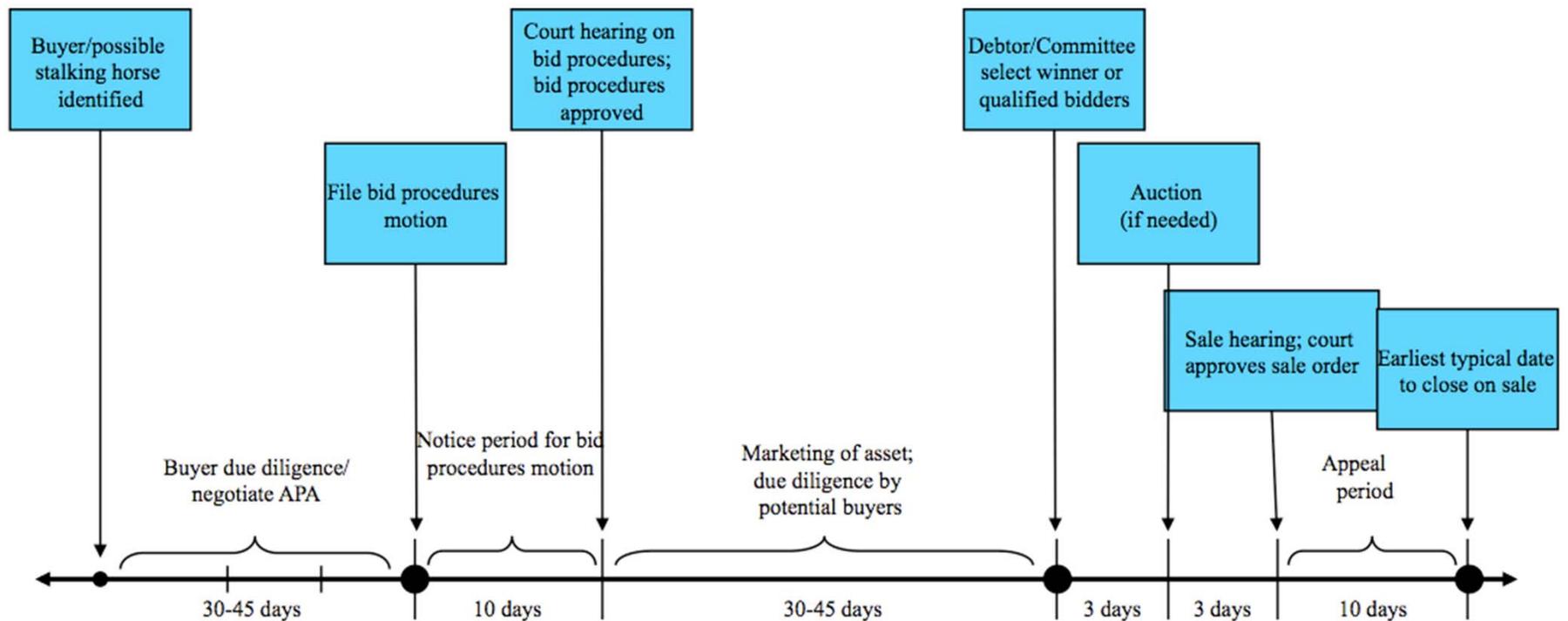
- ❑ Clear Channel
- ❑ Lehman Brothers
- ❑ Chrysler
- ❑ General Motors
- ❑ Polaroid
- ❑ Filene's Basement
- ❑ Eddie Bauer
- ❑ Sun-Times Media
- ❑ Nortel Networks



LEHMAN BROTHERS



Typical Section 363 Sale Process



Certain Other Current Issues

- Creditor lock-up agreements and plan support
- Mandatory appointment of examiners
- Inter-creditor agreements by which senior creditors claim right to control junior creditors

Issues addressed by past Code amendments

- Impact of Debtors' exclusive right to propose a reorganization plan (previously effectively unlimited) on balance of power
- Debtors' delaying assumption and rejection decisions until the very end of the case, leaving lessors in limbo
- Retention bonuses to management
- Rejection of software licenses upon which licensees depend
- Rejection of obligations under collective bargaining agreements, including retiree benefits and pensions, without giving due consideration to the interests of current and retired workers
- Bankruptcy cases filed simply to hold off foreclosure on real estate
- Creditors' failure to disclose the full extent of their interests

Part IV.

Comments on specific provisions of Chapter 6 of the
Companies Act, 2008 in light of U.S. experience

- **Section 128(3) – Specialist judges.** The Act provides that the Judge President of a High Court may designate a judge of that court as a specialist to determine issues relating to insolvency and business rescue.
- **Section 129(7) –Delivery of written notice of non-commencement.** If the board of a company has reasonable grounds to believe that the company will not be able to pay debts coming due in the next six months, or will be insolvent within six months, but has not adopted a resolution commencing business rescue proceedings, it must deliver a written notice to each creditor, shareholder, trade union and non-unionized employee explaining why it hasn't commenced business rescue proceedings.

- **Section 131 – Court order to begin business rescue proceedings.** Any creditor, shareholder, union or employee may apply to court for an order commencing business rescue proceedings. The affected person initiating the application nominates the relevant interim business rescue practitioner, subject to confirmation by a vote of creditors.
- **Section 134 – Reclamation of leased property, sale of assets securing debt.** Under Section 134(1)(c) it appears that a lessor of property to the company that is in business rescue proceedings cannot reclaim the leased property unless the practitioner is acting “unreasonably.” Under Act Section 134(3), property in which any creditor holds a security interest cannot be sold without the consent of that creditor unless the creditor will be paid in full from the proceeds.

- **Section 135 – Post-commencement finance.** Companies in business rescue proceedings may borrow on a secured basis “to the extent” that assets are not otherwise encumbered and such claims will have priority in the order in which they are incurred. Employee claims arising during the business rescue proceeding take priority over all post-commencement financing, whether or not secured, and over all pre-commencement unsecured claims.
- **Section 136 – Suspension or cancellation of contracts.** The practitioner may suspend, for the duration of the business rescue proceeding, the obligations of the company under a contract entered into prior to the business rescue proceeding, and may ask a court to cancel all or part of a contract to which the company is a party. Employment contracts may not be suspended or cancelled and employees must be kept in place during the proceedings on the same terms and conditions as prior to the proceedings. This is without prejudice to the provisions of the business rescue plan which may provide for retrenchment on the terms allowed by the Labor Relations Act 66 of 1995. Agreements for netting, set-off and close-out of derivative transactions may also not be suspended or cancelled.

- **Section 143 – Remuneration of practitioner.** The Act creates a two-part scheme for compensating practitioners: They are to be paid in accordance with a statutory tariff, but that tariff may be supplemented by an agreement providing for additional remuneration, if agreed to by the company and approved by both a majority of creditors and a majority of shareholders.
- **Section 145 – Participation by creditors.** Creditors are allowed to form committees and consult with the practitioner. Creditors vote in accordance with the “value of the amount owed” to them.

- **Section 146 – Participation by holders of the company’s securities.** The Act gives shareholders (and other holders of securities) an explicit approval right on business rescue plans. Securityholders may, if the plan is rejected, offer to buy out objecting creditors.
- **Section 150 – Proposal of Business Rescue Plan.** The plan must be proposed within 25 business days of the practitioner’s appointment unless either the court, upon application by the company, or a majority of the creditors, approves an extension.

- **Section 152 – Proposal of business rescue plan.** The plan is approved if supported by at least 75% in amount of all of the creditors voting and at least 50% in amount of the independent creditors voting, and by a majority of the shares (if it alters shareholders' rights), and if approved binds all creditors and shareholders.

- **Section 153 – Failure to adopt business rescue plan.** The practitioner may seek the court’s permission to set aside creditors’ or shareholders’ negative vote as “inappropriate”. Alternatively, creditors or shareholders or other affected persons (e.g. trade union representatives or unrepresented employees) may ask a court to have the negative vote set aside as inappropriate. If the practitioner does not seek approval for preparation of a revised plan or announce his intention to seek court approval to have the negative vote set aside, any affected person may make a binding offer to purchase the voting interests of those creditors who opposed the business rescue plan, at an appraised value equal to what the person voting against the plan would have received in a liquidation. The practitioner then has five days to amend the business rescue plan to reflect the existence of the offer and must then once again seek approval of the plan. Any affected person can ask the court to re-determine the fair and reasonable price at which dissenters’ interests are to be bought.

- **Section 155 – Compromise between company and creditors.** This section of the statute allows a company, whether or not financially distressed, that is not in business rescue proceedings to propose to its creditors that the creditors compromise their claims. The statute sets out the information that must accompany the proposal. A proposal is accepted if approved by a majority in number, and at least 75% in value, of the creditors voting. The proposal only becomes binding if approved by the court as just and equitable after considering, among other things, the number of creditors present and voting.
- **Director Liability.** -- Section 77 of the Act makes directors liable if they acquiesce in carrying on the companies' business in violation of Section 22(1), which in turn prohibits the carrying on of business recklessly, with gross negligence, with intent to defraud or for any fraudulent purpose. Section 22(2) provides that carrying on business when unable to pay debts as they become due is an independent basis for the Commission to shut down the business.

Appendix: Biography

WACHTELL, LIPTON, ROSEN & KATZ

Philip Mindlin is of counsel at Wachtell, Lipton, Rosen & Katz. He represents buyers, sellers, owners, investors, lenders and borrowers in complex transactions involving balance sheet issues and in cross-border acquisitions. Mr. Mindlin joined Wachtell Lipton in 1985 and became a partner of the firm in 1991.

Mr. Mindlin received his B.A. from the University of Pennsylvania and his J.D. *magna cum laude* from Fordham University where he was a member of the Fordham Law Review and a recipient of the Stillman Memorial Prize, the Chapin Prize and the Constitutional Law Medal.

His recent experience includes representation of key parties in transactions involving Canada's NorTel Networks Corporation (bid for patent assets of bankrupt telecom), Brazil's Pão de Açúcar (cross-border governance dispute, acting for France's Groupe Casino), BTG Pactual (representation of co-founder in connection with sale of Brazil's UBS Pactual to investment bank BTG, and related matters), Burger King (negotiation of joint venture agreements creating Brazilian master franchisee), PlayPower Inc. (out-of-court acquisition by existing lender), Aleris International (in-court debt for equity exchange), Pliant Corporation (acquisition through Chapter 11), Bear Stearns (acquisition), Refco Group (acquisition of commodity broker through Chapter 11) and Cable and Wireless plc's US subsidiaries (restructured troubled US subsidiaries for UK parent).



Of Counsel, Restructuring and Finance

tel 212.403.1217
fax 212.403.2217

PMindlin@wlrk.com

Education

- **University of Pennsylvania**, 1979
- **Fordham University School of Law**, J.D. 1984, *magna cum laude* (*Fordham Law Review*)